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Charter Contracts and the Regulation of Rates

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CHARTER CONTRACTS AND THE REGULATION OF RATES.

CONSIDERING how well-established the doctrine has been for over eighty years that the charters of public service corporations are to be construed strictly in favor of the state when a dispute arises as to the extent of their powers, it may be a matter of surprise on first consideration that there should have been such a large body of litigation over the construction of these charters. Why were they not worded in unequivocal terms? Or have the courts, in the desire of protecting the state, done violence to the plain intent of words?

Eliminating such charters as have been deliberately framed in obscure terms for the purpose of laying a foundation for a possible claim in later years, we find that within the past thirty years not a few cases have been decided against the claim of charter contracts on the principle of strict construction, when it would seem that the claim was well-founded if the intent of the parties at the time of making the contract had been the chief consideration.

Most of the cases have arisen in connection with exemptions from taxation, and with the grant of exclusive privileges to public service corporations, and the right to fix rates of charge for the services performed. We shall here deal with the last only of the above questions, and an endeavor will be made to lay down the general rules established by the Supreme Court of the United States for the construction and interpretation of charters when the claim is made that a contract exists giving to public service corporations the exclusive right to fix their own rates of charge.

1. Following the established principle that the charter of a private corporation constitutes a contract with the state,[1] it was accepted in one of the *Granger cases*[2] that the legislature of a state can, in the grant of a charter, make a binding contract giving to a public service corporation the right to fix its rates of charge, unless there is a right reserved to the state of repealing the charter. What would happen if the rates thus fixed by contract were clearly exorbitant, or should become so in the course of time by reason of changed conditions, the court has not had occasion to decide. It seems that without doubt the state could intervene in such a case, and the courts would justify its action in spite of the contract. And as the legislature can make

[1] Dartmouth College v. Woodward, 4 Wheat. 518.

[2] Peik v. Chicago and Northwestern Ry., 94 U. S. 164 (1877).

a binding contract renouncing its power of regulating rates, so it can delegate to municipalities the authority to make like binding contracts with street railways and other companies, and such contracts cannot be repudiated if within the limits of the authority conferred.[3]

2. In attempting to illustrate the rule that charter contracts are to be construed strictly in favor of the state we are met with a complexity of cases that is not a little confusing. As each case gives only the interpretation of the special charter involved it cannot serve as a precedent for later adjudication, but it may be possible by citing a number of prominent cases to discover the general method of interpretation followed by the court.

In 1883, the case of *Ruggles* v. *Illinois*[4] was decided in favor of the state. The issue turned on the construction of a section of an amendment to a charter, whereby the railroad was given power to "make all by-laws, rules and regulations as may be deemed expedient and necessary to fulfil the purposes * * * of this Act, and for the well ordering, regulating and securing the affairs, business and interest of the company; Provided, that the same shall not be repugnant to the laws of this State. The board of directors shall have the power to establish such rates of toll * * * as they shall from time to time by their by-laws determine." It was held that the clause relating to rates, although following the provision governing by-laws in general, was to be interpreted as equally subject to it;—thus giving the state the power of altering the rates by a later act. Justice HARLAN, although concurring in the judgment for other reasons, dissented from the opinion of the court and held that the clause as to rates was "meaningless, if not intended to assure those who put their means into the proposed road, that, as to the tolls to be levied and collected, they should be established by the directors within the limit of reasonableness, and not left to the uncontrolled discretion of the legislature." In other words, the *probable intent* of the parties to the contract at the time it was made should modify the strict construction of the charter.

