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CONDEMNATION OF TRANSPORTATION FACILITIES: NEW YORK'S RECENTLY DEVELOPED PUBLIC UTILITY COMPENSATION PRINCIPLES AND REMAINING PROBLEM AREAS

Frank A. Aloi† *and Arthur Abba Goldberg*††

Efficient and comfortable transportation is essential to the welfare of urban America.[1] Privately owned transportation systems are increasingly unprofitable,[2] and state regulatory authorities cannot force them to continue operating at a net loss without raising the constitutional issue of "taking of property without just compensation."[3] To avoid this issue and ensure adequate transportation, local governments, with federal assistance,[4] are acquiring and operating mass transit facilities.

In the past few years, at least three governmental entities have acquired transportation facilities, with two of these acquisitions resulting in protracted litigation. Rochester took over the Rochester Transit Corporation; the Port Authority condemned the assets of the Hudson Rapid Tubes Corporation, which provided rail commuter facilities between New Jersey and Manhattan; and New York City

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1 *See* the recitation in the Urban Mass Transportation Act. 49 U.S.C. § 1601 (1964). This Act was passed in 1964 to assist state and local governments to preserve mass transportation systems.

2 For a discussion of this problem as it affects railroads, see Thomas, *Public Utilities: Discontinuance of Railroad Service*, 14 RUTGERS L. REV. 345 (1960). In recognition of the financial crisis, Transportation Secretary John A. Volpe reportedly plans a $10 million program to overhaul the nation's mass transit system. Newark (N.J.) Star Ledger, June 24, 1969, at 1, cols. 7-8.

3 Nevertheless, in 1957 the New Jersey Legislature passed a resolution forbidding further discontinuance of passenger railroad service within the state pending a public study. *See In re* New York, S. & W.R.R., 25 N.J. 343, 347, 136 A.2d 408, 410 (1957). *See also* Susquehanna Transit Commuters Ass'n v. Board of Pub. Util. Comm'rs, 55 N.J. Super. 377, 410-11, 151 A.2d 9, 27 (1959). In *In re* New Jersey & N.Y.R.R., 12 N.J. 281, 96 A.2d 526, *appeal dismissed*, 346 U.S. 868 (1953), the New Jersey Supreme Court suggested that there was no constitutional right, regardless of public convenience and necessity, to discontinue a train on a net-loss railroad.

4 *See* note 1 *supra*.

acquired the Fifth Avenue Bus Coach system. Rochester settled its acquisition after some pre-litigation skirmishing, partially because of the guidelines provided by the previous cases.[5] Those guidelines, however, are unclear and, in some instances, inadequate.

We propose to study the two major lawsuits, *In re City of New York (Fifth Avenue Coach Lines, Inc.)*[6] and *In re Port Authority Trans-Hudson Corp. (PATH)*,[7] which spanned a five-year period in which the New York Court of Appeals wrote three major opinions dealing with the principles of compensation applicable to the condemnation of public utilities.[8] The opinions and the lower court background for each case constitute an intensive effort by the courts of one state to identify and apply rules for valuation in the condemnation of a public utility for continued use. We will present the opinions, summarize each principle of valuation, and comment upon alternative formulas for compensation. Three collateral issues will also be dealt with: the question of the value to be placed upon the franchise of a public utility, the question of pension disposition in the transition from private to public ownership, and the possible unconstitutionality of a statutory function of the Public Service Commission in condemnation cases.

I

THE *Fifth Avenue* AND *PATH* CASES

There is a vital distinction between "utility" condemnations and "private" or "traditional" condemnations. When a private business

5 One author handled the *PATH* litigation in both the United States Supreme Court appeal and certiorari attempts. The other author was employed as special counsel for the Rochester litigation.

