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THE MEANING OF PRESENT VALUE AS PUBLIC UTILITY RATE BASE

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When the United States Supreme Court, in *Munn* v. *Illinois*,[1] decided that property devoted to a use in which the public had an interest was subject to regulation for the common good, it opened up a field of inquiry whose exact boundaries, even after more than fifty years of judicial utterance upon the subject, have not yet been defined. That this power of public control is somewhere limited by the constitutional guaranty of immunity from confiscation of property without due process of law, was settled in *Chicago, Milwaukee & St. Paul Railway Company* v. *Minnesota*.[2] The privilege of a public utility to earn a fair return on the value of its property used and useful in furnishing the service is protected by the courts, in that wherever, by the exercise of regulation, a state so reduces the rate of return that it is no longer 'fair' in relation to the value of the property, such act is confiscatory and void.

The history of public utility valuation for rate making purposes dates from the case of *Smyth* v. *Ames*,[3] decided in 1898. In that case Mr. Justice Harlan, speaking for an undivided court, stated the 'rule' by which the constitutional limitations upon the rate making power might be judged.

> "We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged must be the fair value of the property being used for the convenience of the public. And in order to ascertain that value the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates

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1 94 U. S. 113 (1876).
2 134 U. S. 418 (1890).
3 169 U. S. 466 (1898).

> prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case."

Inasmuch as every rate case since 1898 has quoted and purported to apply the rule in *Smyth* v. *Ames,* it is a matter of first importance to attempt to get some idea of what the rule means and how it is supposed to work. Seven elements in valuation are stated, with the direction that each is to be 'taken into consideration' and 'given such weight as may be just and right in each case.' Does this mean that, so long as the tribunal has permitted the introduction of evidence on each element and avowedly has 'considered' them all, there has been due process, even though it is obvious that the valuation fixed must have been arrived at through the application of one alone? In other words, is the judgment of the rate making body final, under the rule of *Smyth* v. *Ames,* as to the amount of weight to be given a particular element? In the *Minnesota Rate Cases*[4] it was stated by Mr. Justice Hughes, that "the ascertainment of that value is not controlled by artificial rules. It is not a matter of formula, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts." But whose judgment is to be taken? The supreme court of Wisconsin, in *Waukesha Gas Company* v. *Railroad Commission,*[5] was much puzzled by the interpretations given the rule of *Smyth* v. *Ames* by the United States Supreme Court. The Wisconsin court expressed its wonder whether "the mere assertion by commissions and courts that they have considered the cost of reproduction new is sufficient to conclude the appellate court," and states its belief to the effect: "It cannot be that mere repetition of a legalistic formula before the declaration of the trial court's final determination is sufficient to bless and sanctify the result, no matter what it might be." It does not seem, from the opinions in the Southwestern Bell Telephone Case and the Georgia Railway Case, that the judgment of the rate commissions can be taken to be final; but the one proposition at least is clear

[4] 230 U. S. 353 at 434 (1913).
[5] 181 Wis. 281, 194 N. W. 846 (1923).

that refusal to hear testimony as to the various elements of value is of itself reversible error. We shall later consider these cases in detail on the requirements of the rule in *Smyth* v. *Ames*. It will be sufficient at this point to outline the possible ways in which the rule might be interpreted. These are:

1. That the rule of *Smyth* v. *Ames* is only evidentiary, declaring the elements of value which are to be considered, and that refusal to hear testimony bearing thereon is error.

2. That the elements of value named are to be given equal weight, and the ultimate valuation to be a composite or average of all.

3. That a single element of value may be made the controlling and sole basis of valuation, to the exclusion of all others, so long as all were 'considered,' and a deliberate judgment exercised.

4. That certain elements of value are to be given more weight than others, according to what is 'just and right in the particular case.'

   (1) That in fixing the proportion between the weight accorded the several elements, the judgment of the rate making body is to be conclusive.

   (2) That the judgment of the rate making body is subject to review by the courts on the question whether the degree of weight accorded a particular element is proper.

In addition to these there is the further possibility that *Smyth* v. *Ames* has been overruled, and that some one definite valuation base is now controlling.

