University of Pennsylvania Law Review

And American Law Register

FOUNDED 1852

Published Monthly, November to June, by the University of Pennsylvania Law School,
at 34th and Chestnut Streets, Philadelphia, Pa.

VOL. 77

MARCH, 1929

No. 5

VALUE IN CONFISCATION CASES

NATHANIEL T. GUERNSEY

*Smyth v. Ames*¹ laid down the rule that under the Fourteenth Amendment states are not permitted to impose rates upon public utilities which afford less than a fair return on the present fair value of the property in question, thus defining the limitation upon the regulatory power of the states. It is proposed here to review the authorities in order to determine whether they furnish any support for the contention that in this connection the word "value" is not used in its ordinary, accepted sense.

Before taking this up, it is worth while to briefly review some of the cases which preceded *Smyth v. Ames*. At its October term, 1876, the Supreme Court decided *Munn v. Illinois*² and the *Granger Cases*.³ These cases all presented the broad question whether the states have the power to regulate rates. *Munn v. Illinois* involved rates for storing and transferring grain at elevators in Chicago. The *Granger Cases* arose out of state laws establishing commissions whose powers included the regulation of

¹ 169 U. S. 466, 18 Sup. Ct. 418 (1898).

² 94 U. S. 113 (1876).

³ *Chicago, Burlington & Quincy R. R. v. Iowa*, 94 U. S. 155 (1876); *Peik v. Chicago & North Western Ry.*, 94 U. S. 164 (1876); *Chicago, Milwaukee & St. Paul R. R. v. Ackley*, 94 U. S. 179 (1876); *Winona & St. Peter R. R. v. Blake*, 94 U. S. 180 (1876); *Stone v. Wisconsin*, 94 U. S. 181 (1876).

railroad freight and passenger rates. In *Munn v. Illinois* the attack was based on the due process clause, while in the *Granger Cases* the railroads relied principally upon the contention that the laws in question were in violation of their charter contracts with the states. In each instance the power of the state was sustained. In *Munn v. Illinois* the Court said:

"The controlling fact is the power to regulate at all. If that exists, the right to establish the maximum of charge, as one of the means of regulation, is implied." ⁴

And furthermore:

"We know that this is a power which may be abused; but that is no argument against its existence. For protection against abuses by legislatures the people must resort to the polls, not to the courts." ⁵

It is probable that at first both the bench and bar understood the doctrine of these cases to be that the power of the states to regulate rates was unrestricted. This apparently was the view of Mr. Justice Field, who, in his dissenting opinion in *Stone v. Wisconsin*, said:

"The opportunity was presented for the court to define the limits of the power of the State over its corporations after they have expended money and incurred obligations upon the faith of the grants to them, and the rights of the corporators, so that, on the one hand, the property interests of the stockholder would be protected from practical confiscation, and, on the other hand, the people would be protected from arbitrary and extortionate charges. This has not been done; but the doctrine advanced in *Munn v. Illinois*, *supra*, p. 113, has been applied to all railroad companies and their business, and they are thus practically placed at the mercy of the legislature of every State." ⁶

Apparently, it was not long before this conclusion was questioned. *Spring Valley Water Works v. Schottler* ⁷ involved the

⁴ *Supra* note 2, at 134.

⁵ *Supra* note 2, at 134.

⁶ *Supra* note 3, at 184.

⁷ 110 U. S. 347, 4 Sup. Ct. 48 (1884).

power of the state to require the water company to submit to rates fixed by the local board of supervisors, where the general law under which it had been organized provided that they should be established by a board of commissioners to be constituted as provided in that act. The Court sustained the power of the state, saying:

"That it is within the power of the government to regulate the prices at which water shall be sold by one who enjoys a virtual monopoly of the sale, we do not doubt. That question is settled by what was decided on full consideration in *Munn v. Illinois*, 94 U. S. 113. As was said in that case, such regulations do not deprive a person of his property without due process of law. *What may be done if the municipal authorities do not exercise an honest judgment, or if they fix upon a price which is manifestly unreasonable, need not now be considered, for that proposition is not presented by this record.* The objection here is not to any improper prices fixed by the officers, but to their power to fix prices at all."⁸

What has been italicized certainly opened the door for doubt as to whether the power to regulate was unrestricted. In the *Railroad Commission Cases*⁹ we find the same suggestion, the Court saying:

"From what has thus been said, it is not to be inferred that this power of limitation or regulation is itself without limit. This power to regulate is not a power to destroy, and limitation is not the equivalent of confiscation. Under pretence of regulating fares and freights, the state cannot require a railroad corporation to carry persons or property without reward; neither can it do that which in law amounts to a taking of private property for public use without just compensation, or without due process of law."

Two years later *Dow v. Beidelman*¹⁰ failed to materially clarify the situation. The case involved the validity of an Arkan-

⁸ *Ibid.* 354, 4 Sup. Ct. at 51. The italics are the writer's.

⁹ 116 U. S. 307, 331, 6 Sup. Ct. 334, 345 (1886).

