

On the Distinction Between a Nonconfiscatory Rate and a Just and Reasonable Rate

Maurice H. Merrill

Follow this and additional works at: <http://scholarship.law.cornell.edu/clr>

 Part of the [Law Commons](#)

Recommended Citation

Maurice H. Merrill, *On the Distinction Between a Nonconfiscatory Rate and a Just and Reasonable Rate*, 14 Cornell L. Rev. 447 (1929)
Available at: <http://scholarship.law.cornell.edu/clr/vol14/iss4/2>

This Article is brought to you for free and open access by the Journals at Scholarship@Cornell Law: A Digital Repository. It has been accepted for inclusion in Cornell Law Review by an authorized administrator of Scholarship@Cornell Law: A Digital Repository. For more information, please contact jmp8@cornell.edu.

ON THE DISTINCTION BETWEEN A NONCONFISCATORY RATE AND A JUST AND REASONABLE RATE

MAURICE H. MERRILL*

Among the many things read into the due process clauses of the Fifth and the Fourteenth Amendments by judicial interpretation is the rule that rates established for public utilities by governmental authority must yield, after all legitimate charges to operating costs are met, a surplus, alliteratively yclept reasonable return, upon what we used to refer to as the fair value of the property and are coming to call the rate base.¹ Rates which do not yield this surplus are called confiscatory.² Statutes vesting rate-making or rate-controlling authority upon subordinate public agencies, on the other hand, commonly decree as the standard for the exercise of this authority that rates shall be "reasonable and just" or some similar verbal combination.³ The confiscatory rate marks the lower limit beyond which the courts say the constitution will not permit government to reduce charges; the reasonable rate is the standard which the legislature has prescribed for rate-making within constitutional limits.

The very understandable desire of the patrons for service at the lowest possible cost tends toward insistence by their representatives that the reasonable rate to be fixed by the regulatory body should be one just avoiding the judicial ban against confiscation.⁴ It is equally natural that the utilities, insisting upon a more liberal interpretation of the term reasonable and just, should contend that it calls for a rate fixed at a substantially higher figure.⁵ It is the

*Professor of Law, University of Nebraska College of Law.

¹*Smyth v. Ames*, 169 U. S. 466, 18 Sup. Ct. 418 (1898); *Bluefield W. W. & I. Co. v. Public Service Com.*, 262 U. S. 679, 43 Sup. Ct. 675 (1923). See also statements in I WHITTEN, *VALUATION OF PUBLIC SERVICE CORPORATIONS* (2d ed. 1928) 34; GRONINGER, *PUBLIC UTILITY RATE MAKING* (1929) c. 7.

²*Bluefield W. W. & I. Co. v. Public Service Com.*, *supra* note 1.

³The following may be taken as typical: Ala. Civ. Code (1923) §§ 9629, 9777; Conn. Gen. Stat. (1918) §§ 3635, 3636; N. Y. Cons. Laws (Cahill, 1923) c. 49, §§ 49, 72; Tex. Rev. Civ. Stat. (1925) art. 6448; Wis. Stat. (1927) § 196.37.

⁴See comment by Brandeis, J., in *Southwestern Bell Tel. Co. v. Public Service Com.*, 262 U. S. 276, 296, 43 Sup. Ct. 544, 549 (1923).

⁵The views in favor of this contention are set out in Guernsey, *Principles Underlying Reasonable Rates* (1927) 2 ALA. L. J. 3; Guernsey, *State Commission Laws Regulate Rates, Not Profits* (1927) 13 VA. L. REV. 257; Guernsey, *The Test of Reasonable Rates* (1927) 14 VA. L. REV. 1; Updegraff, *Deductions from the Economic Basis of Public Utility Rates* (1927) 12 IOWA L. REV. 249.

purpose of this paper to examine the problem with a view to suggesting the proper solution of the dispute. In such an examination three questions appear to be involved: (1) *May* a "just and reasonable" rate under the statutes be substantially in excess of a barely nonconfiscatory rate? (2) *Must* it be so? (3) *Should* it be so?

WHAT IS A NONCONFISCATORY RATE?

