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JUDICIAL CONTROL OF THE MISSOURI PUBLIC SERVICE COMMISSION

Procedure Before the Commission and Review by the Courts.

There are full provisions in the Act for the hearing of all controversies by the Commission, and the rights of all interested parties seem duly safeguarded both as to notice of such hearings and as to opportunity to be heard and to take part in the hearing.²⁵ Hearings may be held in any part of the state which the Commissions may deem best, and in practice hearings are held in various places, and, at times, portions of the evidence in a single controversy may be taken in several different counties. The Commission reports that: "The more important cases have been heard at the office where all the Commissioners could be present. It is the general practice, however, for the Commission to go to the place where the complaints arise, that all the witnesses may have an opportunity to present their evidence."²⁶

All orders entered by the Commission within the scope of its powers are binding on the public and on the utilities concerned, but the Commission has no power to enforce them directly. If its orders are disobeyed it must have its counsel (provided by the Act) bring suit in the state courts to enforce such orders.²⁷ It will thus be seen that the Commission is not expressly made a court, as in one or two states,²⁸ with power to enforce its decrees directly like any other court, for according to the Constitution as it now stands it cannot be a court. The Constitutional provision which stands in the way is as follows:²⁹

"The powers of the government shall be divided into three distinct departments—the legislative, executive and judicial—each of which shall be confined to a separate magistracy and no person, or

25. Only those matters as to which orders are entered after hearings had, come before the courts as a rule. It must be remembered that the duties of the Commission include a vast lot of administration which is not controversial, and further, if it builds up the proper reputation and is properly backed up by the courts, it may be able to dispense with public hearings in most cases. Thus during the first half of 1922 the Commission ordered a considerable number of decreases in rates without hearings. See 9th and 10th Rep. 18, 19.

26. 7th and 8th Ann. Rep (1919-20) 23. Any commissioner may hold any inquiry, hearing or make any investigation the Commission has power to make and when his order is approved it is deemed the order of the Commission. R. S. 1919, sec. 10441. See also section 119, (R. S. 1919, 10530).

27. See R. S. 1919, secs. 10416, 10473, 10493 and 10515.

28. See Okla. Const. Art. IX, sec. 19; Va. Const., sec. 156. The states have accomplished this by means of an extensive constitutional amendment. An amendment would be required in Missouri to make the Commission a court in words as well as in deeds—to give it power to enforce its own decrees and orders directly. Much can be said in favor of the plan of making the Commission a court of record with an appeal allowed from its orders directly to the Supreme Court.

29. Mo. Const., Art. III, sec. 1.

collection of persons, charged with the exercise of powers properly belonging to one of these departments, shall exercise any power properly belonging to either of the others, except in the instances in the Constitution expressly directed or permitted."

This seems about as strong an expression of the dogma of separation of powers as exists in any of the states except Massachusetts. Needless to say had the Supreme Court been in the mood, it could have destroyed the Commission by holding the Act void as a violation of the above Constitutional provision, for analytically considered the Act clearly does seem to confer on the Commission powers belonging to all three departments. But attempts to draw an exact analytical line of demarcation have always failed. To use the language of Dean Pound:³⁰

"But the attempt to make an exact analytical scheme of the powers of government according to this threefold division has failed. As actually drawn in America, the line is historical only in many places. Students of political science have discarded the theory of separation of powers as an absolute, fundamental doctrine, and courts are finding themselves driven by experience of the impossibility of the thing to recognize that fine analytical lines cannot be drawn. For sovereignty is a unit. The so-called three powers are not three distinct things; they are three general types of manifestation of one power. In the development of sovereignty these three types have differentiated gradually as a result of experience that certain things which demand special competency or special training or special attention are done better by those who devote thereto their whole time or their whole attention for the time being."

As a result of the attempt to apply the above dogma the courts of most states, proceeding along analytical or historical lines, have frequently declared legislation void as a violation of the separation of powers, only to be compelled later to come to an inconsistent conclusion. Fortunately the Missouri reports are not badly cumbered with troublesome decisions on this point,³¹ so the court

30. Pages 5 and 6 of his article on "Justice according to Law", 14 Col. L. Rev. 1. See also Sedgwick, *Elements of Politics*, 363, 364. Goodnow, *Social Reform and the Constitution*, Ch. V.

31. The Supreme Court of Missouri seemingly has never made the attempt to apply any rigid analytical test, as has been done in many states, so it was not seriously embarrassed by previous decisions. It had previously recognized that no hard and fast line could be drawn, and that there is a wide area within which powers might be assigned to one or the other of these departments. In *Rhodes v. Bell* (1910) 230 Mo. 138, 151, 130 S. W. 465, it adopted and approved the principle expressed in the Constitution of New Hampshire which is as follows:

"In the government of this state the three essential powers thereof, to-wit the legislative, executive, and judicial, ought to be kept as separate from, and independent of each other as the nature of a free government will admit, or as is consistent with that chain of connection that binds the whole fabric of the Constitution in one indissoluble bond of unity and amity."

It is evident that under such a principle the court is free to draw the line as the public welfare seems to require. For other cases on the separation of powers under the above Constitutional provision, see *In Re Birmingham Drainage District* (1917) 274 Mo. 140, 202 S. W. 404 and *State v. Nast* (1907) 209 Mo. 708, 108 S. W. 563.

was free to reconcile the act with the above Constitutional provision, yet the way in which it accomplished this seemingly impossible task reminds one of the Chicago attorney, who remarked, "I am engaged in violating the corporation statutes of the State of Illinois", but he added, "I am doing it legally." The court emphatically declares that "the design of the act was to create an administrative agency"³² and that, "It is true the Public Service Commission is not a court; nevertheless, though it cannot exercise judicial functions, it must take cognizance of existing facts and the law It is an 'administrative arm' of the Legislature."³³ Yet we find this "administrative arm" holding hearings and making findings of fact, and entering orders based thereon, which in themselves presuppose findings of law, which orders are final and binding if not reversed by a court. And strange to say the court sets aside these findings of fact if not supported by the preponderance of the evidence, and corrects any errors of law—acts just like it was reviewing a suit in equity. Certainly the Commission, though purely administrative (as the court says) does some things which seem legislative and other things which formerly had been believed to be purely judicial. It does many things much like a court, many things a court cannot do, many things the executive could not do and some things the Legislature could not do. While the court is quite justified in holding the act does not violate the above Constitutional provision, little can be made of the reasons why it so holds. But as a matter of constitutional law the Commission is validly created, its powers so far as they have been passed upon are validly conferred, and it is able to play the part designed for it by its creators, though one can imagine what a Missouri Court of fifty years ago would have done to such a body at the first chance.³⁴

The jurisdiction of the Commission is exclusive as to matters within its powers, but there are full provisions for judicial review of the orders of the Commission, after the entry of an order any aggrieved party must apply for a rehearing if he desires to carry the matter further. If the rehearing is granted and an order is entered on rehearing, or if the rehearing is denied, the aggrieved party, or, if the order be modified on rehearing, any other aggrieved party, may within a certain time petition for a review in the circuit court, and, from the order of the circuit court entered in such review, any aggrieved party may appeal to the Supreme Court, thus making possible a double judicial review of the order of the Commission. Section 111 of the Act provides that,³⁵ "No

32. *St. Louis & San Francisco Railway Co. v. P. S. C.* (1916) 268 Mo. 109, 116, 186 S. W. 703.

33. *Missouri Southern Railway v. P. S. C.* (1919) 279 Mo. 484, 486-489, 214 S. W. 379.

34. See *Sloan v. Pacific Railway Co.* (1875) 61 Mo. 24, where a statute declaring that no railroad should charge more for the transportation of freight on one part of its lines than for similar freight for similar distances on other parts of the line was declared void because (page 32): "An arbitrary rule was adopted by the legislature determining that certain rates were unjust. Whether they were so or not, was a matter depending on circumstances, of which the legislature were not made judges. The liability of the defendant at common law and on general principles not abrogated by the legislature, was a matter for the determination of courts of justice with the aid of juries." This case was answered by Article 12 s. 12 of the Constitution of 1875.