¹⁰ 125 U. S. 680, 8 Sup. Ct. 1028 (1888).

sas statute fixing passenger fares at three cents per mile. Facts were disclosed throwing some light upon the cost of the property and its probable earnings at the proposed rates. The Court states that the general rule of law governing the case had been developed in the opinions in *Munn v. Illinois*¹¹ and the *Granger Cases*¹² immediately following it, and, in discussing these cases, says:

"The same rule was affirmed and acted on in several other cases decided at the same time, in the first of which the Chief Justice, in answering 'the claim that the courts must decide what is reasonable, and not the legislature,' said: 'Where property has been clothed with a public interest, the legislature may fix a limit to that which in law shall be reasonable for its use. This limits the courts, as well as the people. If it has been improperly fixed, the legislature, not the courts, must be appealed to for the change.'"¹³

Notwithstanding this statement tending to support the contention that the Fourteenth Amendment imposed no limit upon the regulatory power, the Court goes on to meet the argument that the three-cent fare was unreasonable because it would earn only a very small amount upon the cost of the road and upon its bonded debt, by the reply that there was no evidence as to what the bonds cost or as to the amount of the capital stock of the corporation as reorganized, or as to the sum paid for the road by the reorganized corporation or its trustees, suggesting a possibility that proper facts might warrant a determination that the legislative rate was unreasonable. There the following statement is made:

"Without any proof of the sum invested by the reorganized corporation or its trustees, the court has no means, if it would under any circumstances have the power, of determining that the rate of three cents a mile fixed by the legislature is unreasonable. Still less does it appear that there has been any such confiscation as amounts to a taking of property without due process of law."¹⁴

¹¹ *Supra* note 2.

¹² *Supra* note 3.

¹³ *Supra* note 10, at 687, 8 Sup. Ct. at 1029.

¹⁴ *Supra* note 10, at 690, 8 Sup. Ct. at 1031.

This outline discloses the situation existing when *Chicago, Milwaukee & St. Paul Ry. v. Minnesota*¹⁵ was presented to the Court in 1890. The power to regulate had been clearly recognized in opinions which strongly suggested that the Fourteenth Amendment did not operate as a limitation upon this power, but statements in some later opinions indicated that this contention had not been entirely foreclosed.

The *Chicago, Milwaukee & St. Paul Ry.* case cleared up this uncertainty. It announced the rule that the Fourteenth Amendment so limits this regulatory power of the states that rates imposed in its exercise must be reasonable. The case involved an order of the Railroad and Warehouse Commission of the state of Minnesota setting aside certain rates established by the railroad for the transportation of milk, and substituting lower rates for them. In a proceeding to compel the railroad to put the commission rates into effect, it asserted that these rates were not reasonable, fair or just compensation for the service rendered, and that the pre-existing rate was reasonable, fair and just. The question was squarely presented whether the company was entitled to a judicial hearing upon this contention. The statute made the determination of the commission final, and did not allow any issue to be made or inquiry to be had as to the equality or reasonableness of the rates in fact. The Court quoted with approval the excerpt which has already been taken from the *Railroad Commission Cases*,¹⁶ and decided that the Minnesota statute violated the Fourteenth Amendment, saying, among other things:

"The question of the reasonableness of a rate of charge for transportation by a railroad company, involving as it does the element of reasonableness both as regards the company and as regards the public, is eminently a question for judicial investigation, requiring due process of law for its determination. If the company is deprived of the power of charging reasonable rates for the use of its property, and such deprivation takes place in the absence of an investigation by judicial machinery, it is deprived of the lawful use of its property,

¹⁵ 134 U. S. 418, 10 Sup. Ct. 462 (1890).

¹⁶ *Supra* note 9.

and thus, in substance and effect, of the property itself, without due process of law and in violation of the Constitution of the United States; and in so far as it is thus deprived, while other persons are permitted to receive reasonable profits upon their invested capital, the company is deprived of the equal protection of the laws.”¹⁷

It will be noted that only five justices concurred in the majority opinion in this case; Mr. Justice Miller filing a concurring opinion and three justices dissenting.

With the establishment of the two propositions: (1) that the power to regulate existed, and (2) that rates established in the exercise of this power must be just and reasonable, the next step in the development of the subject involved the inquiry as to the factors determining whether a rate fixed by public authority is just and reasonable. And this brings us to *Reagan v. Farmers' Loan & Trust Co.*¹⁸ The suit was brought by the Farmers' Loan & Trust Company as trustee under a mortgage of the railroad property to enjoin the enforcement of a schedule of rates which had been established by the state commission of Texas.

The case was tried upon demurrers; the allegations relied upon to show that the rates were unreasonable being that the railroad cost more than the amount of stock and bonds outstanding, that the stock and bonds outstanding represented money invested in its construction, that there had been no waste or mismanagement in the construction or operation of the property, that the net earnings were insufficient to pay the interest on the bonded debt, that no dividends had ever been paid upon the stock representing two-fifths of the value of the property, and that the proposed tariff would reduce the net earnings so that only one-half of the interest on the bonded debt could be paid. It will be noted that there were no direct allegations as to value or fair return. Instead of stating the value of the property, it is stated that it cost more than the outstanding stock and bonds, and that they represent actual investment; and instead of fair return, there are the allegations as to interest and dividends.

¹⁷ *Supra* note 15, at 458, 10 Sup. Ct. at 467.

¹⁸ 154 U. S. 362, 14 Sup. Ct. 1047 (1894).