As a preliminary step it becomes necessary to define what is meant by a rate that is nonconfiscatory. There was an early opinion, apparently centering around a dictum of Mr. Justice Brewer while Circuit Judge,⁶ to the effect that confiscation was present only when the prescribed rates allowed no return whatever over operating expenses.⁷ *Smyth v. Ames*,⁸ however, definitely decided that the mere fact that some return is realized is not enough. There must be a "fair return."⁹ In the main, decisions have been inadequate and uninforming in their treatment of the factors which determine the existence of such a return.¹⁰ In *Bluefield Water Works & Improvement Co. v. West Virginia Public Service Com.*¹¹ Mr. Justice Butler gave the following description of the return to which the utility is constitutionally entitled:

"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

⁶"... the right of judicial interference exists only when the schedule of rates established will fail to secure to the owners of the property some compensation or income from their investment. As to the amount of such compensation, if some compensation or reward is in fact secured, the legislature is the sole judge." *Chicago & N. W. Ry. v. Dey*, 35 Fed. 866, 878 (C. C. Iowa, 1888) Brewer, J. expressed the same view thirteen years later in the following dictum: "As to parties engaged in performing a public service, while the power to regulate has been sustained, negatively the court has held that the legislature may not prescribe rates which, if enforced, would amount to a confiscation of property. But it has not held affirmatively that the legislature may enforce rates which stop only this side of confiscation, and leave the property in the hands and under the care of the owners without any remuneration for its use." *Cotting v. Kansas City S. Y. Co.*, 183 U. S. 79, 91, 22 Sup. Ct. 30, 35 (1901).

⁷See McKenna, Circuit Judge, in *Southern Pac. Co. v. Board of R. R. Com'rs*, 78 Fed. 236, 261 (C. C. Calif. 1896). Cf. *Morgan's L. & T. R. R. & S. S. Co. v. Railroad Com.*, 127 La. 636, 667, 53 So. 890, 900 (1911).

⁸*Supra* note 1.

⁹*Smyth v. Ames*, *supra* note 1, at 547, 18 Sup. Ct. at 434.

¹⁰A full review of the cases may be found in 2 WHITTEN, *op. cit. supra* note 1, §§ 872-875.

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

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 in 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 enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally."¹²

That is, the return must be sufficiently high to enable the utility to secure additional capital, as needed, in competition with businesses involving similar risks at the time and place.¹³ A subsequent decision of the Supreme Court confirms this requirement,¹⁴ and the lower federal courts are applying it.¹⁵ Hence it seems proper to say that the nonconfiscatory rate schedule must yield a return sufficient to enable the utility to compete successfully with other businesses in the struggle for the investor's dollar.

¹²*Supra* note 11, at 692, 43 Sup.Ct. at 679. Cf. the statement in *Willcox v. Consolidated Gas Co.*, 212 U. S. 19, 48, 29 Sup. Ct. 192, 198 (1909): "There is no particular rate of compensation which must in all cases and in all parts of the country be regarded as sufficient for capital invested in business enterprises. Such compensation must depend greatly upon circumstances and locality; among other things, the amount of risk in the business is a most important factor, as well as the locality where the business is conducted, and the rate expected and usually realized there upon investments of a somewhat similar nature with regard to the risk attending them."

¹³Cf. Kirshman, *The Principle of Competitive Cost in Public Utility Regulation* (1926) 35 YALE L. J. 805, 818 *et seq.*

¹⁴*McCardle v. Indianapolis Water Co.*, 272 U. S. 400, 47 Sup. Ct. 144 (1926).

¹⁵*Southwestern Bell Tel. Co. v. City of Ft. Smith*, 294 Fed. 102 (W. D. Ark. 1923), *aff'd* 270 U. S. 627, 46 Sup. Ct. 206 (1926); *Indiana Bell Tel. Co. v. Public Service Com.*, 300 Fed. 190 (D. Ind. 1924); *Citizens Gas Co. v. Public Service Com.*, 8 F. (2d) 632 (W. D. Mo. 1925); *Springfield G. & E. Co. v. Public Service Com.*, 10 F. (2d) 252 (W. D. Mo. 1925); *Pacific T. & T. Co. v. Whitcomb*, 12 F. (2d) 279 (W. D. Wash. 1926); *Idaho Power Co. v. Thompson*, 19 F. (2d) 547 (D. Idaho, 1927).

AS A MATTER OF STATUTORY CONSTRUCTION, MAY A "JUST AND
REASONABLE" RATE EXCEED ONE THAT IS BARELY
NONCONFISCATORY?

The use of the terms under consideration goes back to the earliest acts vesting rate-controlling power in commissions.¹⁶ These early acts, dealing with the power to regulate railroad rates, were framed with a view to give tangible form, through orders of administrative tribunals, to the common law principle that common carriers should serve at reasonable rates.¹⁷ The doctrine of confiscation had not yet arisen. Its first suggestion by the Supreme Court seems to be in 1886.¹⁸ The earlier decisions had indicated no constitutional limits to the rate-regulating power.¹⁹ Hence the original meaning of the words, "just and reasonable," could have had no reference to rates barely clearing a minimum beyond which the state could not go. Indubitably they signified rates that were "fair" in the sense of a public policy that sought to protect the well-being of both utilities and patrons. This involves the use of discretion, of judgment as to the ends to be promoted by utility rates and as to the effect of particular schedules in promoting the desired ends. It calls for taking account of special circumstances affecting the "justness" of the rates for a particular utility. It seems clear that there may be conditions which will make the "fair" rate substantially in excess of the non-confiscatory one.²⁰ And the mere fact of the development of the doctrine of confiscation could hardly give to the terms, "just and reasonable," a narrower significance than that which they had before its rise.