Of the several elements suggested in the Smyth Case, only two have emerged as seriously contested bases of valuation. These are: (1) reproduction cost of the properties, and (2) actual or original cost. Under the Smyth rule, a rate making body is free to adopt both, if that is possible. Whether it may, or must, choose one to the exclusion of the other, is

our present problem. Also it is to be noted that whenever there is a large differential between present and past general price level, the use of reproduction cost as a valuation base will produce a resultant 'present value' radically different from that reached by the use of original cost method. Therefore, in considering the cases two questions are to be kept in mind:

1. Is there one, definite, standard of rate base? In other words, of the several possible methods of determining present value, has any one become controlling?

2. Is there a relation between change in price level and the method of rate base determination favored at the particular time by the court?

In the *Smyth* v. *Ames* Case, the Supreme Court held that fair present value was the correct rate base, but the meaning of "fair present value" and the means by which it might with some degree of certainty be ascertained, were not pointed out. The concept was as undefined as the test of a business "affected with a public interest." Present value means nothing *in vacuo*. It is not synonymous with present cost, nor with original cost, although it might become so for either were the Supreme Court to adopt one or the other as its sole means of ascertainment. Present value is only another word for rate base, and its method of determination is yet in doubt. Were the court to establish the proposition that present reproduction cost is the proper, and only, method by which present value in the rate making sense is to be fixed, then the meaning of present value and reproduction cost would be identical. And similarly as to original cost. But until something like this has happened, it is difficult to see how the statement that "present value is the proper rate base" can mean more than empty repetition.

During the final ten years of the nineteenth century, price level had reached low ebb. Following the panic of 1893, price depression came to a maximum about the date of the decision in *Smyth* v. *Ames*. It therefore was not surprising to find the railroad and utility interests arguing for original cost as represented by capitalization as the proper base to

fix rates. Similarly, on behalf of the public, the adoption of present replacement cost as to measure or evidence of present value was urged. From the beginning the tendency was undoubtedly away from investment as the measure. The case of *Steenerson* v. *Great Northern Railway*[6] decided during this period of price depression, expresses the trend at the time. In this case, the investment theory, and capitalization upon earnings as well, were urged upon the court. It emphatically rejected both, and also the amount of stocks and bonds.

> "The material question is not what the railroad cost originally, but what it would cost to reproduce it. The rights of the bondholders are no more and no less sacred than the rights of other property holders. If the road was built when iron rails cost $85 per ton and everything else in proportion, and now steel rails cost only $16 per ton, if it cost $40,000 a mile to build the older portions of the road when last year as good a road was built for $12,000, that is the misfortune of the owners who paid the higher prices. The state does not guarantee the investor in a railway more than in other property. The cost of reproduction must be estimated on a present cash basis."

In *San Diego Land Company* v. *National City*[7] and *San Diego Land Company* v. *Jasper*,[8] both cases decided during the low price level, the utility contended for original cost as the rate base. In the former case, Mr. Justice Harlan upheld the opinion of the lower court that it is the actual value of the property at the time the rates are to be fixed, and not its cost, that should form the basis on which to compute rates. In the Jasper Case, Justice Holmes said:

> "It is no longer open to dispute that under the Constitution what the Company is entitled to demand, in order that it might have just compensation, is a fair return upon the reasonable value of the property at the time it is being used for the public. *San Diego Land Co.* v. *National City.* That is decided, and is decided against the contention that you are to take the *actual*

[6] 69 Minn. 353 (1897).
[7] 174 U. S. 757 (1898).
[8] 189 U. S. 439 (1902).

> *cost* of the plant, cost of operation, annual depreciation, and a fair profit to the company over and above such charges by way of interest on the money expended. Yet the only evidence of a higher value in this case, is the original cost of the work. . ."

The Commission fixed the valuation at $350,000, on the basis of replacement cost. The company was permitted to introduce evidence of original cost by which it claimed a valuation of $1,000,000, but the Commission exercised its judgment to give controlling weight to the lower reproduction cost factor, and the Supreme Court held the rate fixed not confiscatory, saying: "No doubt original cost may be considered, but in the present case it has no importance."