The Court definitely asserts its jurisdiction to ascertain whether rates are unjust and unreasonable, and to restrain their operation if they are. It says:

"Yet it has always been recognized that, if a carrier attempted to charge a shipper an unreasonable sum, the courts had jurisdiction to inquire into that matter and to award to the shipper any amount exacted from him in excess of a reasonable rate; and also in a reverse case to render judgment in favor of the carrier for the amount found to be a reasonable charge. The province of the courts is not changed, nor the limit of judicial inquiry altered, because the legislature instead of the carrier prescribes the rates. The courts are not authorized to revise or change the body of rates imposed by a legislature or a commission; they do not determine whether one rate is preferable to another, or what under all circumstances would be fair and reasonable as between the carriers and the shippers; they do not engage in any mere administrative work; but still there can be no doubt of their power and duty to inquire whether a body of rates prescribed by a legislature or a commission is unjust and unreasonable, and such as to work a practical destruction to rights of property, and if found so to be, to restrain its operation." ¹⁹

Having disposed of the jurisdictional matter, the Court took up the question whether the rates were unjust and unreasonable, and found that the allegations of the bill were sufficient to support this contention. In this connection it says:

"The equal protection of the laws—the spirit of common justice—forbids that one class should by law be compelled to suffer loss that others may make gain. If the state were to seek to acquire the title to these roads, under its power of eminent domain, is there any doubt that constitutional provisions would require the payment to the corporation of just compensation, that compensation being the value of the property as it stood in the markets of the world, and not as prescribed by an act of the legislature? Is it any less a departure from the obligations of justice to seek to take not the title but the use for the public benefit at less than its market value?" ²⁰

¹⁹ *Ibid.* 397, 14 Sup. Ct. at 1054.

²⁰ *Ibid.* 410, 14 Sup. Ct. at 1059.

The case of *Covington & Lexington Turnpike Road Co. v. Sandford*,²¹ decided about two years later, does not show any substantial progress toward the definition of what the words "just and reasonable" require. Like *Reagan v. Farmers' Loan & Trust Co.*,²² it was disposed of on demurrer. The Court held that rates so low as to render it impossible for the company to maintain its road in proper condition or to pay any dividends whatever to its stockholders were unreasonable and illegal. The question of value was not discussed. A dictum²³ to the effect that the mere fact that the company could not earn more than 4 per cent would not justify setting the rates aside as unconstitutional negatives the idea that the Court up to this time had recognized the right to a fair return as distinguished from some return.

Less than a year and a half after this decision, the Court handed down its opinion in *Smyth v. Ames*.²⁴ This case definitely presented to the Court whether it should pass upon the amount of the profit or return, as well as whether the factor to which this should be applied should be cost or value. Mr. Webster, one of the counsel for the state, admitted that a reasonable rate must pay all of the expenses of operation and something more, and contended that what this excess over operating expenses should be was a question of state policy over which the courts could exercise no control. Mr. William Jennings Bryan, also for the state, contended that if the Court were to pass upon the reasonableness of this profit, "the present value of the roads, as measured by the cost of reproduction, is the basis upon which profit should be computed."²⁵ The railroads, on the other hand, contended for the cost of the property as measured by the outstanding stocks and bonds, asserting that rates insufficient to provide for bond interest and dividends were unreasonable. Mr. Justice Harlan states the effect of the decisions up to that time as follows:

²¹ 164 U. S. 578, 17 Sup. Ct. 198 (1896).

²² *Supra* note 18.

²³ *Supra* note 21, at 596, 17 Sup. Ct. at 205.

²⁴ *Supra* note 1.

²⁵ *Supra* note 1, at 489.

"In view of the adjudications these principles must be regarded as settled:

"1. A railroad corporation is a person within the meaning of the Fourteenth Amendment declaring that no state shall deprive any person of property without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws.

"2. A state enactment, or regulations made under the authority of a state enactment, establishing rates for the transportation of persons or property by railroad that will not admit of the carrier earning such compensation as under all the circumstances is just to it and to the public, would deprive such carrier of its property without due process of law and deny to it the equal protection of the laws, and would therefore be repugnant to the Fourteenth Amendment of the Constitution of the United States.

"3. While rates for the transportation of persons and property within the limits of a State are primarily for its determination, the question whether they are so unreasonably low as to deprive the carrier of its property without such compensation as the Constitution secures, and therefore without due process of law, cannot be so conclusively determined by the legislature of the State or by regulations adopted under its authority, that the matter may not become the subject of judicial inquiry." ²⁶

The word "value" first comes into the opinion in the discussion of the contention that the revenue from all of the business of the companies, state and interstate, should be taken into account, the Court saying:

"Or, must the rates for such transportation as begins and ends in the State be established with reference solely to the amount of business done by the carrier wholly within such State, to the cost of doing such local business, and to the fair value of the property used in conductin it, without taking into consideration the amount and cost of its interstate business, and the value of the property employed in it?" ²⁷

The Court then takes up the contention of the railroads. Their position is stated as follows:

²⁶ *Supra* note 1, at 526, 18 Sup. Ct. at 426.

²⁷ *Supra* note 1, at 541, 18 Sup. Ct. at 431.

