

**THE POLICE POWER AS A LIMITATION UPON THE
CONTRACTUAL RIGHT OF PUBLIC SERVICE
CORPORATIONS.**

The growth of public utilities in recent years and the coincident development of state commissions entrusted with their regulation has led to a unique evolution of the police power. This exercise of the police power in its control of public service corporations has not been accepted without question. Its advancement has been contested at every turn; but eliminating that small coterie of legal talent which has been engaged in confining this power within constitutional limits, there are few who are aware that this recent expansion of the police power to meet the alleged demands of a progressing civilization, has in fact brought in its train an entirely new conception both of property rights and property itself which has already struck at the foundation of traditional conceptions of the contract and due process clauses of the Federal Constitution.

It is the writer's desire, in the brief scope of this article, to analyze this so called police power; to trace its roots and origin, and to show that, whereas it was a power originally conceived to embrace only legislation in the interests of public health, safety or morals, and expressly eliminated from its scope statutes aimed solely toward the advancement of the public welfare, prosperity, or convenience, it now includes in its technical acceptation statutes whose object is the regulation of rates of fare and service of public utilities, although such legislation is predicated upon an exercise of this police power in the interests of the general welfare alone. It will be seen that the Courts in applying this power to public utilities attribute to it substantially every feature inherent in the original power, in so far as it is exercised in derogation of the freedom of contract. It is the writer's further object to point out the limitations upon the exercise of this power thus far prescribed by judicial decision, and to venture a prognosis as to the basis upon which this re-

served police power will in the future be exercised by the courts in the regulation of the business life of the community.

The police power is a term which throughout the course of the past century has challenged definition. As a matter of legal tradition, it may be said to embrace all those measures enacted by the legislature in furtherance of the health, safety or morals of a community.¹

Any discussion of the police power in its application to the modern law of public service corporations would be incomplete without introductory reference to the contract clause of the Federal Constitution. Article X, Section 5, provides that no state "shall pass any law impairing the obligation of contracts." This phrase was inserted by the framers to forestall a repetition of that crop of hostile legislation enacted by the colonies after the revolution in an inequitable attempt to relieve American debtors from the burden of legitimate obligations assumed toward British creditors. Little could it have been realized that this clause, inserted for the purpose of remedying a patent injustice, would be the basis of a century of litigation ultimately focusing in the conflict between the right of a state to control and regulate its creatures as against the assertion of a contract obligation alleged to be inviolable. Equally strange would have been the conjecture that the decision of Chief Justice Marshall in the *Dartmouth College Case*² was to be the gage of the greatest legal battles involving the constitutional immunities and privileges of corporate enterprise. We recall that in that case the Supreme Court announced the principle that a corporate charter constitutes a contract within the constitutional inhibition against the passage of laws impairing the obligation of contracts.

It has been aptly said by Mr. Black in his able treatise on "Constitutional Prohibitions" that this decision "threw a shield of protection on many of the most important enter-

¹ *Barber v. Conolly*, 113 U. S. 27 (1884); *Kidd v. Pierson*, 128 U. S. 1 (1888); *Mugler v. Kansas*, 123 U. S. 623 (1887); *Coe v. Errol*, 116 U. S. 517 (1886).

² 4 *Wheat.* 518 (1819).

prises of the age." The result was the early passage in nearly all of the States of general corporation laws, whereby the state specifically reserved to itself the right to amend, alter or repeal corporate charters. These saving statutes partially restored the power of the state over its creatures, but they by no means prevented those interests, shielded behind a corporate entity, from questioning at every turn, upon the theory of impairment of the contract obligation contained in the charter, each legislative act which purported to be hostile to the interests of the corporation.

The principle of the Dartmouth College case was soon tested in a series of decisions involving taxation of state banks, when such power was not expressly set forth in the charter. Thus in the case of *Providence Bank v. Billings*,³ the bank resisted the payment of certain state taxes upon the theory that the imposition thereof violated the charter contract. The Supreme Court held, again speaking through Chief Justice Marshall, that the power of taxation, being a necessary incident of government, will not be presumed to have been surrendered by the states in the absence of express and unequivocal language showing such an intent. It was not suggested in the decision that the state could not for a valid and adequate consideration surrender its sovereign power to tax, and we find that in subsequent decisions, where the charters contained express exemption from taxation, the Supreme Court upheld such charter provisions, refusing to permit the contract obligation to be impaired by state legislation imposing taxes upon the corporation.⁴

It required little perception to foresee the time when the rights of corporate interests protected under a charter must conflict with the fundamental interests of society, and we find that it is when the Supreme Court of the United States was compelled to face the dilemma of surrendering the decision in the Dartmouth College case, or upholding this

³ 4 Peters 514 (1830).

⁴ *New Jersey v. Wilson*, 7 Cranch 164 (1812); *Commonwealth v. Pottsville Water Co.*, 94 Pa. 516 (1880); *Humphrey v. Pegues*, 16 Wall. 244 (1874); *Northwestern Univ. v. People*, 99 U. S. 309 (1878).

decision as against the best interests of the community that initial recourse is had to the doctrine of the police power. The dilemma of the Supreme Court is best illustrated by the early cases in which it was decided that the police power is something superior to and transcends the obligation of a contract and cannot be surrendered even by the state itself. The conflict is illustrated by the cases of *Boston Beer Co. v. Massachusetts*⁵ and *Stone v. Mississippi*.⁶

The first of these cases involved the right of the Massachusetts Legislature to enact prohibitory liquor legislation; the charter of the Boston Beer Company authorizing that corporation to manufacture malt liquors. It was contended that the prohibitory legislation violated the obligation of the charter contract. The Supreme Court decided that, eliminating the express provision of the Act of 1809 relative to the enactment of future amendatory laws, the police power of the state to legislate for the *health, morals or safety of the community* could not be abridged by contract or bargained away.