35. R. S. 1919, s. 10522.

court of this state except the circuit courts to the extent herein specified, and the supreme court on appeal, shall have jurisdiction to review, reverse, correct or annul any order or decision of the commission or to suspend or delay the execution or operation thereof; or to enjoin, restrain or interfere with the performance of the commission of its official duties." Thus so far as the Legislature was able to make it so, the method of review of the orders of the Commission provided in the Act is exclusive.

After a rehearing is denied by the Commission, or if granted after affirmance of the old order or the entry of a new order on rehearing, any aggrieved party may apply to the ³⁶ "circuit court of the county *where the hearing was held* or in which the commission has its principal office for a writ of . . . review . . . for the *purpose* of having the *reasonableness or lawfulness* of the original order or decision, or the order or decision on rehearing *inquired into and determined.*" Since Section 11³⁷ provides that the principal office of the Commission shall be at the state capitol, it follows that application for writ of review may always be made to the circuit court of Cole County, and in practice this circuit court does handle most of the reviews of the orders of the Commission, and because of the great familiarity with the jurisdiction of the Commission thus acquired, is probably more expert in such matters than any other circuit court in the state. But since the Commission may, and often does hold all or part of the hearing or hearings connected with a particular controversy, in other counties of the state, the question has arisen as to what the clause "where the hearing was held" means. In *Chase v. Seehorn*,³⁸ it appeared that there had been a hearing at which a lot of evidence had been taken in Jackson County, which is the county in which Kansas City is located. All the rest of the evidence and the final arguments were in Cole County. The circuit judge in Jackson County refused to grant a writ of review on the ground, "the hearing was held in Cole County and therefore the circuit court of Jackson County had no jurisdiction." But the supreme court held he had jurisdiction, the court stating that,³⁹ "For the purpose of jurisdiction under Section 111 when the commission has formally set a hearing in any county, and appears and takes evidence in the case and is ready to hear and does hear the parties and their counsel, the circuit court of such county has jurisdiction to issue the writ of review." It would seem from this that "the hearing" as used in Section 111 means any hearing formally set at which the parties appear and at which evidence is taken. It is evident this one case has by no means marked out the boundaries of the jurisdiction of the circuit courts outside of Cole County to entertain writs of review, but it is probably true that in most of the controverted matters in which one or more hearings are held outside of Cole County, such hearing or hearings will all constitute hearings within the decision of this case.

36. Section 111 *supra*.

37. R. S. 1919, s. 10420.

38. (1920) 283 Mo. 508, 223 S. W. 664.

39. Page 530.

Section 111 also provides that the circuit court is to review the order of the Commission on the evidence and exhibits introduced before the Commission only, and that no new evidence can be introduced before the circuit court, and as will soon appear no further evidence can be introduced before the supreme court. Thus the statute settles this point, which is one as to which there has been some controversy. It has been argued that new evidence should be permitted on appeal, since the court may thus be able to enter a final order and dispose of the matter, but on the other side is the fact that the utility, if it has such privilege, will hold back a part of its evidence until it has drawn all the fire of its opponents at the hearing before the Commission, and then make its real fight before the court on review.⁴⁰ Regardless of the merits of the different views the language of the Act here is final. The review of orders of the Commission is for the purpose of having the "reasonableness or lawfulness" of the order "inquired into and determined", that is, to review the proceedings below and not to have a hearing *de novo*. On review the circuit court may affirm or reverse the order of the commission and in certain cases may remand to the Commission for further action.⁴¹

Any interested party desiring a review of the order of the circuit court, including the commission itself, may then appeal to the supreme court and,⁴² "such appeals shall be prosecuted as appeals from the judgment of the circuit court in civil cases except as otherwise provided in this act. The original transcript of record and testimony and exhibits, certified to by the commission, together with a transcript of the proceedings in the circuit court, shall constitute the record on appeal to the supreme court." Thus no new evidence can be introduced before the supreme court.

The part of Section 115 last quoted has the effect of preserving some of the procedure of courts in civil cases which might well have been changed. In *City of Macon v. P. S. C.*,⁴³ the circuit court of Cole County on review, affirmed an order of the Commission, and the city appealed to the Supreme Court without having first made a formal motion for a new trial in the court below, and without having had the evidence preserved in the form of a bill of exceptions and made part of the record, as required by the practice on appeals in civil cases. The Supreme Court held it could review only the bare record of the proceedings in the circuit court, since this was the rule in civil cases. It expressed

40. No evidence ought to be admitted before the courts except in special cases where it would establish some essential point by evidence that cannot be controverted. Most of the situations in which it would be desirable to introduce new evidence on appeals from suits at law, do not arise in proceedings before a commission where technical rules of procedure and evidence are largely eliminated. For a discussion as to the occasions in which it is desirable to permit the introduction of new evidence on appeals from civil suits, see Scott, *Fundamentals of Procedure*, 104, 161.

The experiment of allowing the introduction of new evidence before the courts on review was tried in the Interstate Commerce Commission and it was found to be undesirable. See *C. N. O. & T. P. R. Co. v. I. C. C.* (1896) 162 U. S. 184, 196, 40 L. Ed. 935, 16 S. C. Rep. 935.

41. R. S. 1919, § 10522.

42. See R. S. 1919, § 10525.

43. (1915) 266 Mo. 484, 181 S. W. 396.

regret that the act did not provide a simpler mode of appeal but considered that it had no choice in the matter, saying⁴⁴ "it is plain we can look only to the error of the circuit court. We cannot in a strictly legal sense weigh the alleged judicial errors of a non-judicial and merely administrative body. We can only weigh the acts of courts. The public service commission is not a court. If it were a court then its organization as such would be in the very teeth of the Constitution." This probably is not over important in practice, as the legal profession will soon adjust itself to the proper practice, but a curious result of the fact the Commission is not a court is that under Section 111 the circuit court can review the evidence before the Commission, but unless that evidence is made a part of the record by bill of exception and kept alive by motion for new trial the Supreme Court cannot.

Before the Supreme Court of the United States had handed down its surprising decision in *Ohio Valley Water Company v. Ben Avon Boro*,⁴⁵ the question as to how the circuit and Supreme Court of Missouri should review the orders of the Commission had already arisen and, after some controversy, had been settled in such a way as to provide a judicial review of rate making cases, which fully complies with the Federal Supreme Court's notion of what due process requires. Section 111⁴⁶ of the Act provides that, "the circuit courts of the state shall always be open for the trial of suit brought to review the orders and decisions of the commission, as provided in this act, and *the same shall be tried and determined as suits in equity*." Thus the matter was not left unprovided for by the act as was the case with the Pennsylvania Act involved in the *Ben Avon Case*, but an attempt to reconcile this language with the language of Sections 123 and 124 caused a difference of opinion among the justices.⁴⁷ Section 124 provides that "In all trials, actions, suits and proceedings arising under the provisions of this act . . . the burden of proof shall be upon the party adverse to such commission or seeking to set aside any determination, requirement, direction or order of said commission, to show by clear and satisfactory evidence that the determination, requirement, direction or order . . . is unreasonable or unlawful as the case may be."

44. Pages 490-1.

45. (1920) 253 U. S. 287, 40 S. C. Rep. 527, 64 L. E. 908. The case established that as to valuation of public utilities for purposes of rate making due process of law requires that there be provision made for an independent judicial review of the findings of the Board or Commission. See also *Bluefield Water Works Co. v. Commission* (1923) 262 U. S. 679, 67 L. E. 1176, 43 S. C. Rep. 684; *Southwest Bell Tel. Co. v. P. S. C.* (1923) 262 U. S. 276, 67 L. E. 981, 43 S. C. Rep. 544.