"In the discussion of this question, the plaintiffs contended that a railroad company is entitled to exact such charges for transportation as will enable it, at all times, not only to pay operating expenses, but also to meet the interest regularly accruing upon all its outstanding obligations, and justify a dividend upon all its stock; and that to prohibit it from maintaining rates or charges for transportation adequate to *all* those ends will deprive it of its property without due process of law, and deny to it the equal protection of the laws. This contention was the subject of elaborate discussion; and, as it bears upon each case in its important aspects, it should not be passed without examination."²⁸

The Court denied this contention, and in doing so placed emphasis upon the value factor, both as applied to the property of the carrier and the services rendered by it. It says:

"But the rights of the public would be ignored if rates for the transportation of persons or property on a railroad are exacted without reference to the fair value of the property used for the public or the fair value of the services rendered, but in order simply that the corporation may meet operating expenses, pay the interest on its obligations, and declare a dividend to stockholders."²⁹

The Court then states its conclusion:

"We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public."³⁰

Having determined that value is the basis of these calculations, the Court proceeds to indicate some of the factors to be taken into account in ascertaining value, saying:

"And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock,

²⁸ *Supra* note 1, at 543, 18 Sup. Ct. at 432.

²⁹ *Supra* note 1, at 544, 18 Sup. Ct. at 433.

³⁰ *Supra* note 1, at 546, 18 Sup. Ct. at 434.

the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property.”³¹

Further summarizing the situation, it says:

“What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth.”³²

The rule announced is that, to be just and reasonable, rates imposed by public authority must afford a fair return upon the value of the property in question, and that this value is to be ascertained by giving to all factors bearing upon the matter of value such weight as may be just and right in each case. There is nothing here to indicate that the word “value” is not used in its ordinarily accepted sense, or that the Court intended to attach to it any meaning not in accord with its accepted definition.

Because in *Smyth v. Ames* the revenues under the proposed rates would not afford any return, it was unnecessary there to go into this question of value. Notwithstanding this, the case has been so frequently cited in the Supreme Court and in other courts as announcing this rule as to warrant the statement that it is accepted by the courts as the leading case upon this proposition.³³ The numerous cases which have since arisen assailing particular rates as confiscatory have all involved attempts to apply this rule. It is proposed to examine the decisions of the Supreme Court in these cases to ascertain whether they have modified this rule or

³¹ *Supra* note 1, at 546, 18 Sup. Ct. at 434.

³² *Supra* note 1, at 547, 18 Sup. Ct. at 434.

³³ Up to this time (December, 1928), *Smyth v. Ames* has been cited in decisions of the United States Supreme Court not less than 64 times; in decisions of the lower federal courts not less than 190 times; and in decisions of state courts not less than 141 times.

justify the assumption that the word "value" is not used in its accepted sense.

San Diego Land & Town Co. v. National City,³⁴ decided about fourteen months after *Smyth v. Ames*, was probably heard upon a record made up prior to that decision. There was the same argument for cost as in *Smyth v. Ames*. The Court follows *Smyth v. Ames*, quoting from the opinion much that has been set out above. As to the contention of the company, it says:

"The basis of calculation suggested by the appellant is, however, defective in not requiring the *real value* of the property and the fair value in themselves of the services rendered to be taken into consideration. What the company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property at the time it is being used for the public. The property may have cost more than it ought to have cost, and its outstanding bonds for money borrowed and which went into the plant may be in excess of the *real value* of the property. So that it cannot be said that the amount of such bonds should in every case control the question of rates, although it may be an element in the inquiry as to what is, all the circumstances considered, just both to the company and to the public."³⁵

The expression "real value," twice used here, strongly negatives any suggestion that the word "value" was not used in its accepted sense.

*San Diego Land & Town Co. v. Jasper*³⁶ sought to have certain water rates fixed by the board of supervisors of San Diego County declared unreasonable and void. By the statutes of California, under which the board was acting, it was required to adjust the rates so that the net receipts and profits should be not less than six nor more than eighteen per cent upon the value of the used and useful property. The Court reiterates the doctrine of *Smyth v. Ames*, saying:

"The main object of attack is the valuation of the plant. It no longer is open to dispute that under the Constitution

³⁴ 174 U. S. 739, 19 Sup. Ct. 804 (1899).

³⁵ *Ibid.* 757, 19 Sup. Ct. at 811. The italics are the writer's.

³⁶ 189 U. S. 439, 23 Sup. Ct. 571 (1903).

'what the company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property at the time it is being used for the public.' *San Diego Land and Town Co. v. National City*, 174 U. S. 739, 757. That is decided, and is decided as against the contention that you are to take the actual cost of the plant, annual depreciation, etc., and to allow a fair profit on that footing over and above expenses. We see no reason to doubt that the California statute means the same thing."³⁷

This case illustrates some of the questions which might arise if cost instead of value were the factor. The property had been sold under foreclosure at a price that was less than its original cost, and was taken in by the plaintiff company at this foreclosure sale price. The question arose as to whether this fairly measured the property's value, and as to this the Court says:

"The purchasers organized the present corporation, and the above-mentioned sum is the cost of the land and water-works to it. The appellant protests that this is not a fair value for the property of the company. We doubt whether it is not a liberal allowance. The officers of the two companies at the time thought that they got more than they could have got in any other way. But at all events, it is decided that the price is evidence, we might say more important evidence than the original cost."³⁸

That the Court, in its use of the word "value," uses it in its ordinarily accepted sense, is indicated by the following excerpt from the opinion:

"Of course it is hard to answer the proposition that value expressed in money depends on what people think at the time. That determines what they will give for the thing, and whether they think rightly or wrongly, if they or some of them will give a certain price for it, that is its value then. Nevertheless, it has been held, under some circumstances, even in ordinary suits, that when events have corrected the prophecy of the public, the facts may be shown and a more correct valuation adopted. *Twycross v. Grant*, 2 C. P. D.