The period from 1900 to 1910 marked a gradual but steady increase in general price level, and toward the end of the decade the effect of the increase began to be noted in rate valuations. The case of *Wilcox* v. *Consolidated Gas Company,*[9] decided in 1909, involved the 80 cent gas rate fixed by the New York legislature. Although the issue of original versus replacement cost was not directly discussed in the opinion, yet the language used by Mr. Justice Peckham to the effect that "the value of the property is to be determined as of the time when the inquiry is made concerning rates," shows the insistence upon giving weight in the valuation to present costs. The court seems already to foresee the situation not far ahead in which the enormous increase in property valuation might make the present cost element impossible as the controlling element in fixing a rate base, and paves the way for an exception "where the property may have increased so enormously in value as to render a rate permitting a reasonable return upon such increased value unjust to the public."

Such impossible situations soon arose as prices appreciated, a good illustration being *in re Advances in Rates —The Burlington Claim of Legal Right,* 1911.[10] The contention was that the road was entitled "as a matter of legal right to a fair return upon the actual value of its property

[9] 212 U. S. 153 (1909).
[10] 20 I. C. C. Rep. 307 (1911).

used for transportation, which value . . . is measured by the cost of presently reproducing its physical plant." It represented that the Burlington road cost those who built it $258,000,000, that it would cost to reproduce it $530,000,000, to which should be added some amount for going-concern-value, and a further amount for franchise rights; that this belongs to the owners and they are entitled to a fair return upon it. Although more than $270,000,000 of this sum did not represent the investment of a dollar by the owners, and the road was earning 18 per cent dividends on the stock besides paying all interest on the bonds, yet it sought permission to raise its rates on the ground that they provided an insufficient return on the actual fair value of the road. These contentions the Interstate Commerce Commission refused to approve. In the Minnesota Rate Cases,[11] the Supreme Court approved the Smyth rule as to the consideration of all elements, and definitely refused to make reproduction cost the sole test of value nor even to consider it at whatever point its results would lead to values the court considers not fair. And as far as the present prospect goes, so it will be in most railroad rate cases.

The *Des Moines Gas Company* Case,[12] decided in 1914, did not involve the question of an alternative between reproduction cost and actual cost, for the master found the rate fixed not confiscatory on the basis most favorable to the Company, namely, reproduction cost. He arrived at the valuation by finding what it would cost to produce a similar plant new at the time of the rate hearing; to this he added overhead charges, 15 per cent, $300,000, and from the total deducted $330,000 depreciation, leaving the value as rate base of $1,937,000. In this as in all preceding cases, the judgment of the commission as to valuation was upheld.

No very definite conclusions on valuation and a definite meaning for the rule in *Smyth* v. *Ames* can be drawn from any one, or all, of the rate cases decided by the Supreme Court during the twenty years after 1900. Present value is to be taken as the rate base, but its method of ascertainment yet remains judgment and not rule. Conceivably present

[11] 230 U. S. 353 (1913).
[12] 238 U. S. 153 (1915).

value may be determined (1) by taking the historical cost and adding thereto cost of subsequent improvements, increase in property values, overhead, and going value; or (2) by estimating what it would cost to reproduce a similar plant and organization at present prices. The debate between reproduction cost and actual cost methods of ascertaining present value was now on in good earnest, the tremendous increase in prices due to the war making it a really vital matter.

In 1921 the case of *Galveston Electric Railway* v. *City of Galveston*[13] came before the Supreme Court. The city commission had fixed fares at five cents in 1919, and after operating under the rate for eleven months the company brought a bill for injunction in the federal court. The matter was referred to a master, who found the rate confiscatory; but he was overruled by the lower court, which upheld the rate. On appeal, the United States Supreme Court affirmed the decree declaring the rate not confiscatory. In this case the method of ascertainment of present value was not reproduction cost at present prices, but estimated original cost plus thirty-three and one-third per cent in recognition of the higher price level. Specifically, the method used was to take the estimated historical cost of reproduction as of 1913 when the plant was built (prudent investment method), and add thereto the difference between that price level and a prophesied future price level which was called the "future plateau of prices." The price level at the time of the hearing (1921) was 100 per cent above what it had been in 1913; the company's expert testified the future price level when stabilized would be 70 per cent above 1913; the master, that an increase of one-third would be fair, and the court adopted the latter estimate. Therefore the rate base was made by taking the amount of money which would have been necessary to build the plant in 1913, adding one-third to that sum, and then deducting depreciation. Mr. Justice Brandeis delivered the opinion for an undivided court. Since the increase in price level was recognized and some weight given to replacement cost, all members of the court were in accord on the decision

[13] 258 U. S. 388 (1922).

that the valuation was proper, the matter of proportion seeming to lie within the judgment of the rate making body.