¹⁶Cf. "The limitation of rates to what are reasonable is the enactment in statutory form of an ancient rule of the common law." *Turner v. Connecticut Co.*, 91 Conn. 692, 697, 101 Atl. 88, 90 (1917).

¹⁷See California Act of Apr. 22, 1858, § 4, cited and set forth in *Spring Valley Water Works v. Schottler*, 110 U. S. 347, 349, 4 Sup. Ct. 48 (1884)—"reasonable rates"; Fla. Act of 1887, § 5, set out in *McWhorter v. Pensacola & A. R. R.*, 24 Fla. 417, 465, 5 So. 129, 133 (1888)—"reasonable and just rates"; Ga. Act of Oct. 14, 1879, § 6, set forth in *Tilley v. Savannah, F. & W. R. R.*, 5 Fed. 641, 643 (C. C. Ga. 1881)—"a schedule of just and reasonable rates of charges"; Tenn. Act of March 30, 1883, § 13, set forth in *Louisville & N. R. R. v. Railroad Commission*, 19 Fed. 679, 684 (C. C. Tenn. 1884)—"just and reasonable compensation."

¹⁸*Railroad Commission Cases*, 116 U. S. 307, 331, 6 Sup. Ct. 334, 345 (1886).

¹⁹*Munn v. Illinois*, 94 U. S. 113 (1876); *Chicago, B. & Q. R. R. v. Iowa*, 94 U. S. 164 (1876); *Peik v. Chicago & N. W. Ry.*, 94 U. S. 164 (1876); *Chicago, M. & St. P. R. R. v. Ackley*, 94 U. S. 179 (1876); *Winona & St. P. R. R. v. Blake*, 94 U. S. 180 (1876); *Stone v. Wisconsin*, 94 U. S. 181 (1876); *Ruggles v. Illinois*, 108 U. S. 526, 2 Sup. Ct. 832 (1883).

²⁰For a discussion of this point see p. 460, *infra*.

Curiously enough, while the conclusion reached above seems to have been accepted almost without dissent by judges²¹ and by at least some writers,²² cases which squarely support it are comparatively few. Practically all the judicial pronouncements thereof prove upon examination to be pure dicta.²³ There are a few, however, which may properly be cited as upholding it.

Chief among these are the cases involving the extent of the review of rate-fixing orders by the state courts. Where the statute prescribes that the rate fixed shall be just and reasonable a number of decisions hold that judicial review is not to be limited to the question of confiscation, but is to consider whether the rates meet the statutory description.²⁴ This necessarily implies that a just and reasonable rate may be higher than one that is barely nonconfiscatory.

Further support is given this view by cases from several jurisdictions refusing to consider on appeal contentions by patrons that rates set by the commission are too high.²⁵ These cases are not satisfactorily explained on the ground of judicial respect for the decisions of public utility commissions in the commissions' specialized field. It is doubtless true that the consumers, having no recognized property interest in the receipt of light, heat, or transportation service, do not qualify as candidates for the exercise of the court's "own independent judgment as to both law and facts" within the constitutional rule laid down in *Ohio Valley Water Co. v. Ben Avon Borough*.²⁶ Hence a distinction might very well be drawn between the extent of review available in respect to questions of fact in an appeal by a utility raising the constitutional issue of confiscation and in an appeal by a patron raising the question of reasonableness and justness.²⁷ But it is well settled that judicial abdication stops short of permitting the

²¹The cases cited *infra* notes 37, 38, 41-45 contain judicial pronouncements to this effect.

²²WHITTEN, *op. cit. supra* note 1, at 1880, 1889-1900.

²³See discussion *infra* pp. 455-456.

²⁴*Union Pac. R. R. v. Public Utilities Com.*, 95 Kan. 604, 148 Pac. 667 (1915); *Railroad Com. v. Houston & T. C. R. R.*, 90 Tex. 340, 38 S. W. 750 (1897); *Minneapolis, St. P. & S. S. M. Ry. v. Railroad Com.*, 136 Wis. 146, 116 N. W. 905 (1908). See *Atchison T. & S. F. Ry. v. State*, 23 Okla. 510, 522, 101 Pac. 262, 266 (1909).