"The plaintiff in error boldly takes the ground that, being a corporation, it has a right, by contract, to manufacture and sell beer forever, notwithstanding and in spite of any exigencies which may occur in the morals or the health of the community, requiring such manufacture to cease. . . . The legislature had no power to confer any such right. . . . Whatever differences of opinion may exist as to the extent and boundaries of the police power, and however difficult it may be to render a satisfactory definition of it, there seems to be no doubt that it does extend to the protection of the lives, health and property of its citizens, and to the preservation of good order and the public morals. The legislature cannot by any contract, divest itself of the power to provide for these objects. They belong emphatically to that class of objects which demand the application of the maxim, *salus populi suprema est lex*, and they are to be attained and provided for by such appropriate means as the legislative discretion may devise. That discretion can no more be bargained away than the power itself."

In the case just cited, the Supreme Court was prepared to determine the issue in favor of the power of the state to protect the health, safety and morals of the public, although,

⁵ 97 U. S. 25 (1871).

⁶ 101 U. S. 814 (1879).

in view of the amendatory provision of the Massachusetts law, the decision of the court relative to the alienability of the police power is, in fact, merely dictum.

But in the case of *Stone v. Mississippi* the court could not side step the dilemma presented by the Dartmouth College case. In that case it appeared that lotteries had been prohibited by legislation of Mississippi subsequent to the incorporation of a certain lottery company. On quo warranto proceedings against the lottery company, it was contended that the Acts of the Mississippi Legislature impaired the contract contained in the charter of the lottery company. Here the court had precisely the same situation as in the Dartmouth College case, to-wit: a charter containing certain provisions which were obviously abridged by the legislation in question. The court, however, refused to be controlled by the Dartmouth College decision, and relying upon a principle more embracing than the contract clause, held: that, although lotteries were the subject matter of the original contract, nevertheless, their prohibition under the Mississippi legislation was a legitimate exercise by the state of its reserved police power and as such did not impair the obligation of the charter contract. Speaking of the character of this power, the court says:⁷

"The power of governing is a trust committed by the people to the government, no part of which can be granted away. The people in their sovereign capacity have established their agencies for the preservation of the public health and the public morals, and the protection of public and private rights. These several agencies can govern according to their discretion, if within the scope of their general authority, while in power, but they cannot give away nor sell the discretion of those that are to come after them, in respect to matters the growth of which, from the very nature of things, must 'vary with varying circumstances.' They may create corporations, and give them, so to speak, a limited citizenship; but as citizens, limited in their privileges, or otherwise, these creatures of the government creation are subject to such rules and regulations as may from time to time be ordered and established for the preservation of health and morality."⁸

⁷ On page 820.

⁸ *Boyd v. Alabama*, 94 U. S. 645 (1876); *Fertilizing Co. v. Hyde Park*, 97 U. S. 559 (1878); *Coates v. Mayor, etc. of N. Y.*, 7 Cow. 585 (1827); *Patterson v. Kentucky*, 97 U. S. 501 (1878); *Metropolitan Board of Excise v. Banie*, 34 N. Y. 657 (1866); *Phalen v. Virginia*, 8 How. 163 (1850); *Slaughter House*

Thus by resorting to the principle of the reserved police power the court has succeeded in breaking down the barrier of the Dartmouth College case and it is now clear that no charter or other contract can protect a corporation or individual against the fair and legitimate exercise by the state of this power, the object of which is the protection of the public health, safety or morals of the community.

The justice and logic of exercising the police power as against strict adherence to the contract clause of the constitution in matters of public health, safety or morals, is evident; but it was far more difficult to sustain its application to the regulation of public service corporations where resort could not be had to the catch-all formula "health, safety or morals." Thus when the Supreme Court in *Munn v. Illinois*⁹ sustained the right of the State of Illinois to determine maximum rates charged by warehousemen upon the theory that the business had become "affected with a public interest" which justified the exercise of state regulatory power, the decision became a land mark in the law in addition to creating a storm of criticism which attached to that and the Granger cases which followed.¹⁰ The Court in these cases and in *Munn v. Illinois* does not resort to the use of the word "police power." It exercises a power without defining its nature, doubtless because it was not then prepared to include in the realm of the police power measures purely in the interest of the "general welfare" and it was obvious that rate regulation could not be predicated upon considerations of public health, safety or morals. This failure to define the exact nature of the power exercised in these earlier cases coupled with the expression in the *Piek* case¹¹ that "the State may limit the amount of charges by

Cases, 16 Wall. 36 (1872); Slaughter House Cases, 111 U. S. 746 (1883); *Lawton v. Steele*, 152 U. S. 133 (1894); *New Orleans Gas Co. v. La. Light Co.*, 115 U. S. 650 (1885); *Leiberman v. Van de Carr*, 199 U. S. 552 (1905); *Grand Trunk v. South Bend*, 227 U. S. 543 (1912); *Oil Co. v. Hope*, 248 U. S. 498 (1919); *Barbour v. Georgia*, 249 U. S. 454 (1911); *Lane v. Campbell*, 245 U. S. 304 (1917); *Texas, etc. v. Miller*, 221 U. S. 408 (1910).