6 46 Misc. 2d 14, 259 N.Y.S.2d 313 (Sup. Ct.), *on objection to tentative decree* 47 Misc. 2d 734, 263 N.Y.S.2d 96 (Sup. Ct. 1964), *aff'd*, 23 App. Div. 2d 463, 261 N.Y.S.2d 784 (1st Dep't 1965), *modified*, 18 N.Y.2d 212, 219 N.E.2d 410, 273 N.Y.S.2d 52, *remittitur amended*, 18 N.Y.2d 741, 221 N.E.2d 174, 274 N.Y.S.2d 349 (1966), *appeal dismissed*, 386 U.S. 778 (1967), *on remand to New York Supreme Court*, 157 N.Y.L.J., April 18, 1967, at 18, col. 8, *aff'd*, 29 App. Div. 2d 638, 287 N.Y.S.2d 454 (1st Dep't 1968), *modified*, 22 N.Y.2d 613, 241 N.E.2d 717, 294 N.Y.S.2d 502 (1968), *remittitur amended*, 24 N.Y.2d 773, 247 N.E.2d 861, 300 N.Y.S.2d 41 (1969). For the present status of the *Fifth Avenue* litigation, see Wall St. J., Nov. 25, 1969, at 4, col. 3.

7 48 Misc. 2d 485, 265 N.Y.S.2d 925 (Sup. Ct. 1965), 50 Misc. 2d 613, 271 N.Y.S.2d 95 (Sup. Ct.), *on objection to tentative decree* 52 Misc. 2d 943, 277 N.Y.S.2d 999 (Sup. Ct.), *modified*, 27 App. Div. 2d 32, 276 N.Y.S.2d 283 (1st Dep't 1966), *modified*, 20 N.Y.2d 457, 231 N.E.2d 734, 285 N.Y.S.2d 24, *remittitur amended*, 20 N.Y.2d 968, 233 N.E.2d 860, 286 N.Y.S.2d 858 (1967), *cert. denied*, 390 U.S. 1002 (1968).

8 For historical perspective and a discussion of theories for valuing utility property in general, see 2 L. ORGEL, VALUATION UNDER THE LAW OF EMINENT DOMAIN §§ 200-05, at 58-80 (2d ed. 1953) [hereinafter cited as ORGEL].

is condemned, the purpose is generally to acquire the underlying land. Utility condemnation, on the other hand, seeks to continue the business as a public venture. The rule in private condemnation is that the taking is in rem; accordingly, compensation need be paid only for tangible items, land, and buildings, without allowances for business losses and goodwill.[9] The rationale of the rule is that the owner may relocate and continue his business and that only the land and buildings, not the business, are taken.[10] The condemnation of public utilities, however, proceeds on an entirely different basis. Here, the public authority condemns the utility not only to obtain the physical assets but also to continue operation of the business.[11] Therefore, valuation in utility condemnations must include an allowance for the value of the business.[12]

A. *Fifth Avenue*

In re City of New York (Fifth Avenue Coach Lines, Inc.)[13] involved the condemnation by New York City of two giant omnibus lines. In addition to compensation for such tangible property as land, buildings, and buses[14] the owners sought damages for loss of "going concern value"—that increment of value inherent in a business as an operational entity over and above the value of its tangible assets.[15] The owners also asserted claims for items of consequential damage, including pensions, workmen's compensation, and tort claims administration.[16]

The trial court made detailed findings concerning valuation of the items of tangible property condemned by the city. While some of the findings here are debatable, especially those involving depreciation formulas,[17] they do not concern the subject of this article.

The trial court stated the valuation principle to be market value —"what a willing buyer would pay in cash to a willing seller."[18] In

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9 *Id.* at 58.

10 United States *ex rel.* TVA v. Powelson, 319 U.S. 266, 282 (1943). This view is criticized in Aloi & Goldberg, *A Reexamination of Value, Good Will, and Business Losses in Eminent Domain*, 53 CORNELL L. REV. 604, 626-36 (1968).

11 2 ORGEL 58-59.

12 *Id.*

13 46 Misc. 2d 14, 259 N.Y.S.2d 313 (Sup. Ct. 1964).

14 *Id.* at 16-17, 259 N.Y.S.2d at 319.

15 *Id.*

16 *Id.*

17 *See, e.g.*, the trial court's formula for valuing bus garages and its conclusion that although they were "specially designed as bus garages," they were not specialties. *Id.* at 33, 259 N.Y.S.2d at 335. *Cf.* Aloi & Goldberg, *supra* note 10, at 607-14.