²⁵*Steamboat Canal Co. v. Garson*, 43 Nev. 298, 185 Pac. 801 (1919); *City of Scranton v. Public Service Com.*, 80 Pa. Super. Ct. 549 (1923); *Lewiston Borough v. Public Service Com.*, 80 Pa. Super. Ct. 528 (1923); *Salt Lake City v. Utah L. & T. Co.*, 52 Utah, 210, 173 Pac. 556 (1918).

²⁶253 U. S. 287, 40 Sup. Ct. 527 (1920).

²⁷See *City of Scranton v. Public Service Com.*, *supra* note 25, at 557.

commissions to proceed upon erroneous views of their power under the law,²⁸ and that the administrative tribunals will not be permitted to exercise powers beyond those vested in them by constitution or by statute.²⁹ If the just and reasonable rate prescribed by statute may not substantially exceed a nonconfiscatory rate, it seems clear that an order permitting a rate excessive in that particular would be *ultra vires*. Hence a refusal to review administrative action in that respect necessarily implies that the just and reasonable rate may legally exceed the nonconfiscatory one.

In Ohio it has been held³⁰ that under a statute giving the public utilities commission power to set aside rates set by municipal authority and found to be unjust and unreasonable, the commission is not required to uphold the challenged rates merely because they are nonconfiscatory. Possibly in accord is a New Jersey case³¹ wherein the court says that it holds, under a statute requiring the commission to fix "just and reasonable individual rates," that a refusal to permit an advance is not justified by a finding that existing rates are not shown to be confiscatory, since a finding that they are not confiscatory is not equivalent to a finding that they are just and reasonable.³² An examination of the case, however, shows clearly that upon the facts developed the existing rates were actually confiscatory. Its standing as an authority upon the question under examination therefore seems very doubtful.

But one dictum has been found in opposition to the conclusion here set forth. In *City of Eau Claire v. Railroad Commission*³³ the Wisconsin court said, "We believe . . . that the legislative command to the commission to ascertain the reasonable rate contemplates such a rate as would be held not confiscatory upon the complaint of

²⁸See Curtis, *Judicial Review of Commission Rate Regulation—The Ohio Valley Case* (1921) 34 HARV. L. REV. 862, 871; Brown, *The Functions of Courts and Commissions in Public Utility Rate Regulation* (1924) 38 HARV. L. REV. 141, 156-157; Wiel, *Administrative Finality* (1925) 38 HARV. L. REV. 447, 457-458.

²⁹*City of Lima v. Public Utilities Com.*, 100 Ohio St. 416, 126 N. E. 318 (1919) furnishes an example.

³⁰*City of Portsmouth v. Public Utilities Com.*, 108 Ohio St. 272, 140 N. E. 604 (1923).

³¹*Collingswood Sewerage Co. v. Borough of Collingswood*, 91 N. J. L. 20, 102 Atl. 901 (Sup. Ct. 1918).

³²"The sewerage company was entitled to a formal determination of the claim advanced by it that existing rates are unjust and unreasonable. . . . This right was not met by an adjudication that the rates were not so low as to be confiscatory." *Collingswood Sewerage Co. v. Borough of Collingswood*, *supra* note 31, at 22, 102 Atl. at 901.

³³178 Wis. 207, 189 N. W. 476 (1922).

the utility, and that the public has a right to complain of any rate which yields to the utility more than a reasonable return."³⁴ But as this is in conflict with a prior Wisconsin decision as to the extent of judicial review³⁵ and with a recent Wisconsin dictum,³⁶ it is questionable whether it can be regarded as possessing even the weight usually accorded to considered dictum.

In view of the clear preponderance of such authority as exists upon the proposition it seems that the question whether a just and reasonable rate *may* exceed a barely nonconfiscatory one must be answered affirmatively.

MUST A JUST AND REASONABLE RATE SUBSTANTIALLY EXCEED
A NONCONFISCATORY ONE?

The inquiry to which this question is directed may also be stated thus: Do the statutes impose upon the commissions a duty to set a rate schedule yielding a return substantially higher than that which will clear the confiscation bar? To adopt another phrasing: Is a just and reasonable rate substantially higher than a nonconfiscatory one as a matter of law? A diagram may make the issue clearer.

B————— Let A represent the rate the
return from which is barely non-
C----- confiscatory, that is, just high
enough to induce the continued
A————— flow of capital to the utility as
needed. No rate which equals or exceeds this will violate the rule
against confiscation. There is a point, however, beyond which it is
impracticable to raise rates, namely, the point at which the charge
for the service rendered exceeds its value to so many consumers
that the reduction in the number of patrons due to higher rates
more than offsets the increase in revenue that should be afforded
by higher unit charges. Let B represent this limit. The space
between A and B remains debatable ground. No rate within those
limits will be confiscatory; no rate within those limits will be un-
profitable. The nearer that C (representing the established or "just
and reasonable" rate) approaches B, the greater will be the utility's
return. The nearer it approaches A, the happier will be the patrons.
Our question is whether a statute specifying that rates shall be

³⁴Supra note 33, at 216, 189 N. W. at 480.

