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Public Utility Valuation for Purposes of Rate Control (Book Review)

Pincus M. Berkson

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would seem to be the approach which should lead to the formulation of such a new technique, based upon non-interference by the courts with legitimate trade union organization, activity and collective bargaining.

MATTHEW M. LEVY.

New York City.

PUBLIC UTILITY VALUATION FOR PURPOSES OF RATE CONTROL. By John Bauer and Nathaniel Gold. New York: The Macmillan Company, 1934, pp. xxii, 477.

There are two methods open to the law writer who would make any worthwhile contribution to any branch of law: one is by compiling, arranging and analyzing in convenient form the controlling cases relating to that branch of law; the other is by presenting the subject matter from a critical standpoint in order to reform the law in some particulars by pointing out the errors into which it has fallen and making constructive suggestions by way of substitution. The latter kind of book is the more valuable contribution. Such is the book under review. It deals with the subject of valuation, the most vital phase of rate control. Its aim is not only to state what the law is, but what it ought to be. It examines the adjudicated cases, presents the historical development of the principles of law evolved by the Supreme Court, shows how their application to administrative action has rendered rate regulation ineffective, and finally presents a plan of revision designed to remedy existing defects.

Part I sets forth how the "fair value" concept evolved. The division of its historical development into three periods is both novel and helpful. Each period is set off against the background of economic and social forces that impelled the legislative or administrative action that came up for judicial review. The judicial determinations assume added significance when read in the light of the conflicting public and private interests which the courts aimed to satisfy and safeguard. The historical background also helps to explain the inability of the courts, in the absence of direct legislative sanction, to evolve a systematic method of valuation for purposes of rate control.

This latter phase, however, is overemphasized by the authors at the expense of a comprehensive analysis of adjudicated cases. In this respect, the book shares the failing of a great deal of the literature dealing with rate base valuation. So much is usually said about the shortcoming of the conventional method of valuation that not enough is said of the law itself. As an example of what the reviewer has in mind, mention may be made of the basic judicial concept that underlies most, if not all, the decisions involving valuation procedure and determinations, *i. e.*, that the courts will not sanction "any rule or formula which changed conditions might upset" but will require that all determinations of "fair value" be a matter of sound judgment, involving fact data.¹ The authors fail to analyze or trace the development of this often

¹ Los Angeles Gas & Electric Corp. v. Railroad Commission of California, 289 U. S. 287, 53 Sup. Ct. 637 (1933).

applied judicial criterion of validity of method or result. Yet a clear understanding of it is not only essential to a proper knowledge of the law relating to valuation, but is a helpful guide in formulating new methods of property valuation or to test the validity of any proposed plan or the determination of any rate proceeding. As one reads the recent decision in the case of *West v. Chesapeake & Philadelphia Telephone Company*,² the question comes to mind whether the action of the Maryland Commission would not have been more in harmony with established law and the court's decision would not have been different if the Commission had adopted price trend indices as an exercise of judgment rather than as a mathematical rule of thumb that seems to have excluded independent judgment.

The foregoing strictures, however, do not apply to Part II of the book, which is procedural in scope. The collaboration of the authors, one an economist and the other a lawyer, each an expert in the utility field, and both experienced in rate-making procedure, shows to best advantage. The problems of accountancy, engineering and business economics that dog every step in valuation procedure, are clearly and tersely presented. The treatment of the controversial subject of depreciation is an illustration in point. The reviewer knows of no single treatment of this subject that gives a more concise yet comprehensive and clear analysis of the technical problems of structural and functional factors of depreciation or of the significance of the accounting procedure involved in allocating accruing and accrued depreciation than that found in the chapter on depreciation.