In 1886, in the first of the *Railroad Commission cases*,[5] the court took the extreme step of strict construction in favor of the state. A charter, issued in 1848, gave to the Mobile and Ohio Railroad Co. the power "from time to time to fix, regulate and receive the toll and charges by them to be received for the transportation of persons or

[3] Detroit v. Detroit City Street Ry., 184 U. S. 367 (1902).
[4] 108 U. S. 526 (1883).
[5] Stone v. Farmers Loan and Trust Co., 116 U. S. 307 (1886).

property * * *" There was no reserved right of repeal contained in the charter or in any previous statute. But the court made a distinction between the power to fix reasonable charges and the power to declare what shall be deemed reasonable, and held that the former did not necessarily include the latter. "The right to fix reasonable charges has been granted, but the power of declaring what shall be deemed reasonable has not been surrendered." It is evident that such a distinction could with difficulty be applied to cases in which both parties to the contract stood upon equal footing before the court. What is clearly implied in a contract is no less binding than what is clearly expressed. And what could be more clearly implied in giving a company the power to fix rates than that the legislature should not prescribe what was to be considered reasonable, which is to all intents and purposes equivalent to fixing the rates.

We must observe here that a railroad, in seeking to be released from legislative control over its rates, does not claim the right to be released from all control whatsoever;—it is always subject to the common law rule against unreasonable charges and undue discrimination. Likewise the court acknowledges in this case that if the legislature has the control over rates its control is not unlimited; it must not be exercised so arbitrarily that the railroad would be required "to carry persons or property without reward," or to such an extent as to amount to the taking of "private property for public use without just compensation." The importance of the contention made by the railroads lies in the fact that there is a wide difference between the *highest* rate which a court would not declare unreasonable if fixed *by the railroad,* and the *lowest* rate which it would not declare confiscatory if fixed *by the State.* Rates fixed by the legislatures might differ very materially from rates fixed by the company, and yet either might be sustained by the courts depending upon who had the authority to fix them. In actual practice the burden upon the railroads of proving that the rates fixed by the legislature are affirmatively unreasonable is a heavy one, and the point of actual confiscation might sometimes be reached before the courts would grant relief.

Consistently with his opinion in the *Ruggles* case, Justice HARLAN again dissented on the ground that the intention of the parties at the time of making the contract was contrary to the interpretation put upon the contract by the majority of the court. The capitalists who invested their money in the railroad surely would not have done so, he contended, had they understood that the legislature might at any

time reject the rates established by the company and prescribe others based upon a vague and indefinite theory of value.

Further cases may be rapidly reviewed. In *Georgia Railroad and Banking Co.* v. *Smith*[6] it was held that a provision in a charter that rates should not exceed a fixed maximum did not give the company such a contractual right to fix rates within the limits prescribed, as would prevent the legislature from making changes in the future.

In *Coosaw Mining Co.* v. *South Carolina*[7] an act of the state which the company claimed constituted a grant in perpetuity for certain mining rights was interpreted by the court in the light of a previous act and thus limited to a definite period. The issue was stated clearly. "If the act of 1876 is fairly susceptible of either of the constructions we have indicated, as we think it is, the interpretation must be adopted which is most favorable to the state. The doctrine is firmly established that only that which is granted in clear and explicit terms passes by a grant of property, franchises or privileges in which the government or the public has an interest. * * * Whatever is not unequivocally granted is withheld; nothing passes by mere implication."

Again in *Freeport Water Co.* v. *Freeport*,[8] where a statute of Illinois gave power to a municipality to authorize persons "to construct and maintain [waterworks] at such rates as may be fixed by ordinance, and for a period not exceeding thirty years,"—it was held that the clause relating to the period for which the municipality might contract had reference to the construction and maintenance of the works, and not necessarily to the rates to be fixed,—and therefore by the principle of strict construction the municipality had not the power to contract *as to rates* for a period of thirty years. We observe here that while, if the issue had been between the municipality and the corporation, the principle of strict construction would have operated in favor of the municipality, as between the state and the municipality exercising delegated power the principle operated in favor of the state against a delegation of power.