³⁷ *Ibid.* 442, 23 Sup. Ct. at 572.

³⁸ *Ibid.* 443, 23 Sup. Ct. at 572.

469, 544; *Peek v. Derry*, 37 Ch. D. 541, 591 (not reversed on this point by 14 App. Cas. 337); *Whiting v. Price*, 172 Massachusetts, 240. See *National Bank of Commerce v. New Bedford*, 175 Massachusetts, 257, 262. We think that upon the question before us subsequent events may be considered. The facts mentioned would tend to depreciate the market value of the plant, and very much depreciate the value of the services rendered to consumers during the year when the ordinance necessarily was in force."³⁹

Six years later came *City of Knoxville v. Knoxville Water Co.*⁴⁰ Value is accepted as the basis, and various factors affecting it are discussed. The Court held that depreciation must be deducted in order to arrive at value. It determined that in that case the outstanding capitalization was of substantially no weight in ascertaining value. It reversed the case because it did not affirmatively appear that the ordinance rates would not afford a fair return upon the value of the property.

*Willcox v. Consolidated Gas Co.*⁴¹ was decided on the same day. In Mr. Whitney's brief for the commission, it was contended that land should be valued not in excess of its cost, and manufacturing plants should be valued at what it would cost to produce a modern plant to do the same work. In Judge Parker's brief, also for the commission, it was contended that the court below erred in assigning to the tangible assets any value in excess of their cost, so that again in this case the issue was distinctly drawn between cost and value. The Court states the rule for the disposition of the case as follows:

"The question arising is as to the validity of the acts limiting the rates for gas to the prices therein stated. The rule by which to determine the question is pretty well established in this court. The rates must be plainly unreasonable to the extent that their enforcement would be equivalent to the taking of property for public use without such compensation as under the circumstances is just both to the owner

³⁹ *Ibid.* 444, 23 Sup. Ct. at 573.

⁴⁰ 212 U. S. 1, 29 Sup. Ct. 148 (1909).

⁴¹ 212 U. S. 19, 29 Sup. Ct. 192 (1909).

and the public. There must be a fair return upon the reasonable value of the property at the time it is being used for the public.”⁴²

It proceeds to say :

“In order to determine the rate of return upon the reasonable value of the property at the time it is being used for the public, it, of course, becomes necessary to ascertain what that value is.”⁴³

The Court makes no express reference to the contention that cost should be adopted as the basis.

*Lincoln Gas & Electric Light Co. v. City of Lincoln*⁴⁴ involved the validity of an ordinance fixing rates for gas. The Court reversed the case, with instructions to the court below to refer it to a master because the record was in unsatisfactory form. It says :

“In this, as in every other legislative rate case, there are presented three questions of prime importance: First, the present reasonable value of the company’s plant engaged in the regulated business; second, what will be the probable effect of the reduced rate upon the future net income from the property engaged in serving the public; and, third, in ascertaining the probable net income under the reduced rates prescribed, what deduction, if any, should be made from the gross receipts as a fund to preserve the property from future depreciation.

“The valuation fixed by the court is the main point of attack. That the company is entitled to a fair return upon the value of the property at the time of the inquiry, is the rule.”⁴⁵

Another case decided in the same year is *Cedar Rapids Gas Light Co. v. City of Cedar Rapids*.⁴⁶ The case assumes that

⁴² *Ibid.* 41, 29 Sup. Ct. at 195.

⁴³ *Ibid.* 41, 29 Sup. Ct. at 195.

⁴⁴ 223 U. S. 349, 32 Sup. Ct. 271 (1912).

⁴⁵ *Ibid.* 357, 32 Sup. Ct. at 272.

⁴⁶ 223 U. S. 655, 32 Sup. Ct. 389 (1912).

value is the basis, and is devoted largely to the discussion of items bearing upon this question.

In the next year came the very well-known *Minnesota Rate Cases*.⁴⁷ One question presented was whether certain rates established by authority of the state were confiscatory. Mr. Justice Hughes very clearly outlines the general principles as follows:

"But the general principles which are applicable in a case of this character have been set forth in the decisions.

"(1) The basis of calculation is the 'fair value of the property' used for the convenience of the public. *Smyth v. Ames*, *supra* (p. 546). Or, as it was put in *San Diego Land & Town Co. v. National City*, *supra* (p. 757), 'What the company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property at the time it is being used for the public.' See also *San Diego Land & Town Co. v. Jasper*, *supra*; *Willcox v. Consolidated Gas Co.*, *supra*.

"(2) The ascertainment of that value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts."⁴⁸

Immediately following the excerpt just made, the rule for the ascertainment of value is quoted from *Smyth v. Ames*. The Court negatives the cost theory, saying:

"It is clear that in ascertaining the present value we are not limited to the consideration of the amount of the actual investment. If that has been reckless or improvident, losses may be sustained which the community does not underwrite. As the company may not be protected in its actual investment, if the value of its property be plainly less, so the making of a just return for the use of the property involves the recognition of its fair value if it be more than its cost. The property is held in private ownership and it is that property, and not the original cost of it, of which the owner may not be deprived without due process of law."⁴⁹

⁴⁷ 230 U. S. 352, 33 Sup. Ct. 729 (1913).

⁴⁸ *Ibid.* 434, 33 Sup. Ct. at 754. The discussion of the question of value begins at 433, 33 Sup. Ct. at 754.

⁴⁹ *Ibid.* 454, 33 Sup. Ct. at 762.

