1930

Valuation in the Supreme Court

Alfred Evens
Indiana University School of Law

VALUATION IN THE SUPREME COURT

Theory of Valuation of Public Utility for Rate-Making Purposes Announced in Smyth vs. Ames in 1897—Effect of Changing Economic Conditions on Views of Interested Parties—Consistent Adherence of United States Supreme Court to Announced Principle of Valuation—The O'Fallon Decision Simply Reaffirms This and Declares No New Law

By Alfred Evens
Professor of Law of the University of Indiana

THE O'Fallon decision is now more than twelve months old. Perhaps the exuberance of the apostles of "reproduction" cost and the depression of the devotees of "prudent investment" cost have both sufficiently adjusted themselves to normal to now appreciate that neither won a victory in the O'Fallon decision.[1]

The O'Fallon decision declares no new law. Yet it is one of great importance and far-reaching in its consequences.

In 1897, in the oft quoted decision of Smyth v. Ames,[2] the Supreme Court announced the theory of valuation of a railroad or a public utility for rate making purposes required by the Fourteenth Amendment of the Federal Constitution. The public interest in that case was almost as keen as in the O'Fallon case. In the midst of the panic and general economic depression of the last decade of last century the State of Nebraska sought relief by passing a law fixing maximum freight rates. The stockholders of various railroads affected filed suits questioning the constitutionality of the act. It was the contention of the plaintiffs that this act violated the due process clause of the Fourteenth Amendment. The determination of this question involved as a consideration of prime importance the adoption of a correct theory for ascertaining the values of the railroads involved for rate making purposes.

The economic depression and distress at that time (the act was passed in 1893) was very great. Many public spirited men were deeply interested in the controversy. William Jennings Bryan was an attorney for the defense in the case and with characteristic vigor presented the "people's" cause against the railroads. The several suits were consolidated. The parties presented their views on the correct theory of valuation with great earnestness and with some spleen. The Supreme Court, after mature consideration, announced the principle governing the valuation of a railroad or a public utility property for rate making purposes which has since been adhered to by it and which was reaffirmed in the O'Fallon decision.

It is interesting to note in the various causes involving ascertainment of value how the positions of parties have changed with changing economic conditions. In Smyth v. Ames, Mr. Bryan, on behalf of the public, insisted, with as much earnestness as the utility lawyer of the last decade, on the cost of reproduction as the infallible rule for ascertaining value. He argued "that the present value of the roads, as measured by the cost of reproduction, is the basis upon which profit should be computed. . . The ordinary business man cannot avail himself of watered stock or fictitious capitalization, *nor can he protect himself from falling prices.* (Our italics.) If his property rises in value, he profits thereby; so do the owners of a railroad under similar conditions. If his property falls in value, he loses thereby; so must the owners of a railroad under similar conditions, unless it can be shown that railroad property deserves more protection than other forms of property."[3]

On the other hand the stockholders of the railroads contended "that a railroad company is entitled to exact such charges for transportation as will enable it, at all times, not only to pay operating expenses, but also to meet the interest regularly accruing upon all its outstanding obligations, and justify a dividend upon all its stock."[4] In other words, the stockholders contended for a valuation for rate making purposes equal to their outstanding stock and interest bearing obligations upon the assumption that this sum fairly represents the cost of the property. To support this view great importance was placed on original cost of construction of the railroads at the high prices following the Civil War.

The court held that the constitutional guarantee to the railroad was a fair return on "the fair value of the property being used by it for the convenience of the public."[5] The court further pointed out that a "fair value" could not be ascertained by either the formula of cost of reproduction alone or by the ascertainment of the sum total of the outstanding stocks and bonds of the railroads. The court recognized cost of reproduction, the amount of outstanding stocks and bonds, and the original cost as competent evidence as to value but held that other competent evidence bearing on value must likewise be considered. The court further held that in arriving at fair value not only all relevant evidence should be considered but that each factor should be given such weight, as under the circumstances of the cause under investigation, it was entitled to receive.

The court enumerated various types of evidence that should be given consideration in ascertaining value, namely: (1) original cost of construction, (2) amount expended in permanent improvements, (3) amount and market value of bonds and stock, (4) present as compared with original cost of construction, (5) probable earning capacity of the property under the rate in question, and (6) the sum required to meet operating expenses. The court also points out that the above list of matters to be given consideration is not intended as all inclusive and is not intended to

1. St. Louis & O'Fallon Ry. Co. et al v. United States et al, 279 U. S. 461, 49 S. Ct. 384.
2. Smyth v. Ames, 169 U. S. 466, 18 S. Ct. 466.
3. 169 U. S. 466, p. 489-90.
4. 169 U. S. 466, p. 543.
5. 169 U. S. 466, p. 546.

exclude other relevant evidence as to value. The court holds that each matter above enumerated is to be given such consideration and weight as may be "just and right" under the circumstances of each case.[6]

The court does not attempt to circumscribe the honest judgment of the trying tribunal by any hard and fast formula telling how much weight must be given to any particular character of evidence. All competent evidence must be received and all evidence must be given such weight as under the circumstances of the case under investigation is "just and right."

For thirty-two years the Supreme Court has consistently, we submit, adhered to the principle of valuation declared in Smyth v. Ames. It has cited this case with approval no less than thirty times in a period of thirty years. In the O'Fallon decision it has reaffirmed this principle.

For several years following Smyth v Ames, attorneys for the public continued, it seems, to press reproduction costs as the prime factor in valuation and the utilities continued to insist primarily upon original cost and the amount of outstanding bonds and stock.[7] The Supreme Court has consistently pointed out that, while these matters were proper evidence, each to be given such consideration as was fair to both the utility and the public under all the facts and circumstances developed in the case under investigation, yet the question for determination was the fair value of the property used for the public *at the time under investigation,* not its cost at some time in the past.