Of all rate cases, one of the most interesting is *Southwestern Bell Telephone Company* v. *Missouri Commission*,[14] decided May 21, 1923. In this case the Commission had found present value by a partial estimate of the original cost of the properties less depreciation. Here for the first time in rate valuation, the Supreme Court divided on the issue of reproduction cost against original cost, a minority opinion being filed by Mr. Justice Brandeis in which Mr. Justice Holmes concurred. Also, in this case for the first time since *Smyth* v. *Ames*, the Supreme Court declared void a rate order of a state commission on the ground that the finding of the rate base, or value, was too low. Mr. Justice McReynolds, who wrote the opinion for the majority, said:

> "Obviously the Commission undertook to value the property without according any weight to the greatly enhanced cost 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 at 45 to 50 per cent."

The error of the Commission clearly was that it failed to give any weight to present reproduction cost, or to recognize the higher price level, as was done in the Galveston Case. It seems fairly well settled that had they done so, even though a lesser percentage was by their judgment allowed, the court would have upheld the rate. Some weight must be given present replacement cost; although at that time the determination of how much seemed to lie within the discretion and judgment of the rate making body.

The minority opinion points out all of the difficulties, weaknesses, and defects of the reproduction cost method of valuation, and presents the strongest of cases for the original cost method, or rather, the prudent investment method. From the standpoint of content, compactness, and terse statement of all the voluminous arguments elsewhere written on the subject, the opinion is memorable. Justice Brandeis

[14] 262 U. S. 276 (1923).

and Holmes dissented from the opinion of the majority, disagreeing that reproduction cost should be permitted longer to be even an element in valuation, and urged prudent investment as the sole element; but they concurred in the judgment that the rates were confiscatory, even on original cost. It is to be particularly noted that in this case although the higher price level was at least 50 per cent in advance of that at the time the plant was built, yet the majority opinion only added about 25 per cent to the investment in setting up a valuation on which to judge the adequacy of the rates. At most, therefore, only equal weight was given to reproduction cost as to the actual cost of the properties. It would seem that reproduction cost had not yet become the only factor in valuation, that the insistence was upon some weight and recognition being given to it, and that the matter of proportion still lay within the judgment of the rate making body. On the point that in this case for the first time the judgment of the rate tribunal was set aside by the court and the rates declared confiscatory, note that apparently the rates fixed by the commission were inadequate on any basis of valuation, even original cost, since the minority contending for that method agreed with the decision that the rates were confiscatory.

The case of *Bluefield Water Company* v. *West Virginia Commission*[15] closely parallels the Southwestern Bell decision. Here also the commission's valuation was held confiscatory for the reason that no weight was given to the present replacement cost factor, and that even on original cost basis the rates fixed were too low to secure a fair return.

The case of *Georgia Railway* v. *Railroad Commission,*[16] decided June 11, 1923, the same day of the decision in the Bluefield Case and within a month after the Southwestern Bell decision, presents some difficulties. Here the gas rate for the city of Atlanta had been reduced from $1.65 to $1.55 per M by the Commission, and the rate was attacked by the

[15] 262 U. S. 679 (1923).
[16] 262 U. S. 625 (1923).

company as confiscatory. The federal district court sustained the rate, and the Supreme Court, contrary to its action in the Southwestern Bell and Bluefield Cases, upheld that decision. The commission took, as its measure of ascertaining present value, reproduction cost as of 1914, instead of present reproduction cost (as of 1921) when the price level was about 70 per cent higher. It found a valuation of 5¼ millions as compared with the company's present reproduction cost claim of 9½ millions. It did, however, allow for increased values to the extent of adding $125,000 to represent the appreciation in land values. Mr. Justice Brandeis, who it will be remembered wrote the minority opinion in the Southwestern Bell Case condemning reproduction cost method, delivered the opinion of the court upholding the rate. He distinguished the case from Southwestern Bell no further than by saying:

> "Here the commission gave careful consideration to the cost of reproduction; but it refused to adopt reproduction cost as the measure of value. It declared that the exercise of a reasonable judgment as to the present fair value required some consideration of reproduction costs as well as original costs, but that 'present fair value' is not synonymous with 'present replacement cost,' particularly under abnormal conditions. . . . *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.*"

The opinion in this case makes it clear that there is still no one method by which present value must be ascertained; that all elements and methods of valuation must receive consideration by the rate making body, but that if, upon due consideration, that tribunal exercises its judgment to give greater weight to one than to another, then, at least so long as it gives some weight to each, its judgment as to valuation will not be disturbed. It will be remembered that this case was decided during a shifting price level period. Here the commission gave effect to increased values only to the extent of the appreciated value of the lands, $125,000.