46. See note 41 *supra*.

47. R. S. 1919, ss. 10534 and 10535. Section 123 provides: "All rates, tolls, charges, schedules and joint rates fixed by the commission shall be in force and shall be prima facie lawful, and all regulations, practices and services prescribed by the commission shall be in force and shall be prima facie lawful and reasonable until found otherwise in a suit brought for that purpose pursuant to the provisions of this act." Provisions similar to this one are found in most of the public service acts. There was a similar provision in the Pennsylvania Act at the time the *Ohio Valley Water Company Case supra*, arose. See sections 18135 and 18136 of Pa. State 1920. The latter section declared the burden of proof should be on the one attacking the order. But there was no such extraordinary provision as that contained in section 124 of the Missouri Act. This section would seem clearly void as to rate cases under the doctrine of the

In *C. B. & Q. Ry. v. P. S. C.*⁴⁸ counsel for the Commission argued that the commission was an administrative body, and that the findings of fact of administrative bodies were final and conclusive upon the courts but the Supreme Court, without expressly mentioning Section 124 said:⁴⁹ "This court under the plain mandate of the statute quoted (Section 111) will consider the entire record; and give to the findings of the commission such weight and consideration as we may deem them entitled to under the law and the evidence." The case involved an order of the Commission directing the construction of an exchange track between two railroads and the court might well have held there was no evidence tending to support the findings of fact. But the question soon arose again in *Lusk v. Atkinson*,⁵⁰ a case which involved the question as to whether a railroad had a right to charge interstate instead of intrastate freight rates on certain shipments of railroad ties. The order of the Commission was in favor of the shippers and both the counsel for the Commission and the shippers claimed the findings of fact were conclusive on the court. But the supreme court again held the language of Section 111 above quoted was decisive on the matter. It also pointed out that under this section the courts were to determine the "reasonableness and lawfulness" of the order of the commission and that therefore, in order to do this, the court must weigh the evidence. Both these decisions were unanimous on this point. In *Wabash Railway Co. v. P. S. C.*⁵¹ the commission had ordered the Wabash railroad to build a new station at the city of Macon, the same city which was a party to the first case above, and this order was before the supreme court for review. All the justices agreed there was no substantial evidence tending to support the order and that it must be set aside, yet four of the seven justices concurred in a majority opinion in which the rule was laid down that under sections 123 and 124 the one who assails the order of the commission must show it is unreasonable or unlawful by "clear and satisfactory" evidence as provided in section 124. The court said the provision of section 111 relied on in the two previous cases merely meant that the procedure should be like that in appeals in equity, and not that the evidence on appeal should be weighed as in appeals in equity. As to sections 123 and 124 they said:⁵² "That these provisions are valid cannot be successfully denied, and that the determination of a fact by the Public

Ohio Valley Water Company Case. Certainly if one attacking an order fixing rates, must show it is "unreasonable or unlawful" by "clear and satisfactory evidence" it would be difficult indeed to set aside any such order and there could hardly be an independent review of the findings such as the Supreme Court of the United States says must be permitted.

48. (1916) 266 Mo. 333, 181 S. W. 61.

49. Page 341.

50. (1916) 268 Mo. 109, 186 S. W. 703.

51. (1917) 271 Mo. 155, 196 S. W. 369. That this was mere dictum is shown by the following remarks of the majority: "It conclusively appears that every objection made to the depot, except those to its age and appearance, can be met without erecting a new building in a new place. In these circumstances it is necessary to hold that the order is unreasonable since it is unsupported by any substantial evidence." If this was true then it would seem the railroad had shown the order was unreasonable by clear and satisfactory evidence such as required by section 124.

52. Page 159.

Service Commission cannot be overthrown by a court until he who assails it discharges the burden of proving its unlawfulness or unreasonableness by clear and satisfactory evidence is the only construction of which the unequivocal statutory language is susceptible." The construction thus put on the language of section 111 is hard to justify in view of the fact it is the "reasonableness and lawfulness" of the order, which the court is to review and the section provides "the same shall be *tried and determined* as in suits in equity." It seems difficult to construe this as merely referring to procedure. How is an appeal procedurally "tried and determined" in equity? Three justices dissented vigorously. The curious thing about this decision is that since the decision of the first case on the point, there had been but one change in the personnel of the court, and three justices had changed their minds, some of them permanently it seems from subsequent cases. Two of the four justices swung back to the other view in *State ex rel. St. Joseph, Light and Power Company v. P. S. C.*⁵³ where the court without further discussion of the point, again held that on review of orders of the Commission the courts would weigh the evidence as on appeals in equity. The remaining two justices dissented. The latter decision has been many times affirmed since then without extended discussion of the matter.⁵⁴

Why section 124 appears in the Act at all is something of a mystery, for section 123 contains a provision that orders of the Commission shall be prima facie lawful and reasonable until found otherwise in a suit brought for that purpose. None of the above cases involve valuation or rate making but the rule settled by them of course applies equally well to rate cases. At any rate the act as construed provides for a double judicial review of the kind which the Supreme Court had held essential to due process of law in rate cases. In this respect the outcome was fortunate. Perhaps as to some classes of cases which the Commission deals with, it might be advantageous to have made applicable a section like section 124, but as it stands in the act, it seems to be unlimited in its application and hence irreconcilable with Section 111.

But it is interesting to note what has been the court's attitude toward the orders of the Commission. This was expressed in the important case of *Southwestern Bell Telephone Company v. P. S. C.* as follows:⁵⁵

"Organized as the statute creating the Commission clearly declares, for the purpose of supervising and regulating public service corporations, the courts, in reviewing its actions, proceed upon the assumption that the experience of the members of the Commission has especially fitted them for dealing with the question concerning the powers and activities of such corporations; and, despite the fact that

53. (1917) 272 Mo. 645, 199 S. W. 999. Blair and Williams dissented.

54. *M. K. & T. Ry. Co. v. P. S. C.* (1918) 277 Mo. 175, 210 S. W. 386; *Ozark Power and Water Co. v. P. S. C.* (1921) 287 Mo. 522, 229 S. W. 782; *St. Louis-San Francisco Railway Co. v. P. S. C.* (1922) 294 Mo. 364, 242 S. W. 938; *Southwestern Bell Telephone Company v. P. S. C.* (1921) 233 S. W. 425. There is a long dissent on the point by Blair, J., in which Higbee, J., concurs. *Capital City Water Company v. P. S. C.* (1923) 298 Mo. 524, 252 S. W. 446.

55. (1921) 233 S. W. 425 at 430.

the entire evidence will be reviewed, much consideration is to be given to the findings of the Commission, which, if reasonable, and neither arbitrary nor capricious, will be deferred to."

The court purports to follow the same rule as the Federal Supreme Court in dealing with orders of the Interstate Commerce Commission. In *Capital City Water Company v. P. S. C.*⁵⁶ the court again expressed the same opinion as to the opinions and orders of the Commission. Just what the above language really means it is difficult to say, but it certainly will give room for exercising as much control over the Commission as the court desires to exercise. It is probable the confidence which the court has in the ability and good faith of the Commission may make a very great difference, and at present the Commission seems to enjoy to a high degree the confidence of the court.

Rates and Rate-Making:

1. *In General.*

When we come to rates and rate making we reach the vital part of the ever present controversy between the public and the utilities. Adequate rates are essential to adequate service. Without adequate rates the utilities cannot be operated successfully. The experience of the past has shown that since they are monopolies, if left to fix their own rates, the tendency is to charge all the traffic will bear. On the other hand, there seems a general public tendency to regard all rates as excessive. If this tendency could be easily reflected in the fixing of rates, in many localities some of the utilities would soon be ruined. Hence it is necessary to have some expert and fair minded agency to control the situation—to balance the conflicting interests with a view to the best ultimate interests of the public, for these utilities are operated for profit and are not charitable institutions. The Commission has been entrusted with this task.

The Commission is therefore given power to fix just and reasonable rates to be charged by the utilities for the service they furnish. The numerous provisions of the Act conferring such powers are scattered throughout its pages, but we are here concerned only with those portions which have been construed by the court. But before taking up the cases it may be well to refer to several of the most important of these sections, because they were copied almost verbatim from the New York Public Service Law, and are an example of legislative imitation and perhaps of legislative negligence. Section 47 (1)⁵⁷ of

56. (1923) 298 Mo. 524, 252 S. W. 446 at 448. In both these cases the court states with approval and as applicable the test from *Interstate Commerce Commission v. Union Pacific Railway* (1912) 222 U. S. 541, 56 L. E. 308, 32 S. C. R. 108, to the effect that the reasonableness of an order of a rate-making body, regular on its face may be questioned if (1) the rates are so low as to be confiscatory, or (2) were fixed arbitrarily and unjustly without regard to the preponderance of competent evidence, or (3) were fixed in such an unreasonable manner as to cause the shadow and not the substance to determine the validity of the exercise of the commission's power.

It is doubtful, if this test, good as it sounds to the ear, has proved or can prove of much real value.