So long as prices were depressed and the cost of reproduction remained less than the original cost or the outstanding amount of bonds and stock, the representatives of the public continued to urge cost of reproduction as the prime factor in valuation, and the representatives of utilities and railroads opposed this contention, insisting upon original cost or the amount of outstanding bonds and stock as the controlling factor.

As the country recovered from the economic depression of the last decade of the nineteenth century, the excess of prices at the time of construction over the prevailing construction prices for current work disappeared and in some cases there was a shifting of the balance on the opposite side. Naturally, the utilities and railroads became less bitter in their opposition to reproduction costs as a dominant factor in valuation. They were willing to concede to the public representatives a point which gave to these officials the satisfaction of victory, and which cost the companies nothing. There followed a period in which prices were substantially normal. There was not the great disparity between prices at the time of construction and at the time of the valuation. Consequently there was not the same motive of self-interest to arouse the bitter controversy present in Smyth v. Ames.

Furthermore, records of original costs were defective and in many cases the ascertainment of original construction costs was an impossibility. The result was a practical one rather than a legal one, namely, for many years the cost of reproduction was largely resorted to by commissions (the utilities acquiescing therein) as a means of arriving at value for rate making purposes.

So long as the economic development of the country proceeded along normal lines, self-interest, the parent of economic controversies, found no substantial advantage in advocating either original cost or reproduction cost as a dominating factor in valuation. The interest of the contending parties was, therefore, diverted for the time being from the main controversy between original cost and reproduction cost. Both exercised their ingenuity in attempting to inject or exclude the consideration of some particular factor or factors in determining value in the particular case under investigation.

After the decision in Stanislaus Co. v. San Joaquin,[8] decided in 1904, the utilities seemed not to have seriously urged in the Supreme Court original cost as the dominant factor in valuation. From time to time in particular cases the amount of outstanding stocks and bonds seems to have been rather faintly urged, but the main controversies largely centered around collateral questions which were equally applicable under the reproduction theory or the original cost theory.

For a time valuation cases were tried largely on minor issues. Such questions as the following occupied the attention of the court: (1) may a percentage reduction made by the utility for prompt payment of bills be subtracted from the estimated income to the end that the rate may thereby be increased;[9] (2) questions as to depreciation;[10] (3) may good will be capitalized;[11] (4) may franchises be capitalized;[12] (5) may going concern value be considered in fixing value for rate making purposes;[13] (6) may past losses be capitalized;[14] (7) to what extent may income taxes be deducted from the gross earnings to arrive at net earnings for use in rate making?[15]

The Minnesota Rate Cases,[16] decided in 1913, it is true, did present a rather lively scrimmage between the theory of original cost and reproduction cost, but the scrimmage was on a limited scale, being largely confined to the valuation of naked land. The land values of the railroads in question and particularly their terminal lands in the large cities of Minneapolis, St. Paul and Duluth had enormously increased in value.

The Attorney General of Minnesota advanced the argument that the basis upon which rates should be fixed "is limited to the investments of the corporation."[17]

On the other hand, the railroads sought to apply the reproduction idea to naked land values and in doing so asked for (1) allowances for so-called "railway value" over and above the value of similar land in the vicinity, (2) allowances for "conjectural cost of acquisition and consequential damages," (3) allowance for engineering, superintendence, legal expenses, contin-

6. 169 U. S. 466, p. 547.

7. San Diego L. & T. Co. v. National City, 174 U. S. 739, 19 S. Ct. 804; San Diego L. & T. Co. v. Jasper, 189 U. S. 439, 23 S. Ct. 571; Stanislaus Co. v. San Joaquin etc. Co., 192 U. S. 201, 24 S. Ct. 241.

8. Stanislaus Co. v. San Joaquin etc. Co., Supra.

9. Knoxville v. Knoxville Water Co., 212 U. S. 1; 29 S. Ct. 148; Cedar Rapids etc. Co. v. Cedar Rapids, 223 U. S. 655, 32 S. Ct. 389.

10. Minnesota Rate Cases, 230 U. S. 352, 33 S. Ct. 729, 48 L. R. A. (n.s.) 1151; Knoxville v. Knoxville Water Co., Supra.

11. Wilcox v. Consolidated Gas Co. 212 U. S. 19, 29 S. Ct. 192, 48 L. R. A. (n.s.) 1134; Des Moines Gas Co. v. City, 238 U. S. 153, 35 S. Ct. 811.

12. Wilcox v. Consolidated Gas. Co., Supra; Cedar Rapids Gaslight Co. v. Cedar Rapids, Supra; Des Moines Gas Co., v. City, Supra.

13. Des Moines Gas Co. v. City, Supra.

14. Galveston E. Co. v. Galveston, 258 U. S. 388, 42 S. Ct. 351.

15. Galveston E. Co. v. Galveston, Supra.
A. (n.s.) 1151, Am. Cas. 1916A 18.

16. Minnesota Rate Cases, 230 U. S. 352, 33 S. Ct. 729, 48 L. R.

17. 48 L. R. A. (n.s.) 1151, p. 1153.

gencies and interest during construction on land values.[18]

The court rejected these contentions. It was said, "the property is held in private ownership, and it is that property, and not the original cost of it, of which the owner may not be deprived without due process of law."[19] But the court also said, "The company would certainly have no ground of complaint if it were allowed a value for these lands equal to the fair average market value of similar land in the vicinity, without additions by the use of multipliers, or otherwise, to cover hypothetical outlays."[20]

While the whole theory of valuation is restated by the court in this opinion, it will be observed that the occasion of the controversy was the greatly enhanced land value due to a rapid growth of the three cities in which these railroads had their principal terminals, rather than a general economic inflation or depression.