*Des Moines Gas Co. v. City of Des Moines*⁵⁰ involved ordinance rates for gas. Value was taken as the basis, and in ascertaining it, the reproduction method was used. As stated by the Court, the correctness of the decree below depended upon whether two items—\$300,000 on account of going-concern value, and \$140,000, the cost of removing and replacing pavements over mains—had been wrongfully excluded. The Court made the following excerpt from the opinion in the *Cedar Rapids* case:

“As said, the value of the system as completed, earning a present income, is the criterion. In so far as influenced by income, however, the computation necessarily must be made on the basis of reasonable charges, for whatever is exacted for a public service in excess of this is to be regarded as unlawful.”⁵¹

Newark Natural Gas & Fuel Co. v. City of Newark, Ohio,⁵² involved an ordinance rate for natural gas. The following, taken from the opinion, indicates that value was here recognized as the basis:

“The opinions of the state courts show that they gave careful consideration to the questions of the value of the property of plaintiff in error at the time of the inquiry, the total amount of net profits that could be earned under the rate fixed, and whether this would be sufficient to provide a fair return on the value of the property. The concurring judgments were based upon principles thoroughly established by repeated decisions of this court, *Covington & Co. Turnpike Co. v. Sandford*, 164 U. S. 578, 597, 598; *San Diego Land Company v. National City*, 174 U. S. 739, 754; *Knoxville v. Knoxville Water Co.*, 212 U. S. 1; *Willcox v. Consolidated Gas Co.*, 212 U. S. 19, 48; *Des Moines Gas Co. v. Des Moines*, 238 U. S. 153, 163; and the finding that there was no confiscation is amply supported by the evidence.”⁵³

*Darnell v. Edwards*⁵⁴ involved the reasonableness of certain railroad rates. The Court stated:

⁵⁰ 238 U. S. 153, 35 Sup. Ct. 811 (1915).

⁵¹ *Ibid.* 169, 35 Sup. Ct. at 816.

⁵² 242 U. S. 405, 37 Sup. Ct. 156 (1917).

⁵³ *Ibid.* 407, 37 Sup. Ct. at 157.

⁵⁴ 244 U. S. 564, 37 Sup. Ct. 701 (1917).

"In determining whether rates are confiscatory because not yielding a proper return, the basis of calculation is the fair value of the property used in the service of the public." ⁵⁵

*Denver v. Denver Union Water Co.*⁵⁶ involved ordinance rates for water. A decree holding the rates confiscatory was affirmed. No basis other than value is suggested. It is said:

"What we have said establishes the propriety of estimating complainant's property on the basis of present market values as to land, and reproduction cost, less depreciation, as to structures. That this method was fairly applied by the special master hardly is disputed by appellants, except as they contest the items allowed for 'going-concern value' and for the water rights acquired by complainant and its predecessors by original appropriation." ⁵⁷

The Court disposed of the two disputed items by holding that the going-concern value item should be included, and that it was unnecessary to determine as to water rights because if they were excluded, the return would still be inadequate.

Galveston Electric Co. v. City of Galveston ⁵⁸ involved the contention that a five-cent fare upon the street railroad in that city was confiscatory. Each party accepted value as the basis. The Court states their contentions as follows:

"The company contends that the fare prescribed is confiscatory in violation of the Fourteenth Amendment; the city that it is sufficient to yield a return of 8 per cent. on the value of the property used in the public service." ⁵⁹

The opinion is devoted to the consideration of disputed items bearing upon the value factor, and some disputed items relating to operating expenses.

In the same year *Houston v. Southwestern Bell Telephone Co.*⁶⁰ was decided. In this case, telephone rates established by an

⁵⁵ *Ibid.* 568, 37 Sup. Ct. at 702.

⁵⁶ 246 U. S. 178, 38 Sup. Ct. 278 (1988).

⁵⁷ *Ibid.* 191, 38 Sup. Ct. at 283.

⁵⁸ 258 U. S. 388, 42 Sup. Ct. 351 (1922).

⁵⁹ *Ibid.* 390, 42 Sup. Ct. at 353.

⁶⁰ 259 U. S. 318, 42 Sup. Ct. 486 (1922).

ordinance of the city of Houston were the subject of the controversy. There had been a merger of the telephone properties under an ordinance by which the company agreed that it would not increase the rates then charged in the city

“ ‘unless it appears upon a satisfactory showing . . . that there exists a necessity for an increase of charges, in order that the said company may earn a fair return upon its *capital actually invested* in the Houston plant.’ ” ⁶¹

It was entirely clear that the company was not earning a fair return upon the value of the property. The city contended that this ordinance made cost the basis, thus presenting the cost question from another aspect. The company contended that the ordinance was not binding upon it and the Court sustained this contention.

Obviously, if the law made cost the basis, it would have been immaterial whether the ordinance also attempted to do so, and so immaterial whether the ordinance was void or not, rendering it unnecessary for the Court to determine that question.

Having held the ordinance void, the court below held that the acts of the company had estopped it from contending that it was not bound by its terms. Under these circumstances, the opinion says:

“We think that neither party was bound by the ordinance and the acceptance of it, that the District Court fell into error, and that the proper base for rate-making in the case is the fair value of the property, useful and used by the company, at the time of the inquiry.” ⁶²

Newton v. Consolidated Gas Co. ⁶³ was also decided in 1922. It involved the same statute which was in controversy in *Willcox v. Consolidated Gas Co.* ⁶⁴ Value was the basis adopted. The Court said:

⁶¹ *Ibid.* 320, 42 Sup. Ct. at 487.