57. R. S. 1919 s. 10456.

the Act gives power to establish just and reasonable freight rates and passenger fares on railroads "notwithstanding that a higher rate, fare or charge has been heretofore authorized by statute." The clause quoted is found in section 49 (1) of the New York Public Service Act.⁵⁸ The same clause is found in section 69 (5)⁵⁹ of the Missouri Act giving power to the Commission to fix just and reasonable rates for gas, water and electricity, being copied from section 66 (5) of the New York Act.⁶⁰ The writer has not ascertained why this clause was inserted in the New York Act, but it seems to be in the Missouri Act because it was in the New York Act. As a further instance of the same sort of thing, it might be mentioned that section 82⁶¹ of the Missouri Act is a copy of section 72 of the New York Act,⁶² which provides how hearings as to rate fixing for gas and electricity shall be conducted, and provides "the commission within lawful limits may by order, fix the maximum price of gas or electricity, *not exceeding that fixed by statute*, to be charged by such person or corporation." Subsequent events indicated that this limitation was a mistake for in the period of high costs following the war it left the commission powerless to aid the gas company in New York City.⁶³ The Missouri section covers water rates as well as gas and electric rates, so the words "or water" were added after "electricity" in the clause. Fortunately Missouri had no statute on the subject so the clause has proved harmless.⁶⁴ As to the other clause found in section 47 (1) the supreme court wisely ignored it.

The rate cases may be conveniently discussed under three headings, namely, (a) the effect of prior statutory limitations, (b) the effect of franchise and contract limitations and (c) valuation for purposes of rate making.

2. *Effect of Prior Statutes.*

The only important unrepealed statutory limitation in Missouri was the one fixing freight and passenger rates for railroads. This act, passed in 1905, regulated freight rates and charges on railroads, and, by an extensive amendment in 1907,⁶⁵ a maximum passenger fare of two cents a mile was provided, applying to railroads over forty-five miles long. The validity of this act was sustained in the *Missouri Rate Cases*.⁶⁶ A detailed history of this litigation is

58. Birdseye's Laws 2 ed., s. 6689.

59. R. S. 1919 s. 10478.

60. Birdseye's Laws, 2 ed., s. 6930.

61. R. S. 1919 s. 10591.

62. Birdseye's Laws 2 ed., s. 6945.

63. An idea of the situation which arose, can be gathered from *Newton v. Consolidated Gas Company* (1920) 258 U. S. 165, 66 L. E. 531, 42 S. C. R. 261, and the same case in (1920) 267 Fed. 231. The statutory rate became confiscatory on account of the rise in costs but the Commission had no power to grant a higher rate. This left the utility practically uncontrolled by the Public Service Commission Act so far as rates were concerned.

64. The clause has proved harmless in this case but this is nevertheless a strong argument in favor of care in drafting legislation. Courts are habitually criticised for declaring legislation void; they are seldom commended for their more frequent construction of legislation, vague and ambiguous, so as to make it useful and intelligible.

65. See R. S. 1909, s. 3157 and R. S. 1919 ss. 10046.

66. See (1913) 230 U. S. 474 for the opinion in these cases.

found in the opinion of the court in *St. Louis & San Francisco Ry. Co. v. Barker*.⁶⁷

The Utilities Act of 1913 did not expressly refer to this statute, nor did it expressly limit the power of the Commission to the maximum rates fixed in this statute, hence leaving the whole question as to whether the Commission had power under the Act to fix rates higher than those fixed in the statute to judicial construction.

In July 1913, almost as soon as the Commission had organized, an intrastate railroad fifty-four miles long, petitioned the Commission to fix a passenger rate higher than that allowed by statute. The Commission, after long consideration, denied the petition on the ground the Commission was an administrative body and had no power to modify or amend the statute. The railroad then brought mandamus in the supreme court to compel a hearing before the Commission on the merits. The result was *Missouri Southern Railway Company v. P. S. C.*,⁶⁸ which has been mentioned above. The court in a long opinion by Judge Lamm, held the Commission had power to fix just and reasonable rates, even though higher than those provided by the statute. This opinion was handed down July 2, 1914 during the period of industrial depression just preceding the beginning of the war in Europe. The court admitted section 47 (1) was not clear, but construed the act as a whole, and came to the wise conclusion that the intent was to give to the Commission full power to fix just and reasonable rates, notwithstanding the statute of 1907. In effect then, this statute is in force until the Commission after a hearing fixes a higher rate for particular railroads. Some of the language of this opinion is worth quoting because the argument of the court is put in such a manner as to seem unanswerable: The court said:⁶⁹

“Whatever may be the case in other particulars, it, (the Act) subject to constitutional provisions, occupies the entire field on given phases relating to rates and service. This becomes clear either from a study of the language of section 47, or by getting at the meaning of that section from the broad scope, the philosophy and intendment of the whole act . . .

A court would expect to find in a rounded out Utilities Act, made by a just and intelligent lawmaker, as here, that such an act approached the subject matter of service and rates from several angles . . . Such a court would expect to find that the act runs on the theory that the corporation, in order to spend, must be allowed to gather—that (if we may be allowed a homely figure) the intake bunghole in the corporate barrel would be open simultaneously with the outgo spigot. Without being driven to it *willy nilly* no court would expect to find in such an act the pestiferous idea crystallized into law that the solicitude of the

67. (1914) 210 Fed. 902.

68. (1914) 259 Mo. 704, 168 S. W. 1156.

69. Pages 723-24.

lawmaker was *exhausted*, or stopped short, at prescribing a multitude of onerous duties and a multitude of substantial outlays for the corporation. *Contra*, it would expect to find a corresponding legislative solicitude in the line of providing ways and means essential to carrying out the orders of the commission on safe and adequate service. Moreover, such a court would expect to find evidence in such Utilities Act that the lawmaker knew a corporate money chest did not replenish itself in some miraculous way like the widow's cruse of oil, for instance; knew that the funds for safe and adequate service must directly or indirectly, sooner or later, spring from freight rates and passenger fares. Otherwise the utility corporation would be headed by the act itself toward death through starvation—an absurd and unthinkable hypothesis."

After a full examination of the Act Judge Lamm concluded it came up to the expectations of the court and the writ was accordingly allowed. No mention was made of the clause "not withstanding that a higher rate, fare or charge has been heretofore authorized by statute" which appears in section 47 (1). It might be argued that this clause was inserted with the intent the Commission be limited by the maximum rate fixed by the statute of 1907,—that the Commission had power only to fix rates lower than permitted by such statute. At any rate it would have offered a good opportunity to a hostile court to cripple the work of the Commission. However the decision of the court in the above case seems wise and the argument difficult to answer.⁷⁰

Encouraged by this liberal and friendly attitude of the court some fourteen other railroads applied to the Commission for a dispensation, both as to freight rates and passenger fares, and the Commission, after due hearings, entered an order fixing certain freight and passenger rates higher than the maximums provided in the statute. This time certain citizens, alarmed at the actions of their new agency, appealed to the circuit court of Cole County, and secured a reversal of the order. But the Commission and the railroads appealed to the Supreme Court. The case is *Rhodes v. P. S. C.*⁷¹ The only question raised on this appeal was whether the Commission had power to raise the rates above those fixed by statute and this involved two questions: first, the question before the court in the preceding case, as to whether the Act purported to

70. It is interesting to note how the court clings to the time honored analytical notion of separation of powers while sustaining the Act. It said page 727:

"Respondent disavows power to repeal a statute or to declare a statute unconstitutional. That disavowal is correct. The repeal of a statute is a legislative act. In this state all judicial power is vested in the courts And legislative power is vested in the General Assembly So, respondent claims only administrative powers. That claim is justified."

After the decision in the *Rhodes Case*, *post*, it is probable few, if any, of the maximum rates fixed by the statute remained in force. The statute was not repealed by the legislature, it could not be repealed by the Commission for it has no power to repeal a statute, yet it is in fact repealed. What became of it? It is submitted this continued pretense by courts is neither necessary nor useful. A bold application of the doctrine approved in *Rhodes v. Bell*, *supra*, would seem preferable.