18 46 Misc. 2d at 19, 259 N.Y.S.2d at 321, *quoting* United States v. Miller, 317 U.S. 369, 374 (1943).

applying this standard the court noted that both bus lines throughout much of their operating history were unprofitable and that no willing buyer would pay a substantial amount for such enterprises.[19] The owners contended that city regulation caused the unprofitability. They projected profitable operations if routes were rearranged, certain personnel eliminated, and certain fare increases granted.[20] They argued that the companies' earnings were depressed because of the city's unreasonable fare regulation; accordingly, the companies were entitled to a substantial item of damages for going concern value because eliminating the unreasonable regulation would make possible profitable operation. The trial court rejected this argument.[21]

The trial court also dismissed the owners' claim for compensation for expenditures made in developing an integrated, synchronized, and coordinated coach route operation, including operating schedules, layout of bus garages and shops, operating rights and permits, and perpetual franchises.[22] Again, the trial court based its conclusion upon the market value criterion, commenting: "Nor would buyers ordinarily pay anything for the seller's expenditures in developing a trained labor force or for the other costs claimed here, especially where the end result of those expenditures fails to produce a profit."[23]

The court did conclude, however, that the tangible assets of the companies should be valued as "property in use" rather than as scrap.[24] For example, the court recognized that the garages were specially designed for omnibus use and as such were worth more than their simple economic value as ordinary garages. Applying this premise, the court set awards for each category of tangible property.[25]

A substantial portion of the trial court's opinion concerned the claim for consequential damages. Distingnishing "severance damage," which is compensable, from "consequential damage," which ordinarily is not, the court argued that each item of consequential damage involved items not taken by the city; rather, they constituted "subsisting

19 *Id.* at 25, 259 N.Y.S.2d at 327.

20 *Id.* at 21, 259 N.Y.S.2d at 323.

21 The court argued that there were both practical and legal obstacles to a fare increase. On a practical level, the city's operation of a rapid transit system at 15 cents precluded the increase for reasons of competition. Moreover, the court argued that because the claimants had consented to charge 15 cents in their franchise agreement, they had no constitutional right to the increase. Finally, it concluded that no statutory right to charge a higher fare existed. *Id.* at 21-22, 259 N.Y.S.2d at 323-24.

22 *Id.* at 29, 259 N.Y.S.2d at 330-31.

23 *Id.* at 29, 259 N.Y.S.2d at 331.

24 *Id.* at 26, 259 N.Y.S.2d at 328.

25 *Id.* at 43, 259 N.Y.S.2d at 345.

contractual liabilities of the condemnee."[26] The owners argued that each item of contractual liability was funded from the fare boxes, *i.e.*, payable out of current revenue, and that since the city gained the benefit of the fare box income, it should also assume its burdens and pay for liabilities funded therefrom.[27] The trial court rejected this contention on the ground that the city as a condemnor could be liable only for items actually appropriated and could not be liable for what amounted to a frustration of contract liabilities continuing in the condemnee.[28]

On the basis of the lower court opinions,[29] which set a value for claimants' property in terms of tangible assets only, the *Fifth Avenue* cases were taken through their first appeal. The First Department affirmed the trial court's findings.[30] The first appeal to the Court of

26 *Id.* at 38, 259 N.Y.S.2d at 339.

27 *Id.* at 41, 259 N.Y.S.2d at 343.

28 *Id.* at 39, 259 N.Y.S.2d at 340-41.

29 Upon the filing of objections to the tentative decree, the trial court adhered to its prior decision. It again stressed the necessity of valuing the tangible assets as property in use and rejected the city's renewed argument that scrap value should be the standard applied. *In re* City of New York (Fifth Avenue Coach Lines, Inc.), 47 Misc. 2d 734, 737, 263 N.Y.S.2d 96, 99-100 (Sup. Ct. 1964). Similarly, it rejected any award for goodwill (going concern value) on the ground that the claimants failed to show an actual history of profitable operations. *Id.* at 735, 263 N.Y.S.2d at 98. It is questionable whether the trial court's language—"they must show a history of profitable operations"—represents either the weight of authority or the actual holdings of the decisions cited by the trial court.