⁹ 94 U. S. 113 (1873).

¹⁰ *Piek v. Chicago, etc. R. R. Co.*, 94 U. S. 164 (1873).

¹¹ See note 10, *supra*.

railroad companies for fares, and freights, *unless restrained by some contract in the charter*," at once led to a clouding of the principle that it was in fact the police power which was being applied. *If it were the real police power*, how then could it be bargained away by contract, as indicated above, since the Court had held in former cases that the exercise of the police power could not be foreclosed? The thought was thus developed that it was loose reasoning to hold that such regulation of public services as in the Railroad Commission Cases¹² and *Munn v. Illinois* was an exercise of the police power and thus Mr. Guthrie in his able "Lectures on the Fourteenth Amendment" is found arguing that the power to regulate fares is not an application of the Police Power but merely an exercise of an inherent function of government.¹³

There has, however, been a marked change in the law relative to the regulation of public service corporations since these lectures were delivered, and the writer feels justified in venturing the opinion that it can no longer be doubted that the police power in its technical sense embraces not only legislation in the interests of the public health, safety or morals, but that the vast amount of regulatory enactment as to rates and service of public utilities is an exercise of the police power and can be justified upon no other basis than the public welfare.

The mass of judicial decision relative to legislative control of public service corporations has been the product of a constant conflict between the application of the definite contract and due process clauses of the Federal Constitution, and the indefinite police power of the states. In this evolution it is found that legislation or administrative acts of commissions have consistently been saved from what appears to be a taking of property without due process of law by cataloguing such legislation as a legitimate exercise of

¹² 116 U. S. 307 (1886).

¹³ *Minneapolis v. Minneapolis Street Ry.*, 215 U. S. 417 (1909); *Milwaukee Elec. R. Co. v. R. R. Commission*, 238 U. S. 174 (1915); *Home Telephone Co. v. Los Angeles*, 211 U. S. 265 (1908); *Cleveland v. Cleveland City Ry.*, 194 U. S. 157 (1903).

the police power. Numerous recent decisions of the Supreme and Superior Courts of Pennsylvania in actions involving the powers and jurisdiction of the Public Service Commission under the Public Service Law¹⁸ furnish an apt illustration of this conflict between contractual and property rights on the one hand and the fundamental police power of the states on the other.

Brief reference to the Constitution of Pennsylvania is essential to a thorough comprehension of the problems involved. Under the provisions of the Public Service Law the Public Service Commission is authorized to "inquire into and regulate the service, rates, fares, tolls or charges of any and all public service corporations doing business in Pennsylvania. Article XVI, Section 3, of the Constitution of Pennsylvania provides that "the exercise of the police power of the state shall never be abridged, or so construed as to permit corporations to conduct their business in such manner as to infringe the equal rights of individuals or the general welfare of the public." Succeeding this article we find in Article XVIII, Section 9, the provision that "No street passenger railway company shall be constructed within the limits of any city, borough or township without the consent of its local authorities."

This consent provision of the Constitution of Pennsylvania is indicative of similar provisions contained in other state constitutions. Thus we see that the municipality or local authority is the arbiter of the fate of street railway *operation* under the declared public policy of the state. Under this provision municipalities have exercised their contractual powers for the purpose of obtaining the most advantageous terms from public service corporations seeking permission to operate within local limits. These terms were usually set forth in franchise ordinances or contracts frequently containing provisions for a specified rate of fare, such contracts or franchises antedating the passage of the Public Service Company law.

¹⁸ Act of July 26, 1913, P. L. 1374.

Such was the background of constitutional provision and statutory enactment which the Superior Court of Pennsylvania faced in the recent case of *Wilksburg Borough vs. Public Service Commission*¹⁰ which involved the validity of a schedule of increased rates filed with the Public Service Commission by the Pittsburgh Railways Company. The Borough of Wilksburg protested upon the ground that the new schedule violated the fare provision of the franchise which authorized the street railway to operate in the borough. The Superior Court upheld the power of the commission to enforce the new schedule of rates regardless of prior existing contracts, announcing the principle that the Public Service Company Law is a valid delegation to the Commission of the police power of the state and that "when, as in this case, the parties enter into a contract with a public service corporation relating to rates, they are presumed to have done so with the knowledge that the right of the state to exercise this police power in the future is expressly reserved, and that where the Commonwealth and the interests of the public demand that the provision of the contract thus entered into shall be modified, it can be done without any violation of the provisions of the Constitution of the United States with reference to the impairment of the obligation of contracts."

It will be noted that in this case and other recent cases,¹¹ the court deals with the contract as being "subject to" the possible exercise of the police power through the medium of the Public Service Commission and that the exercise of this delegated power by the commission is not an impairment of the obligation of the franchise contract. This view is consistent with the technical conception of the police power which transcends property rights in the interests of the public welfare. But in the recent case of *Suburban Water*

¹⁰ 72 Pa. Super. Ct. 423 (1919).