³⁵Minneapolis, St. P. & S. S. M. Ry. v. Railroad Com., supra note 24.

³⁶See Waukesha G. & E. Co. v. Railroad Com., 181 Wis. 281, 288, 291, 194 N. W. 846, 849, 850 (1923).

just and reasonable commands the rate-fixing body to locate C at a point substantially above A. Some recent writers appear to contend for an affirmative answer, at least in the absence of unusual conditions.³⁷ The statutes themselves commonly do not set up any specifications of the characteristics of a just and reasonable rate, so that, if the affirmative answer is to be given, it must be established as the result of judicial interpretation of the statutes rather than from any express language of the statutes themselves.

The cases do not seem to support the position of those who contend for an affirmative answer. Dicta which may be interpreted as upholding that view are comparatively frequent. Thus we encounter such statements as the following:

"It [a just and reasonable rate] is a rate which yields to the carrier a fair return upon the value of the property employed in the public service, and it is a rate which is fair to the shipper for the service rendered; and when this rate is established, if it results in large profits to the carrier, the carrier is fortunate in its business, and if it results in a loss of earning power so that the business of the carrier is unprofitable the carrier is unfortunate. But the rate may not be lowered or raised merely upon the ground that the carrier is either making or losing money, providing always the rate is a reasonable and just one."³⁸

"On the one hand a just and reasonable rate can never exceed, perhaps can rarely equal, the value of the service to the consumer. On the other hand it can never be made by compulsion of public authority so low as to amount to confiscation. A just and reasonable rate must ordinarily fall somewhere between these two extremes, so as to allow both sides to profit by the conduct of the business and the improvements of methods and increase of efficiency.

"Justice to the consumer ordinarily would require a rate somewhat less than the full value of the service to him; and justice to the company would ordinarily require a rate above the point at which it would become confiscatory."³⁹

"The rate should be, in the language of the statute, 'just and reasonable'; in other words, not so low as to approach the line of confiscation nor so high as to be unjust and oppressive. A just and reasonable rate need not approach either line."⁴⁰

³⁷See articles cited *supra* note 5. Perhaps the clearest statement of this position is the following: "It [a just and reasonable rate] is a rate that justly and reasonably, that is, fairly and equitably, divides this spread between the cost of furnishing the service, including the cost of the capital involved, and the value of the service to the customer." Guernsey, *Principles Underlying Reasonable Rates*, *supra* note 5, at 7.

³⁸See *Hooker v. Interstate Commerce Com.*, 188 Fed. 242, 253 (Coin. Ct. 1911).

³⁹See *Public Service Gas Co. v. Board of Public Utility Com'rs*, 84 N. J. L. 463, 471, 87 Atl. 651, 655 (Sup.Ct. 1913).

⁴⁰*Waukesha G. & E. Co. v. Railroad Com.*, *supra* note 36.

But decisions squarely holding that the just and reasonable rate must exceed the nonconfiscatory rate do not appear in the reports.

An analysis of the cases cited in the articles referred to⁴¹ supports the statement as to the dearth of authority for the contention that the statutes require the just and reasonable rate to be fixed substantially above the level of freedom from confiscation. To be cited as authority for such a contention it would seem that a case should hold unlawful a commission order on the ground that it sought to hold the rate down to the barely nonconfiscatory level. The nearest approach to such a case is *Collingswood Sewerage Co. v. Borough of Collingswood*.⁴² The authority of that case, as heretofore explained, is shaken by the clearly confiscatory character of the rates involved, and in any event it goes no farther than to hold that a finding that rates are nonconfiscatory is not equivalent to a finding that they are just and reasonable. It does not hold that normally such rates should be above the nonconfiscatory point.

No other cases have been found even remotely approaching the position under discussion. Several involve the extent of review by appellate tribunals over rates established by regulatory bodies.⁴³ In others, rates set by public authority were upheld against contentions that they were confiscatory⁴⁴ or were unduly high.⁴⁵ In some cases, orders were overturned because confiscatory⁴⁶ or because based upon erroneous theories as to valuation.⁴⁷ One case involved the reasonableness of a charge as a matter of common law.⁴⁸ The different factors which enter in when the state has embarked upon a policy of rate regulation obviously render it inapposite here. The points involved in other cases cited have still less bearing upon the problem under discussion.⁴⁹ It seems a fair statement therefore that there is

⁴¹*Supra* note 5.