71. (1917) 270 Mo. 547 194 S. W. 287.

confer such power on the Commission, and as to this the court followed the preceding case; secondly, whether the Legislature had power to delegate to the Commission such powers. It was strongly urged such delegation was void as a delegation of legislative power to an administrative agency. Since this is the important case in which this question is raised and decided, the matter of delegation of legislative power to the Commission will be briefly taken up here, for in no other case has it been since seriously considered by the court, this decision being regarded as decisive on the question, so far as the Act is concerned. A constitutional provision expressly conferred on the Legislature power to fix railroad rates⁷² and it was urged that in some manner this assisted in taking away any power it might otherwise have had to delegate power to fix rates to the Commission. The court after an exhaustive discussion of the authorities, both in states having similar constitutional provisions, and in states having none, came to the conclusion the Legislature could so delegate power to fix just and reasonable rates, the conclusion being expressed in the following significant language:⁷³

“We are constrained to conclude, therefore, that the courts of this nation, seeing the absolute impracticability of any other sort of just supervision over rate-making, have with a unanimity that is remarkable agreed that the delegation of power is not forbidden by the organic law.”

Truly as Judge Lamm quotes:⁷⁴ “The thoughts of men are widen’d with the process of the sun,” for forty years before the unanimity would have been just as marked for the opposite conclusion. But if there ever was any doubt in the state as to whether the powers given the Commission could be validly delegated by the legislature, this case seems to have settled the matter.⁷⁵ True the point has been raised in some other cases,⁷⁶ as has also the matter of separation of powers, but was always briefly disposed of. The next most important

72. Mo. Const., Art. 12 s. 14. It reads as follows:

“Railways heretofore constructed, or that may be hereafter constructed in this State, are hereby declared public highways, and the railroad companies public carriers. The General Assembly shall pass laws to correct abuses and prevent unjust discrimination and extortion in rates of freight and passenger tariffs on the different railroads in this State, and shall from time to time pass laws establishing reasonable maximum rates or charges for the transportation of passengers and freight on said railroads, and enforce all such laws by adequate penalties.”

73. Page 583. Bond, Judge, dissented and his opinion is based on a strict construction of the constitutional provision quoted in the preceding note. He argues since this says the legislature “shall” fix the maximum rates, it necessarily cannot delegate such power to the Commission. He considers the constitution of 1875 as an anachronism as applied to modern conditions and that it ought to be succeeded by a new one.

74. *Missouri Southern Railway Company v. P. S. C.* (1914) 259 Mo. 704, 714, 168 S. W. 1156.

75. The point was decided without citation of authorities in *Southwestern Bell Telephone Co. v. P. S. C.* (1921) 233 S. W. 425, 429.

76. See *Mo. So. Ry. Co. v. P. S. C.* (1919) 279 Mo. 484 at 489, 214 S. W. 379; *M. K. & T. Ry. Co. v. P. S. C.* (1918) 277 Mo. 175, at 192-3; *A. T. & S. F. Ry. Co. v. P. S. C.* (1917) 192 S. W. 460, 462.

case on separation powers is *Missouri Southern Railway v. P. S. C.*⁷⁷ where it was held the power to make a rate is not judicial but legislative, applying the time honored test that if the rate is fixed for the future the act is legislative in character.

3. *Franchise and Contract Limitations.*

It is well settled in the state that the legislature cannot authorize a municipality to make a contract fixing rates, which will limit the exercise of the state police power over such rates. But the matter is so bound up with two constitutional provisions that it deserves brief mention. In *City of Sedalia v. P. S. C.*⁷⁸ the city had a franchise contract with the company under which the latter bound itself to furnish water at \$30 per hydrant and to furnish other service free. The company after a hearing secured an order from the Commission permitting it to charge \$45 per hydrant and the circuit court affirmed this order. The city appealed to the supreme court claiming the obligation of the contract was thus impaired. Section 5 of Art. 12 of the constitution provides:

"The exercise of the police power of the State shall never be abridged, or so construed as to permit corporations to conduct their business in such a manner as to infringe the equal rights of individuals, or the general well being of the State."

Under this provision the court held that as the power to regulate rates came under the police power of the State, it could not be abridged even by the act of the legislature, and therefore the order of the Commission was valid. This decision was followed in the same term by *City of Fulton v. P. S. C.*⁷⁹ where a contract fixing the telephone rates was involved, and *City of Harrisonville v. P. S. C.*,⁸⁰ in which a contract fixing rates for electric current was involved.

But a new turn was given the matter by the next case. In *City of St. Louis v. P. S. C.*,⁸¹ it appeared the city had granted a franchise to a street railway company in 1898, which provided for a five cent fare, and this had been accepted by the company in writing. In 1918 the company applied to the Commission to fix a just and reasonable rate and the city challenged the jurisdiction of the Commission to grant a higher rate than the one provided in the franchise, and thus impair the obligation of the contract. The City relied on Art. 12 section 20 of the Constitution which reads as follows:

77. *Mo. So. Ry. Co. v. P. S. C.*, *supra*.

78. (1918) 275 Mo. 201, 204 S. W. 497. An appeal by the city to the Federal Supreme Court was dismissed for want of jurisdiction. (1920) 251 U. S. 547. But the city refused to pay more than \$30 per hydrant and persisted in such refusal until sued for the balance by the water company. This controversy was carried to the Supreme Court where the decision was again in favor of the water company. This second case is *City Water Company of Sedalia v. City of Sedalia* (1921) 288 Mo. 411, 231 S. W. 942.

79. (1918) 275 Mo. 67, 204 S. W. 386. Appeal dismissed (1920) 251 U. S. 546.

80. (1922) 291 Mo. 432, 236 S. W. 852.

81. (1918) 276 Mo. 509, 207 S. W. 799.

“No law shall be passed by the General Assembly granting the right to construct and operate a street railroad within any city, town or village, or on any public highway, without first acquiring the consent of the local authorities having control of the street or highway proposed to be occupied by such street railroad; and the franchise so granted shall not be transferred without similar assent first obtained.”

It had been established, that because of the above provision, the consent of the local authorities must be obtained to any franchise to use the streets or highways, and it had further been settled the local authorities might impose conditions, for since they could exclude, they could grant the franchise on condition.⁸² It was therefore urged that this power to grant the franchise on condition the street railroad charge a maximum fare of five cents, came from the constitution, and the legislature was powerless to change it by statute. The Commission entered an order fixing a fare of six cents and on appeal to the supreme court, it was held that while the power to grant the franchise came from the constitution, so that such consent must be had to any such franchise, yet the power to impose conditions was not granted by the constitution, but the city could impose such conditions, where the legislature had not forbidden, or until the legislature did forbid, merely because the city could make conditions and regulations for the public good. Hence it was held the constitutional provision in question did not affect the power of the Commission to fix a just and reasonable fare. The case was followed by *Kansas City v. P. S. C.*⁸³ which was pending at the same time, and which involved a raise in street car fares in Kansas City above the rate fixed by the franchise. The same question arose in a new guise in *Southwest Missouri Railway Company v. P. S. C.*⁸⁴ where an interurban railroad applied to the Commission for permission to abandon service on certain spur tracks in Carthage on the ground they could be operated only at a loss. Permission was first asked of the city and refused. The Commission held it had no authority to relieve a street railway from performance of franchise provisions in a franchise granted by a city, though it found on the evidence the spur tracks could only be operated at a disastrous loss. The Supreme Court held the principle of *St. Louis v. P. S. C.* above applied, hence the Commission had full power in such a case to order the service discontinued. The order was reversed and the matter remanded to the Commission for further action.

4. *Determination of Rate Base.*

Under section 111 of the Act, the state courts on review are to determine the “reasonableness or lawfulness” of the orders of the Commission. In theory

82. The authorities for these propositions are cited in the opinion of the case under consideration.

83. (1918) 276 Mo. 539, 210 S. W. 381. Appeal dismissed, (1919) 250 U. S. 652, 63 L. E. 1190, 40 S. C. Rep. 54.