¹¹ See also: *Leiper v. B. & P. R. R. Co.*, 262 Pa. 328 (1918); *Scranton v. Public Service Com.*, 73 Pa. Super. Ct. 192 (1919); *Foltz v. Public Service Com.*, 73 Pa. Super. Ct. 24 (1919); *Metal Products Co. v. P. S. C.*, 74 Pa. Super. Ct. 59 (1920); *Klein Logan Co. vs. Duquesne Co.*, 261 Pa. 526 (1918); *St. Clair Boro v. Gas Co.* 261 Pa. 523 (1918); *Bellevue Boro. v. Ohio Valley Water Co.*, 245 Pa. 114 (1914).

Co. v. Oakmont Borough,¹⁸ which was an action of assumpsit for alleged violation of contract between the water company and the Borough for the supply of water at certain rates under a contract antedating the enactment of the Public Service Law, the Borough contested new rates filed in 1918 as being an impairment of the original contract. The Supreme Court on appeal held not only that the rate provision of a contract between a municipality could be modified by the commission in the exercise of the police power, but that¹⁹ "all public service contracts are viewed in the light of having been made with an implied provision that the rate narred therein is subject to change, according to law, so as to keep it reasonable and nondiscriminatory at all times."

It is submitted that, in view of the many cases²⁰ which typify a long line of similar authorities decided in various jurisdictions of the United States, it can no longer be doubted that the regulation of fares, service and facilities of public utilities is in fact an exercise of the technical police power analogous to that confidently exercised by the court in the Fertilizer and Slaughter House cases²¹ and is not merely an exercise of a "governmental function" as indicated by Mr. Guthrie. There the court disregarded the charter contract solely upon the theory of the supremacy of the police power. It was not suggested that the charter in the Lottery case²² contained any "implied condition" that the police power might be exercised in a manner hostile to the interests of the corporation. It was unnecessary to so hold in view of the nature of the power exercised. The result obtained by the Supreme Court of Pennsylvania is unassailable. No other conclusion could have been obtained when the relation between the state and public service corporations is considered. The writer does, however, differ with the method

¹⁸ 268 Pa. 243 (1920).

¹⁹ at page 252.

²⁰ Pinney, etc. v. Los Angeles, etc. Co., 168 Cal. 12, 141 Pac. 620, L. R. A. 1915 C 282; Railroad v. Mottley, 219 U. S. 467 (1911); Seattle v. Hurst, 50 Wash. 424 (1908); Knoxville Water Co. v. Knoxville, 189 U. S. 434 (1903); Buffalo East Side R. R. Co. v. Buffalo, etc. Ry. Co., 111 N. Y. 132 (1888).

²¹ See note 8, *supra*.

²² Stone v. Mississippi, 101 U. S. 814 (1879); see note 6 *supra*.

by which the court arrived at its conclusion. To-day the police power embraces measures in the interests of general welfare, prosperity and convenience.²³ Regulation of fares, service and facilities, being in the interests of general welfare, is within the scope of the police power. Once within the realm of the police power it is submitted that it is unnecessary to resort to a *fiction* in order to constitutionally exercise this right of regulation. In the exercise of the police power it has been seen that the state may disregard contracts and property rights which may have accrued thereunder. Why therefore resort to the specious fiction which can have no basis of fact that the parties contracted with relation to an *implied provision* relative to the exercise of the police power. Such a statement is simply not the fact. It is futile to argue that there was any implied term in the contract of 1907 between the City of Philadelphia and the Philadelphia Rapid Transit Company that the state might subsequently change the rate of fare through the medium of a commission whose existence could hardly have been dreamed of irrespective of being the basis of a *term* in the contract itself.

The true fact is that the Supreme Court of Pennsylvania, as with all fictions, resorts to the theory of "implied provision" as a method of saying "we are not interested in what the terms of the contract happen to be; the state may disregard its existence." It would appear more logical, and it seems that courts will eventually reach the conclusion that there is no implied term relative to the exercise of the police power in such contracts as a matter of fact or law, but such contracts are "subject to" the fair and legitimate exercise by the state of its control over public utilities through the medium of the police power, and, if the terms of the contract conflict with the general welfare of the community, the court will disregard them entirely, precisely as was done in the early cases involving public health, safety or morals.

²³ Oklahoma Natural Gas Co. v. Corporation Commission, see note 33, *infra*.

The contention that state regulation of rates is a violation of the contract clause of the Federal Constitution when the regulation seeks to supplant a franchise contract rate has frequently been made before the Supreme Court of the United States and it is to be noted that whenever this question has squarely been presented to that tribunal it has, without reservation, announced the doctrine that such contracts are "subject to" the reserved police power of the State. No resort is had to the "implied provision" theory announced by the Pennsylvania Courts. Thus, in the recent case of *Puget Sound Traction Co. v. Reynolds*,²⁴ which involved the validity of orders of the Washington Commission, whose effect was to negative franchise rates, the Supreme Court, speaking through Mr. Justice Pitney, says:²⁵

"Assuming . . . that the provision in the franchise ordinances respecting the rates of fare and the transfer privilege is contractual in form, still it is well settled that a municipality cannot, by a contract of this nature, foreclose the exercise of the police power of the state unless clearly authorized to do so by the supreme legislative power."

And in *Hudson Water Co. v. McCarter*,²⁶ the Court in discussing the effect of an exercise of the police power in the matter of rates says:

"One whose rights, such as they are, are subject to state restriction, cannot remove them from the power of the state by making a contract about them. The contract will carry with it the infirmity of the subject matter."²⁷

The Supreme Court adheres to the clear cut general proposition which might be termed a natural evolution of the doctrine of the Railroad Commission cases²⁸ that the

²⁴ 244 U. S. 574 (1917).