⁴²*Supra* note 31.

⁴³See cases cited *supra* note 24.

⁴⁴*Public Service Gas Co. v. Board of Public Utility Com'rs*, *supra* note 39.

⁴⁵*Hooker v. Interstate Commerce Com.*, *supra* note 38; *City of Detroit v. Michigan Railroad Com.*, 209 Mich. 395, 177 N. W. 306 (1920); *O'Brien v. Board of Public Utility Com'rs*, 92 N. J. L. 44, 105 Atl. 132 (Sup. Ct. 1918).

⁴⁶*Banton v. Belt Line Ry.*, 268 U. S. 413, 45 Sup. Ct. 534 (1925); *Southern Pac. Co. v. Board of Railroad Com'rs*, 78 Fed. 236 (C. C. Calif. 1896); *Morgan's L. & T. R. R. & S. S. Co. v. Railroad Com.*, 127 La. 636, 53 So. 890 (1911); *Louisiana R. & N. Co. v. Railroad Com.*, 131 La. 387, 59 So. 820 (1912).

⁴⁷*State P. U. Com. v. Springfield G. & E. Co.*, 291 Ill. 209, 125 N. E. 891 (1920); *Havre de Grace & Perryville Br. Co. v. Towers*, 132 Md. 16, 103 Atl. 319 (1918).

⁴⁸*Canada Southern Ry. v. International Bridge Co.*, 8 App. Cas. 723 (1881).

⁴⁹*Parkersburg & Ohio River Trans Co. v. City of Parkersburg*, 107 U. S. 691, 2 Sup. Ct. 732 (1883)—whether charge for use of municipal wharf was invalid

no substantial authority for the contention that a just and reasonable rate *must*, as a matter of law, substantially exceed the nonconfiscatory rate in the normal case.

SHOULD THE JUST AND REASONABLE RATE SUBSTANTIALLY
EXCEED A NONCONFISCATORY ONE?

Here we enter the field of policy, of discretion. Primarily, at least, the decision rests with the repositories of state and national policy, the several legislatures. Since they have passed it on to the regulatory agencies with no more specific direction than that rates shall be just and reasonable, broad power of interpreting these terms rests with the commissions. Only in the event of confiscation on the one hand or possibly of gross abuse at the upper limit on the other⁵⁰ would judicial interference be justified. It is from the standpoint of policy then that the proposal that just and reasonable rates should exceed the nonconfiscatory point must be judged.

Much depends upon one's conception of the end to be attained, and views of the ideal social order may vary. But it seems a fair enough statement that the American democratic tradition has for its ideal a social order in which, on the economic side, there may be the widest possible enjoyment of a relatively high living standard. To

as a tonnage duty; *Chicago, M. & St. P. Ry. v. Minnesota*, 134 U. S. 418, 10 Sup. Ct. 462 (1890)—necessity of judicial review of reasonableness of commission orders as part of due process; *Western Union Tel. Co. v. Call Pub. Co.*, 181 U. S. 92, 21 Sup. Ct. 861 (1901)—applicability of common law doctrines of public service to those engaged in interstate commerce; *Cotting v. Kansas City S. Y. Co.*, 183 U. S. 79, 22 Sup. Ct. 30 (1901)—violation of equal protection clause in statute arbitrarily singling out a particular enterprise for regulation; *Homestead Co. v. Des Moines Elec. Co.*, 248 Fed. 439 (C. C. A. 8th, 1918)—common law liability for discriminatory charges; *Detroit & M. R. R. v. Michigan R. R. Com.*, 203 Fed. 864 (E. D. Mich. 1913)—whether review of commission by Michigan Supreme Court is judicial or legislative.

⁵⁰"Unless a rate established by the commission is clearly oppressive on the one hand or confiscatory on the other, no judicial question is presented." *Salt Lake City v. Utah L. & T. Co.*, *supra* note 25, at 227, 173 Pac. at 563. "Having regard to the statute solely, it is apparent that the determination of the Commission cannot be disturbed unless it shall be made to appear to the court by clear and satisfactory evidence that the rate established by it is either unreasonably low or unreasonably high." *Waukesha G. & E. Co. v. Railroad Com.*, *supra* note 36, at 290, 194 N. W. at 850. "The order of the commission in the premises is final unless (1) beyond the power which it could constitutionally exercise; or (2) beyond its statutory power; or (3) based upon a mistake of law; or (4) the result of the commission's having arbitrarily fixed the rates contrary to evidence, or without evidence to support it, or in a grossly unreasonable manner." *Borough of Lansdowne v. Public Service Com.*, 74 Pa. Super. Ct. 203, 209 (1920).

secure this there must be maximum productivity at minimum cost. As Mr. Justice Holmes has said in another connection, there is an eternal conflict "between the effort of every man to get the most he can for his services, and that of society . . . to get his services for the least possible return."⁵¹ Society must permit the individual to take such returns from the common storehouse as will stir him to maximum productivity. To permit him to take more reduces unduly the amount available for general distribution. Our devotion to private enterprise on the competitive basis is bottomed upon the premise that in the long run it accomplishes this purpose of maximum production and distribution at minimum cost.^{51a} In the fields where competition has broken down as a regulative force, compulsory social control, wielded by our various regulatory bodies, enters in, but the ultimate objective remains the same.