Assuming the 9½ millions to be the correct reproduction cost figure, and 5¼ millions the original cost, the addition of the $125,000 to the latter would amount according weight of only 1/33 to reproduction cost, whereas 32/33 weight was accorded original cost. Yet the Supreme Court upheld the valuation.[17] What is the explanation of the different result reached in the Bluefield Case? The method of valuation was identical, both cases were decided on the same day; the only difference is that in the latter case *no* weight was given present or reproduction cost, whereas in the Georgia Case 1/33 of the total weight was given to higher present cost as represented by the $125,000 added for appreciated land values. Evidently it is enough that some weight be given; the matter of proportion seems to lie within the judgment of the rate commission.

We now come to the last of the extraordinary series of cases decided since 1920, the case of *McCardle* v. *Indianapolis Water Company*,[18] decided November 22, 1926. This case is heralded with complete confidence by certain commentators[19] as "sounding a declaration of the amount of consideration to be given the reproduction cost element." It "appears to be a whole-hearted adoption of the cost of reproduction theory, eliminating entirely the other elements specified for consideration in *Smyth* v. *Ames*. Now the cost of reproduction is to be dominant, we are brought safely from the sea of uncertainties, closer to rules and regulations, and farther away from 'judgment and discretion.'"

The valuation found by the Commission of the water company's properties upon which it fixed the rate complained of, was in round numbers $15,000,000. The federal district court enjoined enforcement of the rate on the ground that it was confiscatory, and found a valuation of $19,000,000. On appeal to the United States Supreme Court, that body, in an opinion written by Mr. Justice Butler, affirmed the decree,

[17] Note: In the Georgia Case, Mr. Justice McKenna filed a dissent extremely ironical in character, on the basis of the Bell and Bluefield Cases; between which and the present case he is unable to distinguish. He finds special grievance in the fact that "no attempt was made to distinguish this case and the Bluefield Case."

[18] 272 U. S. 400 (1926).

[19] "Pub. Utility Valuation for Rate Making Purposes," 26 MICH. L. REV. 89.

and declared that upon the evidence the present value of the property was not less than $19,000,000, and that upon that valuation the rate was confiscatory and void.

Of this case, of which so little may be said with comfortable assurance, we may make the following statements:

1. Neither original cost, nor reproduction cost, alone, was either "dominant" or "controlling." Neither was made the sole measure of valuation; both were given some weight. Present reproduction cost of the bare physical properties was by the Commission's (p. 418) $19,500,000, exclusive of going value and water rights valued at $2,000,000, which totals at lowest $21,500,000. Original cost was stated by the Commission (p. 419) to be "12 to 20 per cent less than the $15,000,000 valuation taken by that body as the rate base and disapproved in the decree. The situation is:

Present reproduction cost	$21,500,000
Original cost	$13,000,000
Valuation by Commission	$15,000,000
Valuation by Court	$19,000,000

2. More "weight" was in this case given to reproduction cost than to original cost, in that the valuation figure lies nearer the amount of the former than it does to the latter; but neither was identified with value. Indeed, Mr. Justice Butler denies that reproduction cost is to be considered dominant or controlling method of valuation, citing *Smyth* v. *Ames* and saying: "While some expressions of the district judge indicate that he was of the opinion that dominant or controlling weight should be given to cost of reproduction based on spot prices, it is clear that the $19,000,000 fixed by him as the minimum valuation could not have been arrived at on that basis."

3. The reason for the emphasis here upon the reproduction cost element is that in the opinion of the court the differential between present settled price level and historical cost at time of construction had in this case

become so great that the worth of the latter as evidence of present value is relatively less.