⁶² *Ibid.* 324, 42 Sup. Ct. at 489.

⁶³ 258 U. S. 165, 42 Sup. Ct. 264 (1922).

⁶⁴ *Supra* note 41.

"The fundamental question presented for determination was whether the eighty-cent rate had been confiscatory under conditions existing during 1918 and 1919 and probably would continue so to be. Considering the rulings here in *Willcox v. Consolidated Gas Co.* and other cases, the answer required little more than an appreciation of facts not very difficult to ascertain. The Master's report and opinion disclosed careful and intelligent consideration of the whole matter. 'Resolving all doubts against the plaintiff' and using valuations 'pared down unsparingly,' the trial court agreed with the Master's ultimate findings and ruled that to enforce the statute would result in confiscation." ⁶⁵

In affirming the conclusion of the court below as clearly right, the Court reaffirmed many of the cases to which reference has been made, saying:

"The general doctrine applicable when rates are alleged to be confiscatory has been so often stated that present discussion of it is unnecessary. *Knoxville v. Knoxville Water Co.*, 212 U. S. 1; *Willcox v. Consolidated Gas Co.*, 212 U. S. 19; *Des Moines Gas Co. v. Des Moines*, 238 U. S. 153; *Rowland v. St. Louis & San Francisco R. R. Co.*, 244 U. S. 106; *Denver v. Denver Union Water Co.*, 246 U. S. 178; *Lincoln Gas & Electric Light Co. v. Lincoln*, 250 U. S. 256." ⁶⁶

Southwestern Bell Telephone Co. v. Public Service Commission ⁶⁷ involved a schedule of telephone rates. It was reversed because in ascertaining the value factor the Court held that no weight had been accorded to the greatly enhanced current costs of material, labor and supplies. In this connection, the Court cited *Willcox v. Consolidated Gas Co.* ⁶⁸ and the *Minnesota Rate Cases*, ⁶⁹ among others, and quoted from the *Minnesota Rate Cases* the following:

⁶⁵ *Supra* note 63, at 174, 42 Sup. Ct. at 266.

⁶⁶ *Supra* note 63, at 176, 42 Sup. Ct. at 267.

⁶⁷ 262 U. S. 276, 43 Sup. Ct. 544 (1923).

⁶⁸ *Supra* note 41.

⁶⁹ *Supra* note 47.

“The making of a just return for the use of the property involves the recognition of its fair value if it be more than its cost. The property is held in private ownership and it is that property, and not the original cost of it, of which the owner may not be deprived without due process of law.” ⁷⁰

The Court also says:

“It is impossible to ascertain what will amount to a fair return upon properties devoted to public service without giving consideration to the cost of labor, supplies, etc., at the time the investigation is made. An honest and intelligent forecast of probable future values made upon a view of all the relevant circumstances, is essential. If the highly important element of present costs is wholly disregarded such a forecast becomes impossible. Estimates for tomorrow cannot ignore prices of today.” ⁷¹

Georgia Railway & Power Co. v. Railroad Commission ⁷² involved gas rates established by the Georgia commission for the city of Atlanta. It was contended by the company in that case that the cost of reproduction at current prices, less depreciation, must be adopted as fixing the value factor. Following its earlier decisions, the Court refused to accept this contention. It had not held in *Smyth v. Ames*,⁷³ or in any subsequent case, that the cost of reproduction, less depreciation, or any other single factor, is a measure of value. It had consistently held that all material factors should be taken into account, and this position it maintained. It says:

“The refusal of the Commission and of the lower court to hold that, for rate-making purposes, the physical properties of a utility must be valued at the replacement cost less depreciation was clearly correct. As was said in *Minnesota Rate Cases*, 230 U. S. 352, 434: ‘The ascertainment of that value

⁷⁰ *Supra* note 67, at 287, 43 Sup. Ct. at 546.

⁷¹ *Supra* note 67, at 287, 43 Sup. Ct. at 546.

⁷² 262 U. S. 625, 43 Sup. Ct. 680 (1923).

⁷³ *Supra* note 1.

is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts.' " ⁷⁴

Another case decided in 1923 is *Bluefield Water Works & Improvement Co. v. Public Service Commission*.⁷⁵ The rates involved were those established by the West Virginia commission for water in Bluefield. The appeal was from the Supreme Court of West Virginia. As to the holding of that court, the opinion states:

"The State Supreme Court of Appeals holds that the valuing of the property of a public utility corporation and prescribing rates are purely legislative acts not subject to judicial review except in so far as may be necessary to determine whether such rates are void on constitutional or other grounds; and that findings of fact by the commission based on evidence to support them will not be reviewed by the court." ⁷⁶

In the same general connection, the Supreme Court quotes from the Supreme Court of West Virginia the following:

"It seems to be generally held that, in the absence of peculiar and extraordinary conditions, such as a more costly plant than the public service of the community requires, or the erection of a plant at an actual, though extravagant, cost, or the purchase of one at an exorbitant or inflated price, the actual amount of money invested is to be taken as the basis, and upon this a return must be allowed equivalent to that which is ordinarily received in the locality in which the business is done, upon capital invested in similar enterprises.' " ⁷⁷

Here again the cost theory presents itself. The Supreme Court discards it, and reaffirms the doctrine that the fair return must be upon the reasonable value of the property, to be deter-

⁷⁴ *Supra* note 72, at 630, 43 Sup. Ct. at 681.