The argument for a just and reasonable rate in excess of a non-confiscatory rate seems to run counter to this view. As pointed out,⁵² it calls for a division between utility and patron of the spread between the nonconfiscatory rate and the highest rate which can profitably be charged, upon terms vaguely described as fair and equitable.⁵³ In defense of this it is apparently urged that "economic law" demands it, that in fact neither utilities nor public bodies can successfully set rates that will depart from this fair and equitable division. This assertion is based upon two assumptions: (1) if rates are too low and the return is reduced below that available in other enterprises of equal security, capital will not be available for public utility enterprises, and it will become necessary to raise the rates; (2) if the rates are set too high, the extremely favorable earnings in the public utility field will cause a rush of capital thereto, and competition will force rates down.⁵⁴ Both assumptions seem false. As to the first, the necessity of an adequate return to attract needed capital is recognized, but the rate schedule must yield this return to avoid the stigma of confiscation.⁵⁵ It is not necessary to place the rate above the nonconfiscatory mark to attract capital. As to the

⁵¹Holmes, J. dissenting in *Vegeahn v. Guntner*, 167 Mass. 92, 108, 44 N. E. 1077, 1081 (1896).

^{51a}Cf. Brown, *Economic Basis and Limits of Public Utility Regulation* (1928) 53 Am. B. A. R. 717, 720.

⁵²*Supra* page 453.

⁵³See *supra* note 37.

⁵⁴See Guernsey, *Principles Underlying Reasonable Rates*, *supra* note 5, at 9; Guernsey, *State Commission Laws Regulate Rates, Not Profits*, *supra* note 5, at 267; Guernsey, *The Test of Reasonable Rates*, *supra* note 5, at 17.

⁵⁵*Bluefield W. W. & I. Co. v. Public Service Com.*, *supra* note 1.

second, it ignores the fact that competition in the utility field is practically extinct. To a large and ever-widening extent, the various utilities have a legal monopoly of their respective fields through certificates of public necessity and convenience or through similar devices, and where this is not true the naturally monopolistic nature of the business is an effective guard against competition save in sporadic instances. Thus entrenched, the utilities are in position to place an embargo upon unwanted capital. Investors may be ever so anxious to place their money in the profitable field, but, if the existing utility does not wish to accept it, they are effectually barred. Competition as an effective upper limit to rates in the utility field does not exist.

The demand for a rate substantially above the nonconfiscatory point thus becomes a claim that the utilities shall receive a return substantially in excess of that necessary to induce continued investment in the business, unchecked by the fear of a reduction by the influx of competing capital. It is a claim for a reasonable return in double measure. Economically this seems unsound. It imposes upon the other productive enterprises of society or upon the ultimate consumer, as the case may be, an unnecessary cost burden. In so far as it does this it defeats the American ideal of the widest diffusion of general economic well-being.

Another defense of the plea for greater than nonconfiscatory rates appears to be based upon the premise that the economic basis of regulation is the prevention of monopoly charges, and therefore that interference with the utility's rate schedule can be justified only upon a showing that the schedule constitutes a "monopolistic abuse."⁵⁶ If the rates are no more than would be chargeable under competitive conditions, it is urged, they should be left undisturbed.⁵⁷ It is submitted that the premise is erroneous. State regulation is not an attempt to reproduce the results of competition in a monopolistic field. It is true that monopolistic conditions do away with competition as a regulative force and so create a need for governmental regulation in its place; but it is equally true that whenever competition, though present, fails to regulate efficiently, state control again has a legitimate field for operation. We have no interest in either competition or monopoly in the abstract. What we are concerned with is maximum production and distribution at minimum cost. A system of regulation based upon a theory of reproducing competitive price conditions cannot do this. In the first place, it is utterly impracticable. What competitive conditions would bring about in an

⁵⁶See Updegraff, *op. cit. supra* note 5, at 252.