This admirable treatment is also carried over to the legal phases of depreciation. The analytical digest of decisions relating to depreciation though brief is clear and adequate. However, one very vital phase of depreciation is overlooked. It was presented but not passed upon in the case of *Lindheimer v. Illinois Bell Telephone Company*.³ It involves the harmonizing of judicial concepts with accounting practice. One of these concepts requires that a utility earn a fair return on the present value of the property *at the time of its use*; the other, the "value of service" concept, requires that the ratepayer be charged only the present worth—no more and no less—of the service received *at the time it is rendered*.⁴ Under the straight-line method of accounting, depreciation reserves are accumulated not on the basis of replacing the proportion of property actually consumed during any particular rate-making period but in anticipation of the ultimate retirement and replacement of the unit of property. *Query*. What should be done with the excess reserves accumulated by the straight-line method of accounting? Should the future consumer or the investor have the benefit of the excess which the accumulated reserves bear to the depreciation actually existing at the time of valuation of the rate base upon which a fair return for the future is determined? The authors wholly ignore this perplexing yet vital depreciation problem.

Part III presents suggested changes designed to remedy the defects in the present system and to make rate control more effective and equitable. Briefly stated, the authors propose to have the legislature provide by statute for an

² 55 Sup. Ct. 894 (1935).

³ 292 U. S. 151, 54 Sup. Ct. 658 (1934).

⁴ *Public Utility Commissioners v. New York Telephone Co.*, 271 U. S. 23, 46 Sup. Ct. 363 (1926).

initial revaluation of properties by the conventional method of valuation and thereafter to permanently keep such valuation, subject, of course, to depreciation charges, while new investments are to be entered and appraised in terms of definite agreements made between the company and the investors furnishing the funds and approved by the regulatory commission. The property rate base at any time would consist of the sum of the property account balances less the amount of depreciation reserve and would constitute a fixed rate base upon which a definite rate of return would remain fixed so long as the property remains in service.

For administrative purposes, the proposed plan furnishes a formula that is stable, definite and easy of application. But will it pass judicial muster? The authors believe that if the legislature clearly defines public policy in terms of the public need for effective administration rate regulation and then adopts the proposed plan to effectuate such public policy, the courts would uphold its constitutionality. Unfortunately, the authors did not have the advantage of knowing the recent decision of the Supreme Court in the *West* case, *supra*. The court there held that the method of applying price trend indices as of 1932 to a rate base fixed in 1923, as a substitute for such factors as historical cost and reproduction cost was "inapt and improper, is not calculated to obtain a fair or accurate result and should not be employed in the valuation of utility plants for rate making purposes." The case reaffirms what has been repeatedly held, *i. e.*, that neither legislatures nor commissions may substitute for the exercise of sound judgment in determining present value of existing property any rule of thumb or mechanical formula which changed conditions might upset. Does not the proposed plan come within the condemnation of the *West* case, *supra*? Suppose, by way of illustration, that a period of inflation follows the establishment of a fixed rate base as outlined by the authors, would not a fixed rate of return on a fixed rate base, in the light of reduced purchasing power of money, produce an unfair result and prove confiscatory?

Any proposed revision of law in respect to the valuation of existing investment, to be sound, must keep within the bounds of adjudicated cases. The value of the proposed plan as to existing property would have been enhanced if the authors developed it within the limits of settled law. The case of *Lindheimer v. Illinois Bell Telephone Company*, *supra*, offers a new avenue of approach. It sets up the actual earning experience of the company as the dominant if not the decisive factor in determining the reasonableness of rates. The newly enacted statutory methods for fixing temporary rates on the basis of original cost less accrued depreciation affords another device for attaining some of the objectives which the authors deem desirable. Yet both the standard used in the *Lindheimer* case and the new method for fixing temporary rates are wholly ignored. Even as to the proposed plan, the authors do not cite any cases in support of their position but content themselves with a discussion of general legal principles.

Yet, notwithstanding all the criticism that may be leveled against parts of the book, this fact remains: It marks a valuable contribution to the solution of an increasingly pressing legal, economic and political problem. Perhaps no one author or group of authors can satisfactorily solve it, at one

time. It will require the combined efforts of those responsible for making, administering and interpreting the law. This very instructive and highly stimulating book has much to offer to each group.

PINCUS M. BERKSON.

New York City.

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