30 23 App. Div. 2d 463, 261 N.Y.S.2d 784 (1st Dep't 1965). The primary question argued on appeal to the First Department was the trial court's alleged failure to award damages for loss of going concern value. *Id.* at 464, 261 N.Y.S.2d at 786. The argument that going concern value should have been separately valued was rejected, as was the city's renewed argument that the tangible property (the physical assets) should have been valued as unconnected units of property without relation to their integration into claimants' use for omnibus line operation. The court concluded that "in avowedly bottoming its award on the premise that claimants' properties must be evaluated as properties 'in use', Special Term made ample provision for intangibles of such nature, although without specific itemization." *Id.* at 467, 261 N.Y.S.2d at 788. Implicit in the affirmance was recognition of the propriety of the trial court's application of the fair market value standard to define the limits of compensation for condemned property.

Justice Rabin dissented, principally on the ground that the court below had failed to make awards for certain going concern assets *"without which continuity of service could not have been maintained."* *Id.* at 469, 261 N.Y.S.2d at 790 (emphasis in original). The dissent also concluded, we believe correctly, that "going concern value" is separate and distinct from "goodwill." Justice Rabin did not argue for compensation of goodwill, but noted parenthetically that a value for goodwill could be set "by first fixing a reasonable rate and then capitalizing the net income that would have been earned had such rate been fixed." *Id.* at 470, 261 N.Y.S.2d at 791-92. This formula makes likely the lumping together of all items of intangible damage, and whether a summation of component items of damage for intangibles will equal this figure remains unclear. Justice Rabin appeared to agree with claimants' argument for consequential damages arising out

Appeals was characterized by the majority as presenting only the issue whether the disposition below proceeded on erroneous principles of law regarding the valuation of intangible property.[31] Unlike the courts below, the Court of Appeals concluded that the rate regulation by the city was unreasonable and that *but for* this factor claimants' operations would have been profitable.[32] On the basis of this conclusion the court fixed the standard for compensation as follows:

> The measure of value in this case is the cost of putting the entire transit systems together new plus all improvements, tangible and intangible, less depreciation. . . . [T]he going concern's intangible assets are equally as essential to the city's ability to furnish bus service as are the tangible assets seized and used. These going concern attributes or so-called intangible assets such as coach routes, operating schedules, operating records and systems of procedures and trained personnel made it possible for the city to operate the transit system the day after the condemnation. Under the theory erroneously followed below, the assets in which the owners of the bus systems had invested substantial sums could be taken without compensation. These assets, without which the city would not have operated the system, can no more be taken without compensation than can its tangible corporate property.[33]

Continuing, the court stated that "[c]laimants' undeniably competent and efficient personnel were taken over by the city along with claimants' routes, franchises, operating schedules, accounting and maintenance records, etc.—all going concern assets for which claimants must be duly compensated."[34] The order below was modified and remanded to the Special Term "for a determination of the value of the going concern assets as an addition to the amount heretofore awarded and, as so modified, affirmed . . . ."[35]

of pension liability. "It may well be that such commitments are to pay for a 'thing of value' of which the city is the beneficiary, having taken over not only the properties but the personnel as well." *Id.* at 471, 261 N.Y.S.2d at 792.

31 "The only issue presented on this appeal which calls for a modification is the reliance of the courts below on erroneous principles of law regarding the evaluation of the condemnees' intangible property." 18 N.Y.2d 212, 217-18, 219 N.E.2d 410, 411, 273 N.Y.S.2d 52, 53 (1966).

32 *Id.* at 220-21, 219 N.E.2d at 412-13, 273 N.Y.S.2d at 56. The trial court's holding that a history of profitable operations is a prerequisite to compensation for going concern value (*supra* note 29) was rejected by the Court of Appeals: "[I]n all the cases supporting the view that where there is no earning capacity there is no going concern value, the condemnees were *inherently incapable* of profitable operation because of the economic law of diminishing returns or inefficient management." *Id.* at 220, 219 N.E.2d at 413, 273 N.Y.S.2d at 56 (emphasis added).

33 *Id.* at 221, 219 N.E.2d at 413, 273 N.Y.S.2d at 56-57.

34 *Id.* at 223-24, 219 N.E.2d at 415, 273 N.Y.S.2d at 58.

35 *Id.* at 224, 219 N.E.2d at 415, 273 N.Y.S.2d at 58-59.