The first decade of the present century witnessed the creation of public service commissions in a large number of states and a resulting increase in the effort of the public authorities to regulate rates charged by railroads and public utilities. Congress in 1913 passed the Railway Valuation Act of March 1, 1913,[21] requiring the Interstate Commerce Commission to value the railroads of the country.

Such legislation in itself was sufficient to arouse the interest of students of law and economics in the subject of valuation of such properties for rate making purposes. But the rapid increase in price levels following the outbreak of the world war brought about an economic situation where acute controversies between the representatives of the public and those of the utilities and railroads was inevitable. We were now in another economic upheaval. The difference between the present controversy and the one involved in Smyth v. Ames was that reproduction costs were now abnormally high instead of abnormally low. It is, therefore, no great surprise to the discriminating student of economic history that self-interest now caused the contending forces to take opposite sides of the controversy from those taken in the industrial depression of the last decade of the 19th century.

Since original cost as the sole measure of value had, in response to the arguments of the representatives of the public, been repudiated so often and in such certain terms by the Supreme Court,[22] the representatives of the public now found new names for original cost, namely "historical cost" or "prudent investment cost." Under these new names they eliminated some of the considerations possible under original cost which the Supreme Court had pointed out as weaknesses of that theory as the sole measure of value, such as dishonest or wasteful expenditures. The fact, however, remains that "historical cost" or "prudent investment cost," however camouflaged, is original cost, and many of their advocates of the last ten years have, we submit, become devotees because prices of original construction were materially lower than the prices of reproduction at the time of the inquiry. In other words, the historical facts indicate that either consciously or unconsciously the representatives of the public conceive it to be their duty to obtain the service in question for the public at as low a rate as possible. To do this requires a low valuation. The theory of valuation advocated by them has been, whether in times of depression or inflation, merely a means to this end.

This process of conversion of the representatives of the public from ardent reproduction cost advocates to ardent prudent investment advocates was, of course, a gradual process corresponding fairly closely to the mounting construction prices which followed the industrial depression of the 90's and which preceded the world war. As early as Wilcox v. Consolidated Gas Co., decided in 1909, Mr. Alton B. Parker, who acted as an attorney for New York City, foresaw the shifting of interests and on behalf of the public advanced the prudent investment theory.[23]

On the records of the Supreme Court, Mr. Bryan, the super-champion of the people for a quarter of a century, was the father of the reproduction cost theory as the measure of value for rate making purposes. Mr. Parker, a conservative lawyer, was one of the first advocates of, if not the father of, the prudent investment theory. May not this fact furnish food for thought to those, on both sides of the controversy, who are now finding fault with the Supreme Court's decisions on valuation?

With equal disregard for theoretical consistency in their views on valuation, the representatives of the utlities and railroads conceived it to be their main problem to secure as high rates for the service of their companies as the traffic would bear. To accomplish this result required high valuations. The theory of valuation adopted by them was a means to this end.

Both sides, therefore, have been consistent in pursuing the main end, namely, economic advantage, and have demonstrated the very human quality of giving to themselves little worry because they have changed fronts to attain the desired end.

Modern living conditions have made the cost of gas, electricity, water and transportation matters which touch and vitally concern the entire public. Valuation of utilities and railroads (a subject practically nonexistent to the lawyer and economist of half a century ago) has become a subject for major consideration in both fields. Since 1900 more than fifty cases involving the valuation of a utility or a railroad have reached the Supreme Court of the United States for decision. The number of such cases decided by lower Federal courts, state courts and commissions is legion. Much has been written by students both of law and economics on this subject. Much has been written by the attorneys of actual litigants. It is unfortunate that so many of these writers have been led into errors as to what the Supreme Court has actually held to constitute the true measure of value for rate making purposes. The very bitterness of the controversy and the earnestness with which litigants have in recent years urged their theories as the only correct theories of valuation have, it appears, led some to assume that the question to be decided is the relative merits of original cost (or some modification of that theory, such as historical cost or prudent investment cost) and reproduction cost. Much learning has been expended in arguing this question. From an examination of the decided cases it would appear that in no case from Smyth v. Ames to the O'Fallon case has a majority of the Supreme Court even intimated that either of

18. 48 L. R. A. (n.s.) 1151, pp. 1189-90.
19. 230 U. S. 352, p. 454.
20. 230 U. S. 352, p. 455.
21. 37 Stat. at Large 701, C. 92.
22. Smyth v. Ames, Supra; San Diego L. & T. Co. v. National City, Supra; San Diego L. & T. Co. v. Jasper, Supra; Stanislaus v. San Joaquin etc. Co. Supra.
23. Wilcox v. Consolidated Gas Co. 212 U. S. 19.

these theories of valuation could be used as a sole means of ascertaining value.

Again the desire for an easily applied rule of law instead of a principle of law has led some who correctly understood the decisions of the Supreme Court to criticize these decisions and to demand a simpler and more easily applied rule than the principle announced in the case of Smyth v. Ames. While the writer entertains some skepticism on the subject of making simple, to the extent maintained by some of these writers, the determination of so complicated a question as the ascertainment of the value of a great railroad system, he nevertheless recognizes that constructive criticism is the beginning point of progress. He believes that intelligent criticism of this character has already brushed away some cobwebs, and has been of assistance to the courts in approaching valuation problems more intelligently. To illustrate, the criticism of Justices Brandeis and Holmes in the dissenting opinion in the Southwestern Bell Telephone Case[24] of an unintelligent attempt to make some kind of a composite hodge-podge out of the evidence on the various factors required to be given consideration in Smyth v. Ames has, we believe, caused the courts to re-examine the principle declared in that case. The holge-podge application so criticized has been, we think, somewhat reduced and the intelligent re-examination has demonstrated that the decision does not require a composite hodge-podge at all. The requirements of that decision are that all competent evidence of value be received and that each bit of such evidence be given such consideration as under all the circumstances of the case under investigation is "just and right." This is but the elemental rule as to receiving and weighing evidence in any litigation.