⁷⁵ 262 U. S. 679, 43 Sup. Ct. 675 (1923).

⁷⁶ *Ibid.* 688, 43 Sup. Ct. at 677.

⁷⁷ *Ibid.* 689, 43 Sup. Ct. at 678.

mined through the application of reasonable judgment to all of the relevant facts, citing a number of its decisions and quoting from the *Minnesota Rate Cases* a statement that fair value must be recognized if it is more than cost, saying:

“ ‘ . . . The making of a just return for the use of the property involves the recognition of its fair value if it be more than its cost. The property is held in private ownership and it is that property, and not the original cost of it, of which the owner may not be deprived without due process of law.’ ” ⁷⁸

*McCardle v. Indianapolis Water Co.*⁷⁹ involved the validity of rates established by the Indianapolis Water Company and required a determination of the value of the property. The Court says:

“But this does not mean that the original cost or the present cost or some figure arbitrarily chosen between these two is to be taken as the measure. The weight to be given to such cost figures and other items or classes of evidence is to be determined in the light of the facts of the case in hand.” ⁸⁰

The Court clearly distinguishes between cost and value. It adopts value—not cost—as the basis. The Court says:

“Undoubtedly, the reasonable cost of a system of waterworks, well-planned and efficient for the public service, is good evidence of its value at the time of construction. And such actual cost will continue fairly well to measure the amount to be attributed to the physical elements of the property so long as there is no change in the level of applicable prices. And, as indicated by the report of the commission, it is true that, if the tendency or trend of prices is not definitely upward or downward and it does not appear probable that there will be a substantial change of prices, then the pres-

⁷⁸ *Ibid.* 691, 43 Sup. Ct. at 678.

⁷⁹ 272 U. S. 400, 47 Sup. Ct. 144 (1926).

⁸⁰ *Ibid.* 410, 47 Sup. Ct. at 148.

ent value of lands plus the present cost of constructing the plant, less depreciation, if any, is a fair measure of the value of the physical elements of the property. The validity of the rates in question depends on property value January 1, 1924, and for a reasonable time following. While the values of such properties do not vary with frequent minor fluctuations in the prices of material and labor required to produce them, they are affected by and generally follow the relatively permanent levels and trends of such prices. The fact that original cost was probably 12 to 20 per cent. less than the estimate of the commission's engineer based on the average of prices for the ten years ending with 1921—two years before the rate order became effective—does not tend to support the commission's adoption of that estimate.”⁸¹

CONCLUSIONS

The outstanding, salient points in these cases, covering a period of thirty years since *Smyth v. Ames*,⁸² are:

1. The criterion to be used in determining whether rates are confiscatory is value.
2. This is not to be measured by cost; it is value as distinguished from cost.
3. The ascertainment of value “is not a matter of formulas” or “artificial rules.”
4. No one factor, such as cost or cost of reproduction less depreciation, may be taken as an arbitrary measure of value.
5. Value is to be ascertained as the value of other classes of property is ascertained—by the exercise of “a reasonable judgment having its basis in a proper consideration of all relevant facts.” What facts are relevant, and the weight to which they are entitled, will vary with the circumstances of particular cases.

The presumption that the language used by the Court in its opinions is used accurately is conclusive. When the Court says

⁸¹ *Ibid.* 411, 47 Sup. Ct. at 148.

⁸² *Supra* note 1.

"value" or "real value" or "reasonable value" or "fair value," it means just what it says. To assert where the Court says one thing that what it means is some other and different thing would be to abandon certainty for pure speculation.

The difficulty in determining value in applying this rule does not militate against its soundness. This difficulty is just as real as to property generally as it is as to property of public utilities. But for many years the values of all classes of property, including that of public utilities, have been constantly determined in connection with ordinary commercial transactions with all of the practical certainty which is required for the successful conduct of business.

The fact is that grossly divergent estimates of the value of public utility property, like such estimates of the value of other property, are in general due to conflicting interests. When both parties begin to co-operate in an earnest effort to ascertain the actual value of the property in question, these divergencies will practically disappear.

Nor does the fact that most of the states have attempted to regulate the rates of their utilities sustain the contention that for this reason these properties may not be valued as accurately as other property. Without attempting to discuss this theory, it is sufficient to offset against it the fact that ever since there have been public utilities, their values have been ascertained and fixed for the purpose of purchase and sale and for the other purposes that are incidental to ordinary commercial transactions. What has been and is being done in these commercial transactions can be done and is actually being done in regulatory proceedings. The complete answer to the scientific demonstration that a ball could not be thrown on a curve was the fact that it actually did curve.

In this connection it must be remembered that the commission laws of the states do not establish a new regulation with reference to rates. Their regulation is that rates shall be just and reasonable. This is not new. It has always been the rule applicable to the rates of public utilities. Fundamentally, what is new in these laws is their machinery for the enforcement of old regulations.

Finally, the rule laid down in *Smyth v. Ames* is equitable. The valuation is for the purpose of determining whether or not proposed rates are confiscatory. The criterion, based upon the actual value of what is devoted to the public use, is equitable. Equity requires that the owner of the property be protected to this extent—no more and no less. And this is fair to the customer of the utility. He is only asked to leave unimpaired what is actually being devoted to his service.