The Court of Appeals's modification must be taken as an affirmance of those portions of the trial court opinion concerning consequential damages.[36] Even this should not close the question, since certain language used by the trial court indicates that an award might have been made on the items of consequential damages had claimant been able to demonstrate actual profits.[37] Although the case traveled once again full circle through the trial court and up to the Court of Appeals, nothing further of any consequence was said by any court concerning consequential damages. The courts' summary disposition of this issue is unsatisfactory, leaving this problem area to be developed in subsequent litigation.

On remand, the trial court approached the question of valuing going concern assets by basing its analysis on the market value standard. Quoting from *Kimball Laundry Co. v. United States*,[38] the court held that the claimant must establish the price that a prudent buyer would pay for the intangible assets.[39] Proceeding on this basis, the trial court considered the following categories of going concern assets:

1. Trained personnel: bus operators.
2. Trained personnel: maintenance force.
3. Trained personnel: administrative staff.
4. Trained personnel: clerical employees.
5. Trained personnel: executive personnel.
6. Layout of coach routes.
7. Route development.
8. Operating schedules.
9. Operating systems, procedures and records: accounting.
10. Operating systems, procedures and records: maintenance.
11. Operating systems, procedures and records: personnel.
12. Selection and arrangement of shop and garage equipment.
13. Perpetual franchises and operating rights and permits.

Allowances were made for only five of the foregoing: trained per-

36 *See* text at notes 26-28 *supra*.

37 Claimants argue that "these items were operating expenses recoverable from the fare box and should follow the fare box into the City's hands." This disregards the stark fact that the fare box was progressively becoming less able to take care of even the current operating expenses, leaving nothing available for these expenses attributable to past operations.

46 Misc. 2d at 42, 259 N.Y.S.2d at 344. This emphasis upon actual profitability is perhaps less realistic than Justice Rabin's comment that regardless of profits the city might be liable for pension payments since it admittedly acquired the benefit of an efficient and trained body of personnel upon condemnation. Note 30 *supra*.

38 338 U.S. 1, 19-20 (1949).

39 157 N.Y.L.J., April 18, 1967, at 18, col. 8.

sonnel (bus operators), trained personnel (maintenance force), trained personnel (administrative staff), trained personnel (clerical employees), and operating schedules.[40] With the exception of franchises, each other category of going concern assets was rejected because (*1*) a prudent buyer would not, in acquiring the business or in putting together such a business, expend any funds for the item and/or (*2*) insufficient proof existed.[41] An award for franchises was rejected because "[t]he city did not need to acquire these franchises in order to operate the buses over the routes theretofore used by claimants, since the city always had the right to do so."[42]

The trial court then applied the "percentage tangible asset" test as a check on the accuracy of its computations of damage for going concern assets.[43] Noting cases that had set percentages of from four to ten percent, the court found that its determinations for intangible going concern assets amounted to 8.5 percent of the award for tangible assets.[44]

On appeal from the remand, the First Department ignored the trial court's repeated language that certain items of going concern damage were disallowed partly because a willing purchaser would not in a private acquisition have spent any money for these items. In affirming the award below, the Appellate Division attributed the trial court's failure to make awards for these categories of going concern assets solely to a failure of proof in regard to these assets by claimants.[45]

Justice McGivern dissented, characterizing the language of the Court of Appeals in identifying going concern assets as a mandate to determine a value for these assets rather than a mere suggestion that these items might be compensable.[46] He questioned the trial court's reliance on the "willing buyer-willing seller" market value criterion

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40 *Id.* at 19, col. 4.

41 *Id.*

42 *Id.*

43 On a rehearing necessitated by objections to the tentative decree in *PATH*, a flat 10% increment was added by the trial court to the award for the condemned Hudson & Manhattan tubes. *In re* Port Authority Trans-Hudson Corp., 52 Misc. 2d 943, 945, 277 N.Y.S.2d 999, 1002 (Sup. Ct. 1966). Whether this disposition in any way influenced the trial court on the remand in the *Fifth Avenue* case cannot be ascertained from the decision, since no reference is made to the *PATH* litigation.

44 157 N.Y.L.J., April 18, 1967, at 19, col. 5.