It may be under the circumstances disclosed by the evidence in a particular case that the original cost less depreciation is a fair measure of present fair value. It may be, as the Supreme Court said in the Indianapolis Waterworks Company Case,[25] that under certain conditions reproduction cost less depreciation furnishes a fair measure of value. It may be under the facts shown in one case a valuation for taxation purposes is important evidence of value[26] and under the facts shown in another case such valuation has practically no probative worth.[27] In other words, Smyth v. Ames does not require that a valuation be made by ascertaining value by means of various formulæ, adding these values together and dividing by the number of component valuations in order to get an average which is called fair value. Neither does it attempt to say that the weight to be given to any one factor shall in all cases be in any definite ratio to any other factor. It recognizes that the weight which should be given to any evidence in for reaching value varies as the conditions vary. It requires the consideration of all competent evidence but it requires the valuing tribunal to give to each piece of evidence such consideration, and only such consideration, as is "just and right" under the facts in that case.

It must be noted, however, that the requirement of Smyth v. Ames is not that evidence which under the facts does have probative value may be considered (given lip consideration) and ignored in fixing fair value. It must be considered and given such weight as is "just and right" under the circumstances of that case.[28]

Such are the principles controlling valuation for rate-making purposes which the Supreme Court has declared over and over again.

In the light of the economic advantages to be gained in an abnormal time of price inflation by the respective parties to this controversy, if the Supreme Court could be induced to accept one or the other of these theories of valuation,—or even to decide that the one or the other should be given dominant consideration in determining value, it was inevitable that the question should again be carried to the Supreme Court. The principles of valuation adopted by the courts satisfied the avarice of neither party. Each hoped for an advantage by a restatement of the principle. Each hoped to have the court adopt its formula as a rule for valuation or at least as the dominant factor in determining value. The mere fact that the question had, therefore, been repeatedly decided did not deter. The stake was too high.

In Missouri ex rel Southwestern Bell Telephone Co. v. Public Service Commission,[29] just twenty-five years after Smyth v. Ames, the Supreme Court was again called upon to accept a species of original cost, namely, prudent investment cost, as the sole measure of value. In this case the demands of the public, voiced not alone by the attorneys for the litigants, but also by numerous students of economics and law, made a greater impression upon the Supreme Court than a similar argument of the attorneys of railway security holders made in Smyth v. Ames. For the first time in a valuation case the Supreme Court divided, Justice Brandeis and Holmes dissenting from the majority opinion.

The majority opinion amounts to a re-affirmation of the principles of Smyth v. Ames. It goes no farther in principle. Those who try to find in this opinion a declaration of the reproduction cost theory, or authority to the proposition that reproduction cost must be given dominant consideration in fixing value, do violence to the opinion of the court. What the court did decide was that price levels at the time of making the valuation had been wholly disregarded and that this was error. The Court said:

> "Obviously, the Commission undertook to value the property without according any weight to the greatly enhanced costs of material, labor, supplies, etc., over those prevailing in 1913, 1914 and 1916. As matter of common knowledge, these increases were large. Competent witnesses estimated them as 45 to 50 per centum. . .

In the Minnesota Rate Cases, 230 U. S. 352, 454, this was said:

> "'The making of a just return for the use of the property involves the recognition of its fair value if it be more than its cost. The property is held in private ownership, and it is that property, and not the original cost of it, of which the owner may not be deprived without due process of law.' . .
>
> "It is impossible to ascertain what will amount to a fair return upon properties devoted to public service without giving consideration to the cost of labor, supplies, etc., at the time the investigation is made. An honest and intelligent forecast of probable future values made upon a view of all the relevant circumstances, is essential. If the highly important element of present costs is wholly disregarded such as forecast becomes imposible."[30]

The minority opinion frankly advocates the repudiation of Smyth v. Ames and the substitution of the "prudent investment cost" for "fair value" as a

24. Missouri ex rel S. W. Bell Tel. Co. v. Pub. Service Comm., 262 U. S. 276, 43 S. Ct. 544, 31 A. L. R. 807.
25. McCardle v. Indpls Water Co., 272 U. S. 400, 47 S. Ct. 144.
26. San Diego L. & T. Co. v. Jasper, 189 U. S. 439, pp. 443-4.
27. Wilcox v. Consolidated Gas Co. 212 U. S. 19, pp. 51-2.
28. 169 U. S. 466, p. 547.
29. Missouri ex rel S. W. Bell Tel. Co. v. Pub. Service Commission, Supra.
30. 262 U. S. 276, pp. 287-8.

"rate base." It also attempts to demonstrate that the adoption of such "rate base"—the dissenting justices show some distaste for the word "value"—would not do violence to the due process clause of the 14th Amendment. As a brief for the prudent investment theory, the dissenting opinion is a masterpiece. The lawyer, however, will not forget that it is a dissenting opinion.