84. (1919) 281 Mo. 52, 219 S. W. 380.

what is reasonable and what is confiscatory as to rates are different things. We find the state supreme court in the two most important rate cases determining whether the rates fixed are confiscatory instead of whether they are reasonable, and apparently assuming that a non-confiscatory rate is reasonable.⁸⁵ The court has little occasion to deal with rates that are unreasonable because too high, for the Commission considers itself as created for the purpose of protecting the public from these monopolistic utilities, and for various reasons it is more than probable there will be little just reason to complain of its rates as being fixed so high as to be unreasonable.⁸⁶ At any rate the court seems inclined to consider the question as to whether rates fixed are confiscatory and not whether they are reasonable. Yet when we consider section 123 providing orders of the Commission shall be prima facie lawful and the burden of proof shall be on the one attacking them, and section 124, providing one must prove the order unreasonable or unlawful by "clear and satisfactory evidence," it seems somewhat difficult to give any effect to these sections, and still make a distinction between what is reasonable and what is barely non-confiscatory when the question is whether the rates fixed are too low. It might be urged that under sections 111, 123, and 124 of the act the court could not fairly reverse an order, unless it considered the rate confiscatory.

It might be urged that the Federal Supreme Court has also confused a reasonable rate and a confiscatory rate, in dealing with appeals from state courts, and that this court is only concerned, under the due process clause, with the question as to whether the rate is confiscatory, yet in recent cases it does not clearly make the distinction. But the recent cases which seemingly make this confusion between what is reasonable and what is confiscatory, it is submitted, can be explained on the ground that the court regards any non-confiscatory rate as a reasonable rate. Justice Brandeis in *Southwestern Bell Telephone Company v. P. S. C.*⁸⁷ frankly asserts that unless a rate yields enough

85. The court from time to time speaks of reasonableness of the rate under consideration, yet it approves the test laid down in *Union Pacific Railroad v. Interstate Commerce Commission* (1912) 222 U. S. 541, 56 L. E. 308, 32 S. C. Rep. 108, and therefore states that the reasonableness of an order of a rate-making body may be questioned if (1) the rates are so low as to be confiscatory and hence inimical to the constitutional provision against taking property without due process of law; or, (2) that the rates were fixed arbitrarily and unjustly without regard to the preponderance of the competent evidence; or, that they were fixed in such an unreasonable manner as to cause the shadow, and not the substance, to determine the validity of the exercise of the power.

If the test is as above then it seems the court is not determining the "reasonableness and lawfulness" of the order unless a non-confiscatory rate is also a reasonable rate. The above test is approved both in *Southwestern Bell Telephone Company v. P. S. C.* (1921) 233 S. W. 425, and *Capital City Water Company v. P. S. C.* (1923) 298 Mo. 524, 252 S. W. 446.

86. There seems no protection under the Federal Constitution against a rate that is fixed too high by the Commission. See *City of Scranton v. P. S. C.* (1923) 80 Pa. Super. Ct. Rep. 549.

87. "The compensation which the Constitution guarantees an opportunity to earn is the reasonable cost of conducting business. Cost includes not only operating expenses, but also capital charges. Capital charges cover the allowance, by way of interest, for the use of the capital, whatever the nature of the security issued therefor; the allowance for risk incurred; and enough more to attract capital." Page 291 of the opinion of Justice Brandeis in *Southwestern Bell Telephone Co. v. P. S. C.* (1923) 262 U. S. 276, 67 L. E. 981, 43 S. C. R. 544.

to cover capital charges, including interest on the capital invested, an allowance for risk, and enough more to attract capital (assuming the utility has been reasonably conceived and managed) the rate is confiscatory. The same idea is expressed in the opinion in *Bluefield Water Company v. P. S. C.*,⁸⁸ and the reversals recently, where the estimated returns to utilities have been less than 6% net and the expressions in the opinions that over 7% ought to be allowed, would seem to indicate that the whole court is of the opinion that a rate, to be non-confiscatory, must be high enough to enable the utility to operate in a reasonable manner and to borrow needed funds at a reasonable rate. If this is what the court means, then we need not concern ourselves with any distinction between what is reasonable and what is confiscatory, where the rate is alleged to be too low. That the above ought to be the test of what is confiscatory, probably bankers, financiers, utility experts and economists will agree. At the present time utilities cannot continue adequate service on a bare 6% net, even if that much were guaranteed. As it is the return is estimated, and if it actually falls short the utility loses.

The first valuation case which came before the Missouri Supreme Court was *Watts Engineering Company v. P. S. C.*⁸⁹ The Company operated a gas

88. This same idea is expressed in the majority opinion in *Bluefield Co. v. Public Service Comm.* (1923) 262 U. S. 679, 67 L. E. 1176, 43 S. C. R. 675, where Justice Butler said: "The company contends that the rate of return is too low and confiscatory. What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments on other business undertakings which are attended by corresponding risks and uncertainties but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management to maintain and support its credit and to enable it to raise the money necessary for the proper discharge of its public duties." This opinion was concurred in by all except Justice Brandeis who dissented on grounds stated in the *Southwestern Bell Telephone Case*, but his attitude on this same point is expressed in the quotation from his opinion in that case in the note above.

In *Southwestern Bell Telephone Case* (p. 288) the court said a possible return of 5½ per cent under the circumstances "which is wholly inadequate considering the character of the investment and the interest rates then prevailing." In the *Bluefield Co. Case* the court said: "Under the facts and circumstances indicated by the record, we think that a return of 6 per cent upon the value of the property is substantially too low to constitute just compensation for the use of the property employed to render the service." The court did say in *Georgia Ry. v. R. R. Comm.* (1923) 262 U. S. 625, 67 L. E. 1186, 43 S. C. Rep. 694 that a return of 7½ per cent cannot be deemed confiscatory under the circumstances. In both *Galveston Electric Co. v. Galveston* (1922) 258 U. S. 388, 66 L. E. 678, 42 S. C. Rep. 351, and *Brush Electric Co. v. Galveston* (1923) 262 U. S. 443, 67 L. E. 1076, 43 S. C. Rep. 606, the court seems to be of the opinion a just rate must necessarily be at least 7 or 8 per cent net return on a fair rate base.

89. (1917) 269 Mo. 525, 191 S. W. 412. While the case was pending in the circuit court, it made an order suspending the new rates under sections 112 and 114 of the Act and impounding the excess over the rate fixed. After the Supreme Court decision the company applied for the sum thus impounded and the Supreme Court in *Watts Engineering Co. v. P. S. C.* (1918) 275 Mo. 108, 204 S. W. 385, held this money belonged to the company since it had a right to charge the old rates until the order was made final.

plant at Columbia and certain citizens petitioned for lower rates. It appeared the Company had earned less than six per cent during the past five years on the valuation fixed, the amount of which was not controverted on appeal. The Commission found a fair return would be $7\frac{1}{2}$ per cent net and three per cent additional for depreciation. There was evidence tending to show decreased rates would produce increased sales; that the rates in Columbia were very much higher than in any of the five other cities of the state of similar size, which had independent gas plants; that the cost of coal at Columbia was less than at other points; that the cost of laying pipes etc., was not so great as at some other places. There was some evidence that the last decrease in rates had not increased the sales but as the existing rate was a dollar seventy-five cents per thousand, this is not strange in a community where fuel was plentiful and reasonable in price. The Commission confronted with this difficult situation granted a substantial decrease in rates, but retained jurisdiction with leave to either party to apply for a change in rates, if the result of the order indicated a change should be made. A test order had to be entered or the petition denied. On appeal the court affirmed this test order saying:⁹⁰

“These corporations should not be crushed by the fixing of inadequate rates, nor should the public be imposed upon by arbitrary business methods adopted by such corporations, which would increase rates . . . The price of a product may be so high as to preclude its general use . . .

“In the instant case the evidence tends to show an exorbitant rate for gas at Columbia. It further tends to show that a reduction in rates would increase sales or consumption. Grant it, that there is evidence contra. No one knows just what increase of consumption might follow a reduced rate. This can only be determined by actual test . . . To say that the Public Service Commission cannot, under the showing made in this case, make an order putting in a test rate as in this case would be to sap the very vitals of the Public Service Act.”

Two justices dissented, basing their dissent, first on the ground the rates in other cities should not be compared, unless all the conditions there are also shown, and unless it is further shown the rates there are reasonable; second, that since the Company has earned an inadequate return for five years any reduction would be confiscatory. On the strict evidence the dissent seems right, but is this not restricting the Commission so as seriously to impair its usefulness? The majority of the court evidently thought so. The Commission could easily abuse this power to establish test rates,⁹¹ but in this case it appeared the rate in Columbia was thirty per cent above that of the next highest town, and forty per cent above the average of the five other towns. Such

90. Pages 535-6.

91. In *Kansas City etc. Ry. v. P. S. C.* (1915) 242 Fed. 310, an order establishing test rate for commutation tickets was enjoined.

comparison of rates might not be allowed in a suit at law, but common sense indicates where there is such a marked discrepancy, there must be something wrong with the plant in question. Curiously enough the Commission has been much troubled with these plants with poor earning records.