In *Rogers Park Water Co.* v. *Fergus*[9] an ordinance providing that "the said grantee or assigns shall charge the following annual water rates * * *" was held to be the language of command, not of contract, and therefore would not have bound the municipality even if it had had the authority to contract. A like construction in

[6] 128 U. S. 174 (1888).
[7] 144 U. S. 550 (1892).
[8] 180 U. S. 587 (1901). See also Danville Water Co. v. Danville, 180 U. S. 619.
[9] 180 U. S. 624.

the case of *Knoxville Water Co.* v. *Knoxville*[10] was put upon a municipal ordinance in which it was provided that the "said company will supply private consumers with water at a rate not to exceed five cents per hundred gallons." These words were included in that portion of the contract which contained the promises of the company, and the court held that they did not constitute a promise on the part of the municipality against future reduction.

In *Stanislaus County* v. *San Joaquin Canal and Irrigation Co.*[11] it was held that a statute of California providing that the state board of supervisors should not reduce rates below a certain point did not constitute a contract with the company which would prevent *the state itself* from so reducing the rates.

In contrast with the above cases there are several others to be found in which the principles of construction have been more liberally applied, and which, though not overruling the strict construction doctrine, at least indicate that the court is unwilling to allow a state or municipality to override its clear obligations of contract. In *Detroit* v. *Detroit Citizens Street Railway*[12] there was question of a municipal ordinance giving to a street railway the right to lay certain tracks and to charge not more than five cents for one fare, with reservation in the ordinance of a right on the part of the city "to make such further rules, orders or regulations as may from time to time be deemed necessary to protect the interest, safety, welfare, or accommodation of the public," and it was held that the reservation to make *further rules* did not include the right to reduce the fares agreed upon. "Further rules" meant others of a different character, not new ones relating to a subject fixed in the contract.

Again in *Cleveland* v. *Cleveland City Railway Co.*[13] it was held that a reserved right to alter the rates fixed by an ordinance of 1879 was impliedly revoked by subsequent ordinances which permitted the consolidation of competing companies, fixed their rates, but *contained no reservation* of the right of altering the rates. The new contract entirely superseded the old one.

In the recent case of *Minneapolis* v. *Minneapolis Street Railway Co.*[14] the court held that a reserved right, on the part of the city, of control over the company as respects the "construction, maintenance, and operation" of the street railway did not include the power to reduce rates below those prescribed in the contract. The writer is

[10] 189 U. S. 434 (1903).
[11] 192 U. S. 201 (1904).
[12] 184 U. S. 367 (1902).
[13] 194 U. S. 517 (1904).
[14] 215 U. S. 417 (1910).

not convinced that these last cases either reject or even modify the principle of strict construction, but they do show a greater willingness on the part of the court to admit the just claims of public service corporations in their contracts with states and municipalities.

3. The question as to who shall be the ultimate arbiter of the reasonableness of rates, whether the legislature or the courts, as far as it throws light upon the contract obligations of charters, may be briefly reviewed. In *Munn* v. *Illinois*[15] the court took the position that, following the long established tradition of English and American law, the regulation of rates, where the subject came within the control of the state, was the province of the legislature and its decision was not subject to review by the courts. If the legislature should happen to abuse its power, recourse must be had not to the courts but to the polls for relief. Now it is evident that the mere arbitrary judgment of a legislature before which the public service company cannot have a hearing the evidence of which will necessarily control the decision of the legislature, may work grave injustice to the company; and it would seem that the rigor with which the principle of strict construction against the right of the company to fix rates was applied should certainly have been modified in view of the injustice which might result to the company. We shall note later a case in point.

However, the *Munn* decision was definitely, though not avowedly, reversed thirteen years later, and in *Chicago, Milwaukee and St. Paul Railway* v. *Minnesota*[16] the court held that rates fixed by a legislature are at all times subject to review by the courts upon the ground of alleged unreasonableness. Hence all rates can now be pronounced upon by the courts and the burden of proof that they are affirmatively unreasonable will rest upon the state or the company according as there is or is not a charter contract giving to the company the power to fix them.