Less than thirty days after this decision was handed down, the decision in the Bluefield Water Works Case[31] and the Georgia Railway & Power Case[32] were handed down on the same day (June 11, 1923). The Bluefield opinion was written by Justice Butler, the Georgia Railway & Power opinion by Justice Brandeis. Justices Butler and Brandeis are both brilliant lawyers, but two men more different in temperament would be difficult to find. Justice Brandeis was fresh from the field of battle with his colleagues in the Southwestern Bell Telephone Case, and though outvoted, he was probably not convinced that his views as expressed in the dissent in that case were erroneous. What, therefore, is more natural than that Justice Brandeis should say in deciding the Georgia Railway & Power Case:

"The refusal of the Commission and of the lower court to hold that, for rate-making purposes, the physical properties of a utility must be valued at the replacement cost less depreciation was clearly correct."[33]

If he got any satisfaction out of this expressed repudiation of the reproduction cost theory as the sole measure of value in exchange for the refusal of the court to accept his prudent investment theory in the Southwestern Bell Telephone Case, the majority of the court did not begrudge him the satisfaction. This statement as a proposition of law was entirely sound and was in conformity with the opinion of the majority of the court. This was simply stating in other words what the court had said in Smyth v. Ames and in all of the cases following it on this subject. Indeed, Justice Brandeis supports this proposition by citing and quoting from the Minnesota Rate Cases,[34] Smyth v. Ames and Wilcox v. Consolidated Gas Co.[35]

Let it be noted further that in this opinion the court says:

"Here the Commission gave careful consideration to the cost of reproduction; but it refused to adopt reproduction cost as the measure of value."[36]

And again:

"The lower court . . . gave careful consideration to replacement cost."[37]

Also:

"The question on which this Court divided in the Southwestern Bell Telephone Case, supra, is not involved here."[38]

The somewhat satirical dissent of Justice McKenna in this case has furnished an occasion to those who have been zealous in trying to find inconsistencies in the decisions of the Supreme Court upon which to base an argument that upon similar facts the Court reached opposite conclusions in the Georgia Railway & Power Case and in the Bluefield Case. The majority of the court, however, saw sufficient differences in the facts to reach the conclusion that in the former case the "Commission gave careful consideration to the cost of reproduction," while in the latter case the Commission "did not accord proper, if any, weight to the greatly enhanced costs of construction in 1920 over those prevailing about 1915 and before the war, as established by uncontradicted evidence; and the Company's detailed estimate cost of reproduction new, less depreciation, at 1920 prices, appears to have been wholly disregarded. This was erroneous." [39]

The opinion of the state court in the Bluefield Case[40] shows clearly that in making the valuation in question, both the Commission and the West Virginia court accepted the original cost as qualified by the prudent investment idea as the measure of value. The court, after calling attention to the limitation of original cost by considerations of extravagant construction costs, or purchase at exorbitant or inflated prices if the history of the utility showed such facts, said:

"That original cost considered in connection with the history and growth of the utility and the value of the services rendered constitute the principal elements to be considered in connection with rate-making, seems to be supported by nearly all the authorities."[41]

It, therefore, appears in the Georgia Railway & Power Case that the Commission made an honest effort to arrive at value and gave (along with other evidence) "careful consideration to the cost of reproduction" but "refused to adopt reproduction cost as the measure of value." This the Supreme Court approved.

In the Bluefield case the Commission and the State Court adopted an historical original cost as the "principal" element in determining value as their working hypothesis. They gave lip service to fair value in the following language:

"After maturely and carefully considering the various methods presented for the ascertainment of fair value and giving such weight as seems proper to every element involved and all the facts and circumstances disclosed by the record."[42]

However, the fact that they gave consideration to present construction costs only for the purpose of rejecting them, appears from the Commission's report. They said:

"It, therefore, seems that when a plant is developed under these conditions (has kept accurate books) the net investment which of course means the total gross investment less depreciation is the very best basis of valuation for rate-making purposes and that the only other methods above referred to should be used only when it is impossible to arrive at the true investment."[43]

Neither the Commission nor the State Court gave proper, if any, weight to the greatly increased costs of construction of the valuation period and wholly disregarded the utilities' estimates of the cost of reproduction new, less depreciations. This, the court held, was error.[44] The Georgia Railway & Power Case rejects reproduction cost as the "measure of value" but recognizes its consideration as evidence of value. The Bluefield case rejects the original historical cost as constituting the sole or "principal" element of value and requires a "proper" consideration of reproduction cost as evidence of value.[45] Moreover, the Court in the Bluefield Case required more than a consideration of reproduction cost for the purpose of rejecting it because it conflicted with the theory of valuation used by the Commission and the State Court. "Proper" consideration of "greatly enhanced costs of construction" was required, namely, such consideration as is just and right to both the Public and the Utility un-

31. Bluefield Water Works Etc. Co. v. Pub. Serv. Comm., 262 U. S. 679, 43 S. Ct. 675.
32. Georgia Ry. & P. Co. v. Railroad Comm., 262 U. S. 625, 43 S. Ct. 680.
33. 262 U. S. 625, p. 630.
34. 262 U. S. 625, p. 630.
35. 262 U. S. 625, p. 631.
36. 262 U. S. 625, pp. 629-30.
37. 262 U. S. 625, p. 630.
38. 262 U. S. 625, p. 631.
39. 262 U. S. 679, p. 689.
40. Bluefield Waterworks etc. Co. v. Pub. Serv. Comm. 89 W. Va. 736; 110 S. E. 205.
41. 110 S. E. 205, p. 207.
42. 262 U. S. 679, pp. 688-9.
43. 262 U. S. 679, pp. 687-8.
44. 262 U. S. 679, p. 689.
45. 262 U. S. 679, pp. 689-90.

der all the facts in the case; a judgment factor to be sure, but a judgment fairly arrived at in the light of the facts. The court required a finding of present value not a finding of cost, less depreciation.