4. The Commission's valuation was declared bad, not because it failed to use present reproduction cost as its sole measure of value, but for reasons as follows:

   (a) "The price level adopted by the Commission—the average for ten years ending with 1921—was too low. It should have taken into account the high level of prices prevailing in 1922 and 1923 in finding value as of January 1, 1924." (p. 412)

   (b) "The average of prices (for the ten year period ending 1923 which the Commission should have taken) was shown by the Commission's engineer to produce a result 14 per cent higher than the figure adopted." (p. 411).

   (c) "Commission's reduction from $1,416,000 to $980,000 for water rights and going value was not justified and is error." (p. 415).

   (d) "The deduction made for depreciation is not proper in kind, and cannot be approved, since it was not based on an inspection of the properties, but was the result of a straight line calculation based on age and the estimated or assumed useful life of perishable elements." (p. 416).

On a fair analysis of the McCardle Case it does not seem that the rule of *Smyth* v. *Ames* has been departed from. Reproduction cost has not been made synonymous with present value, but, like original cost, it yet remains no more than one of the factors to be considered in determination of the rate base. A relatively permanent and stabilized higher price level will operate to influence the relative weight given the several factors, but that is a far different thing than that reproduction cost has become identified with present value.

The cases from 1920 to 1927 present an interesting study in the conflicting points of view of the several justices of the Supreme Court on the matter of rate base. McReynolds, Butler, and McKenna on the one hand emphasize the replacement cost factor, while Brandeis, Holmes, and Stone, on the other, hold original cost as of first importance. In

the Southwestern Bell Case, the majority opinion is written by McReynolds, the court continuing its policy of fixing present value after consideration of all of the factors. The minority opinion is written by Brandeis, with whom Holmes concurs, and therein prudent investment as the only proper measure of present value is strongly urged. In the Bluefield Case, Mr. Justice Butler delivered the opinion of the court, and the rate base here, as in the Bell Case, was declared confiscatory, quite evidently because no weight had been given the reproduction cost factor. Here again Mr. Justice Brandeis dissents from the reasoning of the majority, and on the same grounds, although he is again concurring with the judgment. In the Georgia Railway Case, decided the same day as the Bluefield Case, it is Mr. Justice Brandeis who writes the opinion for the majority, upholding the rate. Quite unexpectedly, Justices McReynolds and Butler are with the majority, they evidently endorsing Brandeis' statement that: "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." Mr. Justice McKenna here files a dissent in the interest of consistency, he being unable to distinguish this case from the Bluefield Case. Then when we come to the McCardle Case, the pendulum has swung back, the rate is declared confiscatory, and it is Mr. Justice Butler who delivers the majority opinion, emphasizing reproduction cost in terms stronger than can be found in any previous case. Mr. Justice Brandeis writes a vigorous dissent in which he is joined by Mr. Justice Stone. Holmes concurs in the result, but not in the reasoning by which it is reached.

Two statements of the Supreme Court, one in the Georgia Case, and the other in the McCardle Case, are very frequently cited as standing for two different propositions. Proponents of the original cost theory, in support of their position, quote the following expression from Mr. Justice Brandeis' opinion in the Georgia 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."

Reproduction cost adherents, on the other hand, and also those who are urgent for a "definite" rule on valuation, quote the following phrase from Mr. Justice Butler's opinion in the McCardle Case to show that the Supreme Court in this latest decision has identified reproduction cost with present value:

> "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 reconstructing the plant, less depreciation, if any, is a fair measure of the value of the physical elements of the property."

We have already considered the actual results reached in the two cases; it remains to analyze these expressions with a view to discovering whether they actually are commitments on either method of valuation. Paraphrased, Mr. Justice Brandeis' statement amounts to this:

> *The Commission may, properly, refuse to hold that reproduction cost is the equivalent of present value for rate making purposes.*

Similarly, Mr. Justice Butler's statement in the McCardle case,

> *The Commission may, where price level is stabilized, hold that reproduction cost is a fair measure of present value for rate making purposes.*

If these are fair interpretations of the two statements, then all inconsistency in the Court's attitude disappears, for it is saying the same thing in both cases, and the same thing it has always said since *Smyth* v. *Ames,* namely, that it is within the judgment and sound discretion of the rate making body to give "such weight to the several elements of value as may be just and right in each case." The tribunal may refuse to find the rate base by reproduction cost,

(Georgia Case), or, where price level is stabilized, it may (if in its judgment it deems that method just and right in the case under consideration) adopt the reproduction cost figure as the rate value (McCardle Case). It is submitted that neither expression of the Supreme Court states what the rate body *must* do.