²⁵ On page 579.

²⁶ 209 U. S. 349 (1908).

²⁷ See also: *State ex rel Webster v. Superior Court*, 67 Wash. 37 (1912); *Milwaukee Ry. v. Railroad Com.* 238 U. S. 1 (1915); *Home Telegraph & Tel. Co. v. Los Angeles*, 211 U. S. 265 (1908); *Atlantic Coast Line Co. v. Goldsboro*, 232 U. S. 548 (1914); *C. B. & Q. R. R. Co. v. Nebraska*, 170 U. S. 57 (1898); *Union Dry Goods Co. v. Georgia P. S. C.*, 248 U. S. 372 (1919); *Mangault v. Springs*, 199 U. S. 473 (1905); *Railroad v. Quincy*, 219 U. S. 549 (1911); *L. & N. Rd. v. Mottley*, 219 U. S. 467 (1911); *Rail & River Co. v. Ohio, etc. Commission*, 236 U. S. 338 (1915).

²⁸ *Pick v. Chicago etc. R. R. Co.*; see note 10.

power to regulate is an exercise of the police power, is supreme and transcends all contractual obligations which may conflict therewith, and nowhere is resort had to the doctrine that the contract contains an implied term as to the exercise of the police power. This power cannot be curtailed or impaired unless expressly surrendered by the legislature as in the case of *Detroit United Railway v. Michigan*.²⁹

As has been indicated, this power to regulate in apparent derogation of contractual rights has been contested at every turn. It was early contended that the constitutional provision requiring consent of local authorities as a condition precedent to street railway operation was a delegation of the police power pro tanto to the municipality, and that valid franchise contracts made pursuant thereto setting forth definite schedules of rates could not be impaired by subsequent legislation. The early case of *Allegheny City v. Milville Railway*³⁰ is typical. There the city passed an ordinance authorizing the construction of a street railway within the local limits, provided the railway company agreed to certain fixed rates of fare and paid the city a certain proportion of its income. It was further provided that the ordinance should not be effective unless accepted by the company within thirty days of its passage. The ordinance was never in fact accepted but the company, notwithstanding, commenced to construct its lines within the city limits. In an injunction proceeding instituted by the city, it was contended by the company that the provisions of the ordinance were oppressive and unreasonable and beyond the power of the city to impose. The court, however, sustained the right of the city to impose in its franchise grant whatever conditions it saw fit regardless of their character.

The absolute right of a municipality to impose conditions in the franchise ordinance having been conceded in this case, it was but a step to contend that, by a condition in the franchise contract, the right of the state to regulate

²⁹ 242 U. S. 238 (1916).

³⁰ 159 Pa. 411 (1893).

its creatures could be foreclosed for all time. If such reasoning were to prevail the practical effect of a franchise contract would be a usurption by the city of power to regulate under the guise of a mere contract or franchise ordinance. The fallacy of such reasoning lies in its confusion between the *right to contract* and the *power to regulate*. The sole question involved in the Milville case, was the right of the municipality to impose *conditions* in its grant to the railway company. This right was held to be and is absolute. The legislature has delegated to the municipalities the right to determine upon what conditions a street railway may enter into the local limits, but no inference can be drawn that there has been or ever was intended to be a delegation of the supreme power of the state in its control of fares, facilities or service of public utilities operating under franchise from local authorities.

This distinction is well set forth in the recent case of *Woodburn v. Public Service Commission*,³¹ where the court passed upon the right of the commission to approve a schedule of rates at variance with that set forth in the franchise ordinance. The court in sustaining the new schedule says:

"The right of the state to regulate rates by compulsion is a police power, and must not be confused with the right of a city to exercise its contractual power to agree with a public service company upon the terms of a franchise. The exercise of a power to fix rates by agreement does not include or embrace any portion of the power to fix rates by compulsion. When Woodburn granted the franchise to the telephone company, the city exercised its municipal right to contract, and it may be assumed that the franchise was valid and binding upon both parties until such time as the state chose to speak; but the city entered into the contract subject to the reserved right of the state to employ its police power and compel a change of rates, and when the state did speak, the municipal power gave way to the sovereign power of the state."³²

³¹ P. U. R. 1917 B 967 (Ore.)

³² See also: *Joplin & Pittsburgh Railway Co.*, P. U. R. 1919 F 171; *United Railways Co.*, P. U. R. 1919 F 264; *Citizens Water Co.*, P. U. R. 1919 F 523; *Moore v. Valley Railways Co.*, P. U. R. 1919 F 493; *Appalachian Power Co.*, P. U. R. 1919 D 286; *Salem Light & Power Co.*, P. U. R. 1919 D, 882; *Chamber of Commerce v. West Chester St. Ry. Co.*, P. U. R. 1919 D 130; *New Castle v. Mahoning, etc. Co.*, P. U. R. 1919 D 783; *Tamaqua v. Eastern Penna etc. Co.*, P. U. R. 1919 F 712; *Central Illinois Public Service Co.*, P. U. R. 1918 F 821 & 829; *Harbor Creek Twp. v. Traction Co.*, P. U. R. 1918 E 164; *United*

Thus far we have discussed the application of the police power to cases involving the apparent impairment of contractual obligations between public service corporations and municipalities and have seen that, in such cases, no contract right can be deemed to have become vested so as to foreclose the exercise of the power of the state when it speaks through the medium of its administrative commissions, unless such power has been expressly surrendered. It seems futile, in view of the reasoning of these cases, to discuss those in which this same power has been held to cut through the contracts between public utilities and their patrons purporting to regulate rates, service or facilities.