Such are the inconsistencies between the Georgia Railway Power Case and the Bluefield Case so much cultivated by interested advocates of particular theories of valuation.

The question remains, did the majority of the Supreme Court give its approval to reproduction cost less depreciation as either the sole, or as the dominant factor in determining value in the Indianapolis Water Co. Case.[46] Many utility attorneys have asserted this thesis in their efforts to induce commissions and other courts to apply reproduction cost less depreciation in the case then under consideration. Many writers who have been unwilling to accept the theory of Smyth v. Ames have been diligent in seeking for conflicts in the decisions of the Supreme Court as a ground work for their thesis that the question of a proper theory of valuation is still an open one. These writers have been quite willing, though actuated by different purposes, to go along with the utility attorneys in asserting that in this case the Supreme Court either (1) went over to the reproduction cost theory or (2) in substance accepted this theory by requiring that reproduction cost be accorded dominant consideration in arriving at value.

That the District Court was of the opinion reproduction cost should be accorded "dominating consideration" seems certain. Both the majority opinion [47] and the dissenting opinion[48] call attention to this fact. That the value of not less than $19,000,000 fixed by the District Court was materially less than reproduction cost less depreciation, plus value of water rights, working capital and going concern value as shown by uncontradicted evidence is equally certain.[49]

That the majority of the Court approved the valuation of $19,000,000, not because they approved the reasoning of the District Judge, but because the facts proved enabled the Supreme Court to say that the value of the property as of January 1, 1924 (the valuation date) was not less than $19,000,000 is likewise clear.[50]

The Commission in fixing a value on the water company's property adopted the estimate of the cost of reproduction less depreciation of its own engineer on the basis of the average prices of labor and material for the ten-year period ending with 1921. The two years immediately preceding the valuation date were eliminated from this calculation. With reference to this valuation, the Commission itself said:

"There is no doubt that the element of original cost has been recognized sufficiently. There is doubt as to whether or not the element of cost of reproduction new today has been given sufficient weight."[51]

The Court's statement of the controlling principles for the determination of value is in the following words:

"It is well established that values of utility properties fluctuate, and that owners must bear the decline and are entitled to the increase. The decision of this Court in Smyth v. Ames, 169 U. S. 466, 547, declares that to ascertain value 'the present as compared with the original cost of construction' are, among other things, matters for consideration. But this does not mean that the original cost or the present cost or some figure arbitrarily chosen between these two is to be taken as the measure. The weight to be given to such cost figures and other items or classes of evidence is to be determined in the light of the facts of the case in hand."[52]

Thus, it is seen the court in the Indianapolis Water Case reaffirmed Smyth v. Ames and specifically accepted the authority of that case as controlling. The court reiterated what it had so often said before—that fair value (1) does not mean the original cost, or (2) the present cost, or (3) some figure arbitrarily chosen between these two to be taken as the measure." The court declared again:

"The weight to be given to such cost figures and other items or classes of evidence is to be determined in the light of the facts of the case in hand."

The court goes on to illustrate under what conditions original cost constitutes a fair measure of value, and under what conditions present cost constitutes a fair measure of value of physical equipment. The court said:

"Undoubtedly, the reasonable cost of a system of waterworks, well-planned and efficient for the public service, is good evidence of its value at the time of construction. And such actual cost will continue fairly well to measure the amount to be attributed to the physical elements of the property so long as there is no change in the level of applicable prices. And, as indicated by the report of the Commission, it is true that, if the tendency, or trend of prices is not definitely upward or downward and it does not appear probable that there will be a substantial change of prices, then the present value of lands plus the present cost of constructing the plan, less depreciation, if any, is a fair measure of the value of the physical elements of the property."[53]

In any event, the task before the Commission and the courts was to ascertain the "property value" as of the valuation date, not its original cost nor the cost of reproducing it.

The court approved a valuation of not less than $19,000,000, not because the evidence showed that sum to be the cost of "spot" reproduction, but because the court found "on a consideration of the evidence . . . the value of the property as of January 1, 1924 (the valuation date) and immediately following was not less than $19,000,000." [54]

The dissent of Justices Brandeis and Stone in this case is not at variance with the majority opinion that neither original cost nor the present cost nor some "figure arbitrarily chosen between these two is to be taken as the measure" of value. Smyth v. Ames is cited in the dissent as a controlling authority. The erroneous conception of the lower court as to giving "dominating consideration" to evidence of "spot" reproduction, as heretofore mentioned, is severely criticized. But the real dissent is that the case should have been reversed and remanded for a new trial instead of the Supreme Court's examining the evidence and entering such judgment as to that court seemed right. The dissenting justices recognized the right of the Supreme Court to take the course of action which it did take, but differed from the majority as to the expediency of doing so. The substance of the dissent is found in this language:

"The evidence introduced before the trial court, which seems to be in substance the same as that introduced before the Commission, is now before this Court. We have power to examine the evidence and to enter such decree as may be appropriate. Compare Denver v. Denver Union Water Co., 246 U. S. 178. But the better practice requires that the case be remanded to the District Court, so that the evidence may be re-examined there in the light of the applicable rules (au-

46. McCardle v. Indpls. Water Co. 272 U. S. 400, 47 S. Ct. 144.
47. 272 U. S. 400, p. 418.
48. 272 U. S. 400, pp. 421-2 and note 1.
49. 272 U. S. 400, pp. 418-19.
50. 272 U. S. 400, pp. 420-21.
51. Commission's report as quoted 272 U. S. 400, p. 410.
52. 272 U. S. 400, p. 410.
53. 272 U. S. 400, p. 411.
54. 272 U. S. 400, p. 421.

thorities cited). To this end the decree should, in my opinion, be reversed."[55]

Had the principles controlling a proper valuation for rate-making purposes been an ordinary legal question, the repeated pronouncements of the Supreme Court would have been accepted as final by the profession long ago. But valuation of railways and utilities is not an ordinary question. The vast sums involved, alone, remove it from that category. The stakes are so tremendous that long chances are not to be unexpected. Furthermore, the parties in interest to such a controversy are not ordinary litigants. On the one side the public is the party in interest. On the other side, every railroad and every utility within the jurisdiction of the hearing tribunal is interested in the outcome. Such parties in interest in such a controversy are not easily deterred from trying once more in the hope of a somewhat more favorable decision the next time.