⁵⁷*Ibid.* at 257.

actually monopolistic field is a matter of pure speculation. The answer received will vary according to the type of competition that is assumed. Even then there must remain a doubt whether the actual result would coincide with the estimate. If rate regulation is to be conditioned upon a demonstration that the charges claimed by the utility exceed those realizable under competitive conditions, it will be well-nigh impossible to comply with the condition precedent. In the second place, the proposed test would in many instances deprive the public of the advantages springing from monopoly organization. The lowest possible rates under a regime of competing utilities, safeguarded by the constitutional rule against confiscation, may be so high as to leave a wide field within which charges yielding returns to a monopolistic enterprise entirely out of proportion to that necessary to induce investment might be sustained.

It is submitted therefore that the sound policy is to confine utility rates to the point yielding a return sufficient to induce continued investment as needed, that any higher return represents an economically unjustifiable burden upon the customers. For this view there is sanction in the utterances of judges,⁵⁸ even in the very opinions cited in favor of a more liberal allowance to the utilities.⁵⁹ But such a rate schedule is also that which is prescribed as a minimum by the rule against confiscation. It follows that in the normal situation the just and reasonable rate should not substantially exceed the nonconfiscatory one.⁶⁰

⁵⁸"The rate may be made high enough to cover the cost of service, the carrying charges, a reasonable sum for depreciation, and a fair return upon the investment. Less than this will not give the railway a reasonable rate. The action of a utilities commission which reduces a rate below this point unduly deprives the owners of their property without just compensation. If a rate exceeds this point to an appreciable degree and the commission, upon proper application, declines to reduce it, the court would, in the absence of other controlling facts, reduce it to a reasonable point." *Turner v. Connecticut Co.*, 91 Conn. 692, 699, 101 Atl. 88, 91 (1917).

⁵⁹"The real test of the justice and reasonableness of an individual rate seems to be that it should be as low as possible and yet sufficient to induce the investment of capital in the business, and its continuance therein." *Public Service Gas Co. v. Board of Public Utility Com'rs*, *supra* note 39, at 474, 87 Atl. at 656. To the same effect is the language employed in *O'Brien v. Board of Public Utility Com'rs*, *supra* note 45, at 49, 105 Atl. at 134. "The real test of the justice and reasonableness of any rate seems to be that it should be as low as possible and yet sufficient to induce the investment of capital in the business and its continuance therein." *State P. U. Com. v. Springfield G. & E. Co.*, *supra* note 47, at 219, 125 N. E. at 896.

⁶⁰See further upon this point Edgerton, *Value of the Service as a Factor in Rate Making* (1919) 32 HARV. L. REV. 516, 534 *et seq.* The whole matter is so well

Of course, as the Oklahoma Corporation Commission has said recently, the utility should not be held "down to the last dollar."⁶¹ Rates are fixed for the future and prophecy is an essential part of the process. In making the forecast of probable return, sufficient leeway should be allowed to take care of any reasonably probable change in circumstances that may affect adversely the company's earning power, as well as of such increases in the rate base as may occur through additions and improvements not counterbalanced by added earnings. But such an allowance, properly made, does not award a return in excess of that which is nonconfiscatory. It is merely a means of assuring that the return will not fall below the confiscation point.

It is not intended to deny that there may be cases in which a substantially larger return may be justified by sound policy. In that event, as has been suggested in the prior discussion, a proper interpretation of the statutory direction to fix just and reasonable rates renders it in the power of the regulatory bodies to permit such a return. The instances calling for the exercise of this power are of course not susceptible of detailed enumeration, but the point may be illustrated by naming a few in which it seems that a return in excess of the nonconfiscatory rate might properly be allowed. Thus if a utility has suffered severe loss through embezzlement or mismanagement of an officer, placing it in a precarious financial position, it might be sound policy to permit recoupment by a temporarily high rate of earnings though there would be no legal or constitutional obligation to do so. Likewise provision might be made for the encouragement of experiments looking to improvement of service or to the development of new machinery. And an inducement to increasing efficiency of operation to a point in excess of the standards of the time and place in the particular utility might be set up by permitting the retention of part of the gain by the utility in the form of a return somewhat in advance of the nonconfiscatory return.⁶² In this manner a higher return to efficiently managed utilities might be combined with a reduction of rates to their patrons. The significant thing, however, is that these special earnings should be permitted only as a matter of grace to accomplish special ends. Ordinarily the just and reasonable rate should not exceed the nonconfiscatory level.

discussed by Professor Edgerton that further treatment would have seemed unnecessary but for the added arguments adduced in the articles cited *supra* note 5.

⁶¹See *MacThwaite O. & G. Co. v. City of Ada*, 20 Okla. Corp. Com. Rep. 570, 575, P. U. R. 1927D, 833, 843 (1927).

⁶²See suggestion to this effect in *Public Service Gas Co. v. Board of Public Utility Com'rs* *supra* note 39, at 473, 87 Atl. at 656.