It is in that final group of cases involving contracts between public utilities themselves that we find the high water mark both as to definition and extent of application of this reserved police power in its control and regulation of public service corporations. Until recently we were justified in assuming that the doctrine that a court will refuse to relieve parties against the obligations of a hard bargain

R. Co., P. U. R. 1918 D 392; Kansas City Railway Co., P. U. R. 1919 E 132; Lincoln County Power Co., P. U. R. 1919 C 862; *Portland v. Public Service Com.*, P. U. R. 1919 A 127; *Re: Kewance Home Telephone Co.*, P. U. R. 1918 B 172.

The following cases purport to deny the right of the state to alter rates fixed by contract but, on analysis, all may be distinguished on their facts. Thus in *Detroit v. Detroit, etc., Railway Co.*, 184 U. S. 368 (1902), the state legislature had expressly authorized the municipality to contract with reference to rates for a specified time; hence the court sustained a municipal contract as against a subsequent ordinance reducing the rate of fare, the police power of the state having been surrendered pro tanto to the city.

See also: *Plymouth Twp. v. Railway*, 168 Pa. 181 (1895); *People ex rel New York v. Railway Co.*, 217 N. Y. 310 (1916); *Adamson v. Nassau Electric R. Co.*, 89 Hun. 261 (N. Y. 1895); *People ex rel Frontier Electric Co. v. North Tonawanda*, 70 Misc. 91 (N. Y. 1910); *Public Service Commission v. West Chester Ry. Co.*, 206 N. Y. 209 (1912); *Gaedeke v. Staten Island Ry. Co.*, 43 Ap. Div. 514 (N. Y. 1899); *People ex rel Traction Co. v. Wilcox*, 133 Ap. Div. 556 (N. Y. 1909); *Detroit v. Michigan*, 242 U. S. 238 (1916).

The following recent New York cases deny the right of the Public Service Commission to alter rates fixed by franchise contract, sustaining the contract as against attempt to bring it within the scope of the police power. It is difficult to sustain the reasoning adopted by the court. The only possible basis of distinguishing them is that the provisions of the Railroad Law of New York do not reveal a legislative intent to deal with contracts between local authorities and the railroad corporation: *Quinby v. Public Service Commission*, 223 N. Y. 244 (1918); *Niagara Falls v. Public Service Com.* P. U. R. 1921 A 39; *People ex rel Garrison v. Nixon*, P. U. R. 1921 A 27 (see dissenting opinion of Crane, J. in this case).

would be applied to contracts between public service corporations with the same force as to contracts between individuals where there was no evidence of fraud or unfair dealing, and where the parties were not deceived as to the subject matter of the contract. We find, however, a radical departure from this traditional doctrine in the application of the police power to public utilities. If we accept the premise that the police power may be exercised solely in the interest of general welfare, and that such general welfare depends upon the continuance in profitable business of a *certain* public service company, we have little difficulty in arriving at the conclusion of the Supreme Court of Oklahoma in the recent case of *Oklahoma Natural Gas Co. v. Corporation Commission*,³³ where the Supreme Court of Oklahoma applied the police power to re-write a contract between two public utility companies.

The Oklahoma Natural Gas Company, engaged in the production and piping of natural gas in the State of Oklahoma, entered into a contract with the Guthrie Gas Company, engaged in the distribution of gas throughout the City of Guthrie. According to the terms of this contract, the Guthrie Company agreed to market gas piped to it by the Oklahoma Company at a fixed rate until 1928. Subsequently it appeared that the Oklahoma Company was realizing large profits from this contract while the Guthrie Company was barely able to secure operating revenue and was on the verge of abandoning its business. The Guthrie Company thereupon petitioned the Corporation Commission for relief in the form of an *equitable adjustment* of the rates set forth in the contract. The Corporation Commission refused to entertain jurisdiction but, on appeal, the Supreme Court of Oklahoma resorted to the entirely unique remedy of reconstructing the contract between the parties in such manner that the Guthrie Company should receive a greater percentage of the gross revenue than that stipulated in the contract.

³³ P. U. R. 1918 D 515.

This was not a case where any corporation, individual or political subdivision of the state was by virtue of contract, asserting a right superior to that of the state. It was an assertion on the part of the state, in a controversy between two public utilities, of a jurisdiction to reform valid existing contracts, for the benefit of one party and to the detriment of the other, upon the sole ground that such "reformation" was essential in the interests of the "general welfare." The reasoning of the court illustrates the extent to which the police power will be carried, and from it may be obtained a basis upon which to speculate as to its possible future exercise. The court says:

"Since the question of compensation to a distributing agent for service is one affecting the service of a public utility, it is clear that the Commission is vested with jurisdiction to see to it, on complaint filed before it, that the public utility complained of employ such methods in the conduct of its business as *will afford its agents compensation reasonably commensurate to the value of the service required*, and such as the Commission, under all the facts and circumstances of the case, shall deem reasonable and just to *the end that the agent may not abandon the service* to the consequent suffering and injury of the public. And the obligation of this contract cannot stand in the way of the Commission in exercising the jurisdiction involved. This for the reason that such jurisdiction is the exercise of the police power conferred by the grant conferred in the act aforesaid. Such contract being entered into between public utilities involving a subject matter affecting *the welfare of the public*, is presumed to have been made with the knowledge that the parties thereto cannot withdraw such subject matter from the police power of an instrumentality of the state exercising delegated authority, that is, the Corporation Commission."²⁴

We are thus compelled to accept the fact that state control of rates, service and facilities of public service corporations is not an exercise of a governmental function, but is an application of the police power in its technical acceptation. It can no longer be argued that contract rights are supreme as against a legitimate and fair exercise of the police power when applied to regulation of public utilities. Just as the police may without compensation abate a nuis-

²⁴ See: *Winfield v. Public Service Com.*, P. U. R. 1918 B 747.

ance so may that same power disregard property rights which have vested under a contract curtailing the control of the state over its creatures. In only one respect does the police power applied to public utilities differ from the traditional police power exercised in the lottery and analogous cases *supra*, to wit: it may be bargained away by the supreme legislative authority.

We now approach the logical query, whether any contract to which a public service corporation is a party is protected by the due process and contract clauses of the Federal Constitution and is immune from the operation of the police power. It does not follow from the fact of the peculiar relation of a utility to the public as to fares and service that this relation deprives such a corporation of constitutional protection as to matters not connected with fares and service. It is only because of the intimate connection between fares, service and the general welfare that contracts relative thereto are subject to the exercise of the police power. It is the subject matter of the contract, and not the fact that it is the contract of a utility which is the test in each case and determines whether the contract is inviolate or subject to abridgment under the police power.

In the cases which have been discussed, the court was dealing with a contract relating to fares or service. The relation between the subject matter of the contract and the public interest is obvious. The contracts were "affected with a public interest." This is true of contracts as to rates of fare as between the public and the utility; of charges by the utility to the consumer; of contracts between utilities themselves relating to a service rendered to the public or to each other.

Where, however, the contract does not involve a subject matter concerning fares or service, it is dealt with as any private contract of an individual or a corporation, and entitled to the same protection. The sanctity of what may be termed the private contracts of public utilities is illustrated by recent cases in which an attempt has been made to

abrogate rental contracts between lessor and operating public service companies. The question has arisen in valuation proceedings where complaint has been made of alleged exorbitant rentals paid by operating or lessee companies to lessor or underlying companies. Thus far a deaf ear has been turned by the courts to the contention that such contracts are subject to the police power, and are not protected against impairment. In *Indianapolis v. Traction & Terminal Co.*,³⁵ a case involving the relation of rentals to rates of fare, the court thus disposes of this contention.

"If the lessee paid more than a fair rental it would be its sacrifice. If less than a fair rental, it would be to its advantage, but not to the disadvantage of the public; that would pay only a definite percentage return on the property put to its use regardless of rental. The rental paid by the petitioner in nowise affecting fares paid by the public is in this proceeding a matter of no concern."

Vested rights secured under such rental contracts are not matters of public concern. That in no case will the fares paid by the public be affected by the amount of such rentals paid by operating to lessee companies is clear from the opinion of Commissioner Rilling:³⁶

"If such rentals, be they much or little, are to be paid, they should only be paid out of the fair return that the Philadelphia Rapid Transit Company is entitled to receive upon the fair value of the used and useful property in the system operated by it. When the company made these leases it assumed full responsibility therefor, which it cannot now shift and place upon the public. If any mistakes have been made they should be visited upon the company, and not upon the car riders."³⁷

³⁵ P. U. R. 1919 A 278, at page 312.

³⁶ In re contract of the City of Philadelphia with the Philadelphia Rapid Transit Company, 7 Pa. Corp. Rep. 125 (1919).

³⁷ Re Union Electric Light and Power Co., 6 Mo. P. S. C. 488; Re Utah Light & Traction Co., P. U. R. 1920 B 262; Milwaukee Electric Co. v. Milwaukee, P. U. R. 1919 D 504; Washington Mills v. U. S. Ry. Administration, P. U. R. 1919 E 638; Re Hepsen Light & Power Co., P. U. R. 1919 C 873; Citizens Passenger Ry. Co. et al v. Public Service Commission, Super. Ct. of Pa. October Term, 1920, no. 252, where the Superior Court of Pennsylvania refuses to order an investigation of the rentals paid to underlying companies in the City of Philadelphia and followed the cases cited, *supra*.

The conclusions reached in the cases cited³⁶ are clearly in accord with the correct theory governing the exercise of the police power in its application to contracts of public utilities. The test in each case must be whether the subject matter of the contract pertains to fares paid by or a charge made upon the public; in short, whether the subject matter is a matter of public interest in the legal sense. If the contract does not relate to such a subject matter, it cannot be subjected to the exercise of the police power, for it is only through the medium of rates or service that such contracts are connected with the public welfare in any way. Although on casual consideration the rental contracts of public service corporations would seem to pertain to the public welfare and hence be subject to revision under the police power, nevertheless, analysis reveals that they affect the public neither directly nor indirectly.