The Interstate Commerce Commission came to its herculean task of valuing the railroads of the country at a time of rapidly mounting prices. The railroads in these hearings strove to have reproduction costs given dominant consideration in determining value. The representatives of the public strove for the adoption of an historic or prudent investment cost. Both sides seemed to be blissfully innocent of the fact that the Supreme Court had in definite and certain terms repudiated the contentions of both. Both sides cited and quoted Supreme Court decisions to support theories that the cases cited repudiated in positive terms. Both entered the realm of abstract economics and tortured economic or pseudo-economic theories into ponderous and voluminous arguments in support of their respective views. The result was confusion. The controlling principles of law were lost sight of.

Unfortunately, the Interstate Commerce Commission found placed upon its shoulders the main burden of representing the interests of the public in this controversy. It likewise was required to sit as a tribunal for the determination of value. The Commission as an advocate espoused the cause of prudent investment cost and the Commission as a tribunal was convinced by its own argument as an advocate.

The O'Fallon Case[56] brought to the Supreme Court the Commission's theory of railway valuation for approval or disapproval.

The theory of valuation adopted by the Commission was substantially this: (1) All man-made property which was in existence June 30, 1914, was valued on the basis of cost of reconstruction at 1914 prices, less depreciation to valuation date. This basis was used as a means of arriving at a fair substitute for original cost as to this property, the facts as to actual cost not being available. (2) Like property installed between June 30, 1914, and June 30, 1919, was valued on the basis of 1914 construction costs less depreciation and there was added a sum representing price increases for that period—again a substitute for original cost. (3) Like property acquired between June 30, 1919, and valuation date was put in at original cost less depreciation. (4) Land was valued as of the valuation date.[57] Thus, it will be seen that the Commission adopted as to all man-made elements of the railway, the nearest possible approach to original cost as the sole factor in determining value. Satisfactory evidence of actual original costs was not available and the Commission adopted the above method of finding a figure which substantially represented original cost, less depreciation to valuation date of these items.

A large portion of the opinion of the Commission is devoted to a brief in support of the prudent investment theory of valuation for rate-making purposes as superior to the reproduction theory.

The theory of valuation contended for by the Commission is clearly at variance with the law as declared by the Supreme Court. The majority of the Court is clearly borne out by the fact in holding that reproduction costs of the man-made property of the railway as of the valuation date, were not given any consideration by the Commission in fixing its value.

To students of valuation who were neither advocates of interested parties nor devotees of an economic theory which they felt it their duty to further, the outcome of the O'Fallon Case was never in serious doubt. The majority opinion asserts no new principle of law. It simply reasserts that original cost, or some synthetic substitute for original cost, is not the sole measure of value. That construction costs at the date of the valuation must not be ignored. The majority of the court find, as to all man-made items of the O'Fallon property, the Commission refused to give consideration to current reproduction costs; that the question presented for decision was not how much weight should be given to current reproduction costs but whether or not such costs must be given consideration at all. The following from the majority opinion is the kernel of the opinion:

"The question on which the Commission divided is this: When seeking to ascertain the value of railroad property for recapture purposes, must it give consideration to current, or reproduction, costs? The weight to be accorded thereto is not the matter before us. No doubt there are some, perhaps many, railroads the ultimate value of which should be placed far below the sum necessary for reproduction. But Congress has directed that values shall be fixed upon a consideration of present costs along with all other pertinent facts; and this mandate must be obeyed."[58]

The minority opinion of Justice Brandeis, in which Justices Holmes and Stone concurred, demonstrates with great clearness that Justices Brandeis, Holmes and Stone are not in sympathy with the principles of valuation adopted by a majority of the court. It is a masterful restatement of the arguments of the prudent investment theory. However, it must not be overlooked that, while still unconvinced of the wisdom of the majority, the minority do recognize the authority of the principle that value for rate-making purposes is present actual value; that current reconstruction cost is evidence to be considered in ascertaining present value; and that the Commission may not arbitrarily disregard the probative effect of evidence. The dissenting opinion says:

"The Commission undertook, as will be shown, to find present actual value, and, in so doing, both to follow the direction of Congress and to apply the rule declared in the Southwestern Bell Case."[59]

And again, the dissenting opinion says:

"An arbitrary disregard by the Commission of the probative effect of evidence would, of course, be ground for setting aside an order, as this would be an abuse of discretion."[60]

This dissent further states:

"The fundamental question in the Southwestern Bell Case was one of substantive constitutional law, namely: Is the rate base on which the Constitution guarantees to a public utility

55. 272 U. S. 400, pp. 424-5.
56. St. Louis & O'Fallon Ry. Co. v. U. S. et al, 279 U. S. 461, 49 S. Ct. 384.
57. 124 I. C. C. 37; 49 S. Ct. 384, p. 388.
58. 49 S. Ct. 384, p. 388.
59. 49 S. Ct. 384, p. 390.
60. 49 S. Ct. 384, p. 390.

the right to earn a fair return the actual value of the property at the time of the rate hearing, or is it the cost or capital prudently invested in the enterprise? The court decided that the rate base is the actual value at the time of the rate hearing. That proposition of substantive law the Commission undertook to apply to the facts presented in the case at bar. Recognizing that evidence of increased reconstruction costs is admissible for the purpose of showing an actual value greater than the original cost or the prudent investment, it found in respect to some of the carrier's property that the evidence of enhanced reconstruction cost was persuasive of higher present value. As to the rest of the property, it held that the evidence was neither adequate nor persuasive.