4. The effect of a reserved right on the part of the state to alter and repeal the charters of corporations, as giving to the state the right to reject agreements with a company on the subject of rates, is now the accepted doctrine, but it did not pass unquestioned when first announced. In *Chicago, Burlington, and Quincy Railway* v. *Iowa*[17] the majority of the court held that a charter which had been granted subject to future rules and regulations of the legislature left it free for the legislature to intervene at any time and fix the rates of charge. Justice FIELD dissented (in which Justice STRONG con-

[15] 94 U. S. 113 (1877).
[16] 134 U. S. 418 (1890).
[17] 94 U. S. 155 (1877).

curred) on the ground that "the reserved power has not generally been supposed to authorize the legislature to revoke the contracts of the corporation with third parties" (such as would be done if the rates were fixed so low as to impair the value of the mortgages upon the property of the railroad) "or to impair any vested rights acquired under them." His dissent also covers the case of *Peik* v. *Chicago and Northwestern Railway Co.*[18] immediately following, in which the charter of the railroad had been given subject to a constitutional provision of Wisconsin that all acts of incorporation could be altered and repealed by the legislature at any time after their passage. When it is remembered that by these same *Granger* decisions the action of the legislature in fixing rates was not subject to review by the courts, however arbitrary it might be, the dissent of Justice FIELD is not without force. This will appear more strikingly in the case of *Spring Valley Water Works* v. *Schottler.*[19] The charter of the company, formed under a general law of 1856, was taken subject to the California constitution of 1849 which provided that all general laws might be altered or repealed. The law of 1856 created an impartial tribunal to determine the rates to be charged. The constitution of 1879 abolished the impartial tribunal and appointed a board of supervisors composed of municipal officers, and therefore *partisan* in character. The court held that under the right of alteration and repeal reserved to the state by the constitution of 1849, the provision of the constitution of 1879 was valid. Consistently with his opinion in the *Granger cases,* Justice FIELD dissented on the ground that "the contract between the State and the corporators by which the plaintiff became a Corporation is not to be confounded with the contract between the State and the Corporation when created." Now the reservation of the right of alteration and repeal, he contended, applies only to the contract of incorporation, to the corporate existence, franchises and privileges granted by the state. It gives the state no right over the business and property of the corporation or over its contracts with third parties. But the creation of a partisan tribunal to determine the rates is clearly the exercise of a right over the property of the corporation. If the rates were to be fixed below the paying point the result would be practically equivalent to an enforced sale of the property at a price fixed by the agents of the consumers. This is something quite different from the taking of property under the right of eminent domain where compensation is fixed by an impartial tribunal.

[18] 94 U. S. 164 (1877).
[19] 110 U. S. 347 (1884).

With the shifting in 1890 of the power of final decision upon the reasonableness of rates from the legislature to the courts the doctrine opposed by Justice FIELD is less likely to work injuriously upon public service corporations, which have now merely the burden of proving that the rates established by the legislature are affirmatively unreasonable.

Two other important cases[20] involving the obligation of contracts in connection with the power of fixing rates turn upon an alleged distinction between what a city may do in its proprietary character, as owner of a waterworks system, and what it may do in its municipal character as agent of the state,—the distinction in both cases being denied.

The law of the cases discussed may be briefly summarized as follows:

1. It is within the power of the legislature, provided there be no restriction in the state constitution, to make binding contracts with public service corporations, by which it can renounce its general power of regulating the rates for their services. This power of making binding contracts the legislature may delegate to municipalities, whose ordinances therefore are only binding within the limits of the authority conferred.

2. Such contracts of a legislature or municipality with public service corporations are construed strictly against the corporation in favor of the state or municipality. But as between the state and a municipality exercising delegated power, the existence of the delegated power is construed against the municipality.

3. The right of ultimate decision as to the reasonableness of rates, whether by the legislature or by the company, resides in the courts.

4. The reservation, either in the charter or in the constitution of a state or in a general law, to which the charter does not form a clear exception, of the power of alteration and repeal gives to the state the right to reject any agreements it may make concerning the rates to be charged.

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[20] See Walla Walla v. Walla Walla Water Co., 172 U. S. 1 (1898); Los Angeles v. Los Angeles City Water Co., 177 U. S. 558 (1900).