We next come to the troublesome problem of valuation for purposes of rate making, or the determination of the rate base. Over twenty years ago a vague direction was laid down as to how such value was to be determined in *Smyth v. Ames*.⁹² According to this case the fair value at the time of valuation of the property being used for the convenience of the public, is to be ascertained by considering the original cost, the cost of improvements, the cost of construction, the probable earning capacity, and other elements not specifically mentioned, all these to be given such weight as may be just and right in each case. After twenty years struggle at applying this scheme of valuation, nearly every one except the courts has admitted its complete failure.⁹³ Yet no better scheme has been tried, though what Justice Brandeis terms the prudent investment theory has been suggested.⁹⁴ Nearly all writers agree the rule of *Smyth v. Ames* has proved unsatisfactory and the decisions seem to show this conclusively. The value of the utility depends on the rates it may charge, and as the utility is valued for the purpose of fixing reasonable rates, no one has yet succeeded in finding a way to square the vicious circle.⁹⁵ If you know the rate you can fix the value, but what you want to do is fix the rate and to fix this, you must first fix the value. This matter of rate base is most vital to both the utility and to the public. It is the big thing which requires regulation. In time, after there are records of earnings and records of improvement costs for a long period, the matter may work itself out in some shape, even under the doctrine of *Smyth v. Ames*.

Before the telephone lines were taken over by the government during the war, the Commission had valued three of the sixty-five local telephone ex-

92. (1898) 169 U. S. 4661. c. 546.

93. There are numerous articles in which the doctrine has been discussed and criticised. See "The Effect of the Recent Decisions of the Supreme Court on Reproduction Cost as a Test of Value" by Nathan Matthews, 37 H. L. R. 431; "Public Utility Valuation" by Edwin C. Goddard, 15 Mich. L. Rev. 205; "The 'Physical Value' Fallacy in Rate Cases", 30 Y. L. J. 710; "A Permanent Basis for Rate Regulation", by Donald R. Richberg, 31 Y. L. J. 263; "Fair Value for Rate Purposes" by Robert H. Whitten, 27 H. L. R. 494.

94. Justice Brandeis mentioned the "prudent investment" in his opinion in *Galveston Electric Co. v. Galveston* (1922) 258 U. S. 388 at 391, 66 L. E. 678, 42 S. C. Rep. 351. He and Justice Holmes approved it in the *Southwestern Bell Telephone Co. Case* (1923) 262 U. S. 276 at 289, 67 L. E. 981, 43 S. C. Rep. 544, *et seq.*, where he said, "I concur in the judgment of reversal. But I do so on the ground that the order of the state commission prevents the utility from earning a fair return on the amount prudently invested in it The thing devoted by the investor to the public use is not specific property, tangible and intangible but capital embarked in the enterprise. Upon the capital so invested the Federal Constitution guarantees to the utility the opportunity to earn a fair return." The opinion enlarges on the idea and refers to various articles on the subject. It is probable that this method of finding the rate base is preferable to the old method based on *Smyth v. Ames*.

95. This is clearly brought out in the article by Mr. Nathan Matthews in 37 H. L. R. 431.

changes in the state belonging to the Southwestern Bell Telephone Company,⁹⁶ a corporation operating in several states and which is, itself, a subsidiary of the American Telegraph and Telephone Company. The government turned the property back to the owners with a proviso, that the existing rates (which had been fixed by the Postmaster-General) should continue for four months, unless modified by the proper state authorities. After hearings, the Commission fixed the base rate of the Company at \$20,400,000 and ordered certain reductions and changes which it was estimated would reduce the annual income \$383,000. (The Company claimed the reduction would be \$465,000). It seems the Commission found this rate base largely by taking its own valuation of the three exchanges made earlier, and finding the percentage the reproduction value, as estimated by the Company for these three exchanges, exceeded this valuation. It then assumed the estimated reproduction value of the Company was too high by this percentage for the total property, so the whole was proportionately reduced, and to the figure thus obtained ten per cent was added to cover intangibles. The result was the above figure, which it was found was very near the Company's book value less some depreciation. A temporary rate was then fixed which would produce an estimated return of $13\frac{1}{3}$ per cent on this rate base, and after allowing 6% for depreciation, would leave a net return of $7\frac{1}{3}$ %. The Commission intended to continue to value each exchange separately, and thus secure a better rate base. The Missouri Supreme Court affirmed this temporary order thus determined.⁹⁷ In *Southwestern Bell Telephone Company v. P. S. C.*⁹⁸ the United States Supreme Court reversed the order on the ground the rate was confiscatory. The Commission in finding the rate base followed the scheme of *Smyth v. Ames* and the Court approved this, but it said no consideration was given to the present high costs. The court said⁹⁹ "witnesses for the company asserted—and there was no substantial evidence to the contrary—that excluding the cost of establishing the business, the property was worth at least 25% more" . . . so the court concluded the rate base should be at least \$25,000,000, and on this figure the estimated earnings would allow only $11\frac{1}{3}$ %, which after allowing 6% for depreciation, would leave a net return of $5\frac{1}{3}$ %. It might be noted the old rates would have yielded a bare 7% on this rate base and hence would be dangerously close to being what the court has regarded as confiscatory. This is particularly true if, as has been above suggested, the present attitude of the Supreme Court is to hold a rate confiscatory, unless it covers operating expenses, interest on capital and enough more so that the utility can borrow needed funds at reasonable terms.¹⁰⁰ If

96. The exchanges so valued were those at St. Louis, Springfield and Carruthersville. However, the combined value of these three amounted to more than half the total value of the total property of the company within the state.

97. *Southwestern Bell Telephone Company v. P. S. C.* (1921) 233 S. W. 425.

98. (1922) 262 U. S. 276, 67 L. E. 981, 43 S. C. R. 544.

99. Page 288.

100. See notes 87 and 88, *supra*.

this is the meaning of a non-confiscatory rate, the margin between the confiscatory rate and the reasonable rate is narrowed more than has been imagined. A rate may be higher than this minimum non-confiscatory rate, and yet be reasonable in that it is not too high, but any minimum non-confiscatory rate would also be a reasonable rate.

The State and Federal Court opinions in this case illustrate the difficulties of rate making, and an advocate of either the public side or the utility side of the case, can find plenty of arguments to support his views. It may be doubted whether the decision of the Supreme Court is based on more than a great fear that the rate fixed was too low, though the error relied on by the majority was that the Commission did not give proper consideration to the current high costs in making its valuation. The Commission since has been endeavoring to give effect to the direction of the Supreme Court in this respect, even going so far as to add fifty per cent in one case to the estimate cost before the war, to cover this item.¹⁰¹ But the Commission and the state courts still purport to follow the doctrine of *Smyth v. Ames* in arriving at the rate base, which is not strange, since it has the approval of the majority of the Federal Supreme Court justices.

In *Capital City Water Company v. P. S. C.*,¹⁰² another troublesome rate case is found. The Company operates a water plant at Jefferson City, and seemingly has a very poor earning capacity. The consumption of water was very low for a city of this size. The plant had been purchased in 1912 for \$273,000 (probably much more than it was worth) and there had been improvements amounting to about \$81,000 which was added. The rate base was thus fixed at \$360,000 allowing nothing for depreciation since 1912. No going value was allowed (though the Company insisted on the allowance of \$50,000) the reason being that the price paid for the going plant had been high, and there seemed to be no additional element to increase the going value. The rate base allowed was about \$50,000 above the present reproduction estimate of the Commission's engineer, and about \$40,000 lower than the figures of the Company. The Company claimed also a 5% brokerage commission though no such commission had ever been paid, and some \$23,000 for accumulated deficits between the actual earnings, and what they considered would have been a reasonable return since 1912. These were disallowed. The rates were fixed in Feb. 1918 on a basis of 7% net and 1¼% for depreciation. The earnings for the next year fell \$13,000 short of the estimated figure, and on new application for increased rates, the Company asked that one-fifth this amount be added to the rate base for five years to reimburse the company. A second order granted still higher rates, but meanwhile costs had so risen that the basis was 6% net and one per cent for depreciation. The Commission feared a point had been reached where increase in rates would result in decreased consumption and

101. See *Re United Railways Company of St. Louis* (1923) 1923 D P. U. R. 759, 850; *Re Peoples Gas & Electric Company* (1923) 1923 E P. U. R. 127, 137-40.