"Of both railroads and the local utility it is true, under the rule of substantive law adopted in the Southwestern Bell Case, that value is the sum on which a fair return can be earned consistently with the laws of trade and legal enactments."[61]

Thus, it is seen that this minority opinion does not dissent from "the rule of substantive law adopted in the Southwestern Bell Case, that value" and neither current reproduction cost nor prudent investment cost is the legal rate base.

The court divided on the question as to whether or not the Commission did in fact give proper consideration to current reproduction costs in making its valuation, not on the controlling principles of substantive law.

The minority, while admitting that the Commission declined to give weight to the evidence introduced to show current reproduction costs greater than those of 1914, as to structural property and equipment acquired prior to June 30, 1914,[62] were of the opinion that the Commission gave sufficient consideration to the requirements of the substantive law by valuing land at current prices and by giving to additions and betterments made after June 30, 1914, "a value approximating their cost less physical depreciation."[63] The minority seem in their zeal to support the Commission to overlook that there was no difference in the theory of valuing all structural property and equipment acquired before June 30, 1914, and such property acquired after that date. The Commission adopted the same theory as to both, namely: prudent investment. They used actual costs after June 30, 1919, as the books were available. They used 1914 cost estimates equated to the estimated time of construction basis for additions between June 30, 1914, and June 30, 1919. They used 1914 estimates unequated for structures and equipment made and acquired before June 30, 1914, because: "The Commission had before it 'the cost of reproduction new of the structural portion of this property estimated on the basis of our 1914 unit prices, coupled with the knowledge that costs of reproduction so arrived at were not greatly different from the original costs'."[64] The only property in the valuation of which the Commission gave weight to current prices was naked land value.

This clearly was not a compliance with the requirements of the statute which required "due consideration to all the elements of value recognized by the law of the land for rate-making purposes."[65]

The minority opinion is patently a brief in support of an economic theory which the majority of the court had theretofore refused to accept as law. It, in effect, admits that its theory has been rejected by the court as in violation of the Federal Construction. But, it seeks to trade a lip service to the admitted, established, substantive law for the practical adoption of its rejected theory.

61. 49 S. Ct. 384, p. 405.
62. 49 S. Ct. 384, p. 407.
63. 49 S. Ct. 384, p. 407.
64. 49 S. Ct. 384, p. 407.
65. Sub. 4 Sec. 15a Transportation Act, 49 U. S. C. A., pp. 443-4.

Were the dissent in this case less ably stated, or were it not sponsored by three very able jurists for whose learning and high-mindedness the profession entertains the greatest respect, the inconsistency between the principles of law admitted therein and the result sought to be reached would be obvious. The recognition of the principle that an arbitrary disregard of the probative effect of evidence by the Commission is ground for reversal of the Commission's order; that the Southwestern Bell Telephone Case and the Indianapolis Water Case contain a binding statement of the substantive law in respect to valuation; coupled with an earnest argument that the Commission, under the economic conditions prevailing in 1920, 1921, 1922 and 1923 as disclosed by the evidence in this case, could comply with the law by receiving evidence of current reconstruction cost for the sole purpose of rejecting it without giving any weight to it, as to all the structural property and equipment of a railroad, requires great courage.

We venture the suggestion that those of the profession who approach this decision with open minds rather than as advocates either of an interested litigant or of a preconceived economic theory will have little difficulty in agreeing that the majority opinion is soundly reasoned.

Through economic depression, normal times, and economic inflation, the Supreme Court has steered a straight course, uncontrolled by the clamor of contending parties seeking for temporary advantage. It has adhered to the view that railroads and utilities were private enterprises engaged in services for the public. That the rights of both the owners and the public, as declared by law, must be protected. That the protection which the owners are entitled to is a fair return on the fair value of their property devoted to the public use. That fair value for rate-making purposes must be ascertained as of the time under investigation. That fair value is synonymous with neither original cost nor the current cost of reproduction. It is maintained that both original cost and present cost of reproduction are competent evidence of value to be considered along with all other competent evidence. That each bit of evidence, whether original cost, reproduction cost or other competent evidence, must, in determining value, receive such consideration as under the circumstances of the case is right and proper in arriving at a true fair value. That any evidence in determining value must be given due consideration in the light of the circumstances of the case under investigation and that an arbitrary disregard of evidence having probative value is error.

The Supreme Court has not prescribed any formula for ascertaining fair value nor attempted to control the exercise of a proper judgment on the part of the trying tribunal. It has, however, insisted that the trying tribunal ascertain fair value as of the time under investigation. It has insisted that all competent evidence offered be received and that evidence having probative value be not arbitrarily ignored.

In this fruitful field of litigation, the Supreme Court has been singularly consistent for more than thirty years in adhering to these controlling principles of valuation. Litigants have not hesitated to exchange valuation theories to conform to economic advantage. It will be interesting to watch the effect of the next economic depression on both the theories of the present advocate of reproduction cost and those of the present advocates of prudent investment cost.