It is not within the scope of the subject of this paper to go into the relative merits or defects of the debated methods of rate valuation. Our problem is whether or not there has developed within the thirty years of judicial interpretation of the rule in *Smyth* v. *Ames* any one, definite, standard of rate base. We conclude there has not. The matter of determination of present value for rate making purposes still remains a matter of judgment and not of formula; the several elements must receive due consideration and be given "such weight as may be just and right in each case."

The consistent refusal of the Supreme Court to adopt any one method of valuation, its insistence that all be considered, seems, in view of recent developments in the railroad rate problem, the most fortunate thing that could have happened. Had the Court departed from the principle of *Smyth* v. *Ames,* and identified reproduction cost with rate base, it would be already committed to a decision in the case of *Excess Income of St. Louis & O'Fallon Railway Company,* now pending, the result of which decision the Interstate Commerce Commission has declared would be "nothing short of a public calamity."[20] In 1920, the time of the general railway rate increase, the aggregate value of property used for transportation purposes was taken by the Commission to be eighteen billions of dollars based on 1914 price level. As pointed out by the Commission in its report on the O'Fallon Case,[21] had the cost of reproduction theory been used, the value of the same property would have been over forty-one billions—an increase of twenty-three billions of dollars on which the public would have been required to pay a fair return. An impossible valuation—impossible because rates based thereon would be more than the traffic would bear. Increasing rates beyond a certain point inevitably

[20] 124 I. C. C. Rep. 3, at p. 53 (1927).
[21] *Ibid.,* at p. 53.

means diminishing, rather than increasing, returns. As to many commodities, transportation rates already have reached what might be called the efficient maximum.

If in its decision of the O'Fallon Case the Supreme Court should declare that the fair value of the railroads for purposes of recapture and of rate making must be determined by reproduction cost, the result would be tantamount to an abolition of rate regulation. Although accurate figures for total valuation of all railroads and utilities by reproduction cost are unknown, still the approximation reached by the Commerce Commission is that, "In the case of railroads and public utilities the current cost of reproduction doctrine would probably increase the public burden by upwards of $30,000,000,000."[22] With the rates at present in force already approaching efficient maximum, based for the most part, at least as to railroad property, on original cost, it is not difficult to predict that a thirty billion dollar increase in rate base would be to raise the maximum beyond what the traffic will bear. Such rate regulation as would exist thereafter must inevitably lie in the realms of pure theory.

It is extremely doubtful that the Supreme Court in the O'Fallon Case will insist that controlling weight be given reproduction cost. It may be that, like the district court,[23] it will ignore the whole question of valuation and decide simply that there is no confiscation, even on the reproduction cost value contended for by the railroad. But even if the method of valuation employed by the Commission is reviewed, it is difficult to see where in any of the past cases the Supreme Court has precluded itself from indorsing the original cost valuation employed by the Commerce Commission, if in this particular case it deems that method "just and right."

CONCLUSION.

Considering all of the rate cases in perspective, the following broad propositions may be suggested by way of conclusion:

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[22] *Ibid.*, at p. 54.
[23] St. Louis & O'Fallon Ry. Co. *v.* U. S., 22 Fed. (2d) 980 (1927).

1. It cannot be said that the Supreme Court has ever committed itself to any one method of ascertaining present value for rate making purposes. No single element of value has been made the controlling and sole basis of rates. Determination of present value remains a matter of judgment and not of formula, and the judgment of the rate making body thereon will not be disturbed by the courts so long as the several elements were given proper weight in forming the judgment.

   As a corrollary to this, we may say that the rule of *Smyth* v. *Ames* is not dead; that it remains the guiding principle in valuation, in that no one method has been adopted to the exclusion of the others; but *the deliberate intention of avoidance of such action is yet maintained in order that future cases arising under changed conditions may receive a proper consideration.*

2. Where the differential between the general price levels of the time of original construction and of the time of the rate inquiry is great, and where it appears that present price level is relatively permanent and stabilized, substantial weight should be given the reproduction cost factor wherever it is practicable to do so.

3. The judgment of the rate making body cannot, since the McCardle Case, be said to be conclusive in fixing the proportionate weight to be accorded the several factors of valuation; its judgment is subject to review by the courts on the question whether the degree of weight accorded a particular element was proper.