102. (1923) 298 Mo. 524, 252 S. W. 446.

decreased earnings, but the Company still clamored for higher rates. The last order was entered on March 20, 1920, and this order was affirmed in the circuit court and later by the supreme court. The latter was moved by the belief that by 1923 costs would have fallen so as to improve the net earnings, but it approved the order anyhow. It also pointed out that if it reversed the order, all the Company could do would be to ask for a new hearing and this they could do anyhow, so to reverse seemed useless. The above case illustrates the ingenuity of utilities in trying to add to the base rate.¹⁰³

The above case was the second case where the utility was one with low earning capacity and in *Case v. P. S. C.*¹⁰⁴ we find a third case of the sort. Here it appeared that the Kansas City Power & Light Company furnished electricity and steam heat in Kansas City and a hearing was held to fix rates as to both. Certain citizens objected to the rates fixed for steam heat and on appeal to the circuit court of Jackson County the order as to rates for steam heat was set aside, whereupon the Commission appealed to the Supreme Court. The Company had a plant used for producing current, the exhaust steam being used for heating, but the cost of producing current at this plant was so great, it was not operated, except when the steam could be used for heating. In a way the current produced was a by-product of the heating plant. The controversy was over the apportionment of value. The Commission apportioned 15% to the electric service and 85% to the heating service, and there was evidence to support such apportionment. But since many of the customers still had furnaces the Commission feared to fix the rate so as to give an adequate estimated return on the rate base, for fear there would be a heavy loss of consumption. It therefore fixed rates estimated to give a return of only 2.92% on the rate base. The citizens contended the apportionment of value should be fifty-fifty. The supreme court again sustained the order of the Commission. So far as the citizens were concerned a fifty-fifty valuation would only have resulted in trebling the rate, so the appeal seemed fruitless.

5. *Federal Injunctions against Rates.*

The Federal Courts have jurisdiction to enjoin the enforcement of rates if they appear to be confiscatory. In a number of cases this form of relief has been sought by utilities. In *Springfield Gas and Electric Co. v. Barker*,¹⁰⁵ the District Court granted a temporary injunction against the enforcement of electric rates fixed for the city of Springfield. The order fixing rates was entered in 1914, and the Company alleged the rate base was much too low. The opinion of the court is far from clear, but it did complain that the Commission had,

103. A case where there were similar ingenious attempts to increase the rate base by brokerage, deficits, etc., is *Galveston Electric Company v. Galveston* (1922) 258 U. S. 388, 67 L. E. 1076, 43 S. C. R. 606. The Missouri court followed this case in denying all such items.

104. (1923) 297 Mo. 459, 249 S. W. 955.

105. (1915) 231 Fed. 331 (D. C. for West. Dist. of Mo.)

enumerated in general terms the items included in the valuation without setting out the amount of each, which made it difficult to review. The court doubted whether this was in accordance with the purpose of the act.

In *Public Utilities Commission v. Landon*,¹⁰⁶ the United States Supreme Court held that the regulation of rates of local gas companies which purchased and distributed gas from an interstate gas company was only indirect interference with interstate commerce and the interstate company could not complain even though the local rates were confiscatory, for it was not obliged to sell gas to such local companies. This reversed an injunction which had been granted in the District Court.

In *Kansas City etc., Ry. v. Barker*¹⁰⁷ a temporary injunction was also granted as to an order providing for the sale of commutation tickets by a railroad company between Kansas City and suburban towns, where no such traffic existed, but there was evidence a traffic might be built up which would be profitable to the Company. Without these reduced commutation rates the estimated net return to the Company at existing rates was 6.2%. The court on the preliminary hearing thought these rates confiscatory when the net return was so low, and it further held the Commission could not establish test rates based on expected business. These cases are of little importance. In *Joplin & Pittsburg Railway Company v. P. S. C.*¹⁰⁸ the injunction seems clearly justified by the facts. Here an interurban railroad operated between Joplin, Missouri and Pittsburg, Kansas, one-fourth of the track being in Missouri. The Kansas Commission had fixed the intrastate rate in Kansas at 2.5 cents per mile and the Interstate Commerce Commission allowed 2.6 cents on interstate traffic. After two hearings the Commission fixed a rate of 2.12 cents per mile for intrastate traffic in Missouri, and the company sought an injunction. The valuation made by the Commission seemed very low compared with that made by the Kansas Commission and by the Interstate Commerce Commission, and the road as a whole was not earning enough at the time to pay its fixed charges. The comparative values seemed very wide apart so the court granted an injunction. It appeared the Commission in fixing the rate base had given controlling weight to the original cost of the property, and this the court criticised. This tendency of the Commission to take the original cost or the reproduction cost before the war, and add to it improvements made since then, for the purpose of finding the rate base, has been marked in the cases that went to the higher courts. This caused the difficulty in the *Southwestern Bell Telephone Company Case*. In *St. Joseph Railway, Light and Power Company v. P. S. C.*¹⁰⁹ the same tendency led to another injunction against rates for street car fares and for heating in St. Joseph. This Company furnished electricity and heat and operated a street railway. It asked an increase in street car fares and

106. (1916) 249 U. S. 236. This was reversing *Landon v. P. S. C.* (1916) 234 Fed. 236.

107. (1915) 242 Fed. 310.

108. (1919) 267 Fed. 584.

109. (1920) 268 Fed. 267.

heating rates. The Commission granted part of the increase in fares but refused to grant an increase in heating rates. In fixing the rate base, it appeared that the Commission relied on the estimates of its own engineers, which were based either on original cost, or on reproduction cost as of about 1910. The result was a rate base of \$5,800,000, while the Company's estimates of present reproduction costs without depreciation were \$11,521,000. The rate base fixed was just about equal in amount to the company's funded debt, and the rates fixed were estimated to yield only 5.4% on this base rate which would just about cover the interest on such debt. The court therefore granted the injunction on the ground that the method of valuation adopted by the Commission was wrong, in that it did not consider present value in determining the valuation.

Judging from the decided cases, the tendency of the Commission during the period of rising costs from 1916 to 1921 was to base valuation largely, if not wholly, on either the original cost or the reproduction cost at some period before the war. This led to low valuations and low net earnings. It is probable the members of the Commission, like many other persons during this period, considered that it would soon end and costs would fall near to pre-war levels—that they were always expecting the break which did not come until 1921. Then too they were constantly under political pressure, and were trying to hold down rates as much as possible during this difficult period for the sake of the public interest, as they considered the Commission was created to protect the public. The peak of the period of high costs is now well past, and the Commission is in a great measure relieved of this difficult situation.

6. *Valuation When a Moot Question.*

In *Columbia Telephone Co. v. Atkinson*,¹¹⁰ citizens had petitioned for a decrease in telephone rates and the Commission after fixing a valuation concluded the existing rates were reasonable and so entered an order. On appeal to the supreme court the Company contended the valuation so fixed was too low and might prove detrimental to the Company in the future. This contention was based on section 101¹¹¹ of the Act which provides that findings of the Commission when properly certified shall be admissible in evidence before the Commission, or in any action before any court in which the State, or any agency of the state and the utility affected, are interested, and, that such findings "shall be conclusive evidence of the facts stated therein as of the date therein stated under the conditions then existing." The court held this was only a moot question in this case, and it could not indicate any opinion until some case arose where such evidence had been made use of. If such valuations are to be a starting point for future valuations for purposes of rate making, one can easily see that the fear of the Company was in some measure justified.

110. (1917) 271 Mo. 28, 195 S. W. 741.

111. R. S. 1919 s. 10511.

There was a similar holding in *West St. Louis Water Company v. P. S. C.*¹¹² No case where a former finding of the Commission has been introduced under section 101 against the objections of the utility has yet arisen.

112. (1917) 197 S. W. 340.

(To be continued)