It is fundamental that in determining what is a reasonable rate of fare, rate making bodies are concerned with but one major factor: The actual fair value of the property of the utility devoted to the public service. The rate allowed is calculated to represent a reasonable return upon such valuation over and above maintenance and depreciation charges. That fixed charges, such as interest on investment and rentals are not an element in valuation is demonstrated in the cases cited.³⁷ The fare paid by the public is in no way increased or decreased by the amount paid as rentals or fixed charges. Not being an element in valuation nor a factor involved in the ultimate sum paid by the public, nor affecting the service rendered to the public, such rental contracts, regardless of their character of fairness or unfairness, cannot be deprived of the protection afforded by the contract and due process clauses. Property rights secured thereunder cannot be confiscated under the guise of an exercise of the police power.

A concrete illustration may emphasize this point. The United Gas Improvement Company in Philadelphia seeks

³⁶ Cases cited in notes 36 and 37.

³⁷ See notes 36 and 37.

relief against the City from the alleged onerous terms of a lease between the city and the Gas Company. It is averred that the Gas Company cannot obtain a fair return by the charges allowed under that lease. Without attempting to forecast the action of the Pennsylvania Commission in this case, it seems obvious under the decisions, this contract is within the jurisdiction of the police power. It concerns a charge made by the utility against the consumer. It practically involves the question of the return to be allowed the utility and such a contract, if circumstances warrant, may be altered in the legitimate exercise of the police power. If, on the other hand, the same Company sought relief against the terms of a contract under which the Bethlehem Steel Corporation had agreed to furnish structural iron for the erection of a new plant, it is clear that the courts would grant to such an agreement the full protection of the contract clause of the constitution. What the Gas Company pays for structural steel in no way concerns the public; the amount paid by the public is not dependent in any way upon the amount so paid by the utility. The contract, not affecting rates or service, does not fall within the operation of the police power.

Thus far the writer has confined himself to diagnosis. We have seen the "marvelous expansion of the police power from a function strictly confined to a few specific purposes to be practically unrestrained authority to legislate for the public welfare."⁴⁰ The contract and due process clauses have consistently been battered down by the indefinite right of the state under the police power to legislate for the general welfare. As applied to public service corporations, we have seen that this power has been wielded to such an extent in matters of fares and service that no contract relative thereto, whether of individual, corporation or municipality, is immune from its exercise.

Any discussion of the present day application of the police power without a brief prognosis as to its future exer-

⁴⁰ "Social Legislation and the Courts" by Henry Cambell Black; North American Review for February, 1921, page 198.

cise would be futile. We profit by precedent only in so far as it may be a guide to accurate thought in the future. Twenty years ago a suggestion of the extent to which the courts have expanded the police power in derogation of the contract and due process clauses would have been branded heresy. The writer does not wish to be subjected to such a charge when he ventures the opinion that we may anticipate an even broader application of the police power in the future.

The futility of a definite test in the application of a fundamentally indefinite power is obvious. We have reached a point where, although the power still remains effectively indefinite, a sound measure of its application in regard to contracts of public service corporations has unconsciously been evolved by the courts. In the old case of *Munn v. Illinois*, the Supreme Court of the United States, without once using the word police power, in fact determined the basis of its exercise to be whether the business in question had assumed such proportions as to have become "affected with a public interest." A warehouseman's calling having been so affected was held to be subject to the exercise of Government control as to reasonableness of rates and discrimination. And today in unconscious development of that same constitutional policy we find courts applying the identical test in measuring the scope of the police power as applied to contracts to which a public utility is a party. The rule is not stated as in *Munn v. Illinois*. Indeed, no rule is stated, but the same test is applied by the courts consciously or unconsciously in every decision on the question. Whether the contract to which a utility is a party is immune from the exercise of the police power hinges on one test: Is the subject matter affected with the public interest? Substitute for "subject matter" the word "business" and we have the identical test of *Munn v. Illinois*.

Whether or not the subject matter of the contract may be deemed to be affected with a public interest in the legal sense of the phrase cannot be determined by any definite yard stick. It is a matter primarily depending upon econ-

omic thought and political development. Today a contract between a coal company and a utility relative to the supply of coal unquestionably falls within the category of private contracts and would receive the full protection of the due process and contract clauses. Any attempt by a public service body to abrogate the terms of such a contract under the guise of an exercise of the police power would be unsuccessful. But with the advancing agitation concerning nationalization of mines, the frequent use by intelligent men of the word "public use"⁴¹ as applied to the coal industry, it would be unwise to venture the dogmatic opinion that for all time such a contract will be protected as has been indicated. When the subject matter of the contract as a result of the current economic thought of the day becomes affected with a public interest, all traditional barriers of constitutional prohibitions fall.

In 1918 in New York State a private lease of an apartment house would have been considered to be an inviolate contract. In 1920 we find the Legislature of New York by statute declaring that owing to the economic necessities questions of housing are affected with the public interest, and today through the medium of the police power the Legislature of New York refuses to recognize the contract obligation of a private lease and administrative bodies in that state are applying the same principles of fair return to disputes between landlord and tenant as are being applied in valuation proceedings in disputes between a consumer and a public utility.⁴²

The writer feels that we have not yet reached the peak in the application of this power, whose virtue is its elasticity, which permits expansion to meet the requirements of a progressing, complex business community.

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⁴¹ Calder Bill.

⁴² On April 18th, 1921, the United States Supreme Court held these laws constitutional. See note 43, on page 316, *supra*.