45 29 App. Div. 2d 638, 639, 287 N.Y.S.2d 454, 456 (1st Dep't 1968). The Appellate Division failed even to approach the question whether this "failure of proof" indicated no competent evidence in the record or whether the trial court's persistence in applying an improper valuation premise—willing buyer to willing seller in hypothetical market—precluded it from utilizing competent proof in the record.

46 *Id.* at 639-40, 287 N.Y.S.2d at 456-58 (dissenting opinion).

when the Court of Appeals had specifically stated that going concern value should be calculated on the basis of a development cost theory; the dissent also argued that allowances should have been made for the items disallowed by the trial court.

B. *PATH*

In this posture, an affirmance by the Appellate Division over a strong dissent, the *Fifth Avenue* case again reached the Court of Appeals. In the interim, the Court of Appeals had decided *In re Port Authority Trans-Hudson Corp.*[47] In *PATH*, the Court of Appeals specifically disagreed with the percent method of valuing intangibles. The court again stressed the importance of using the development cost theory to value going concern assets and repudiated the traditional market value method for utility condemnations.[48]

At the time of taking the Hudson Tubes were in poor financial condition, having recently gone through a bankruptcy reorganization.[49]

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[47] 20 N.Y.2d 457, 231 N.E.2d 734, 285 N.Y.S.2d 24 (1967).

[48] [W]e believe that Special Term erred in awarding $5,000,000 for going concern value by taking 10% of the total award for tangible property. While there is evidence that such a value exists in this case, there is no proof in the record to sustain Special Term's finding that the claimant is entitled to an award of an additional 10% of the values fixed for the tunnel and non-tunnel properties. There is no basis or warrant in law for any such rule of thumb. A finding of going concern value must be based upon evidence paralleling what we held would have to be shown in the *Fifth Ave. Coach* case, that is, the cost of organizing and systematizing the enterprise, such as the cost of developing operating schedules, operating records, systems of procedure and the training of personnel.

Id. at 471-72, 231 N.E.2d at 740, 285 N.Y.S.2d at 33 (footnotes and citations omitted).

[49] The railroad had been beset by financial troubles since beginning operations in 1911. It had not paid a dividend on its common stock since 1932 or on its preferred stock since 1933. It had not paid full interest on its junior indebtedness since 1934 or any interest on its total indebtedness since 1950. It had produced no net income since 1952 and, in the four years immediately preceding 1962, had incurred the following operating deficits:

1958	$331,000
1959	$488,000
1960	$504,000
1961	$466,000

The railroad was also faced with capital replacement requirements impossible of resolution so long as it remained in private hands.

The railroad was forced into reorganization in 1954 and emerged from reorganization at the beginning of 1962 under a new corporate structure. The reorganization plan recommended by the trustee and adopted by the bankruptcy court was premised on the conviction that the railroad was utterly insolvent. The result was that *(a)* all stockholders' interests, both common and preferred, were wiped out; *(b)* unsecured creditors were paid in cash at the rate of 10 cents per dollar; and *(c)* the railroad operation was severed from the only income-producing asset of the old railroad company, the twin 22-story office buildings that were constructed on top of the railroad's downtown Manhattan terminal, to prevent the railroad's deficits from causing the financial demise of the office buildings.

Unlike the situation in *Fifth Avenue,* there was no unreasonable regulation; the company was simply commercially incapable of profitable operations.[50] There were no prospective commercial purchasers. Although the Court of Appeals noted that under the circumstances traditional rules required a determination that the value of the property "to its owners was liquidation or scrap value,"[51] it nevertheless modified the award below and remanded for a determination of value for going concern assets.[52] The court stressed the owner's expenditures in creating a useful transportation system[53] and invoked an equitable balancing rule, commenting: "when the market value has been too difficult to find, or *when its application would result in manifest injustice to the owner or public,* courts have fashioned and applied other standards."[54]

C. *The Second Fifth Avenue Opinion*

In its second *Fifth Avenue*[55] opinion, the Court of Appeals indicated that the trial court on remand improperly applied a market

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50 The fact is crucial to understanding why the principles of the *Fifth Avenue* case may have been erroneously applied to the facts of the *PATH* case. This is suggested by Justice Burke, who enunciated the principles of *Fifth Avenue* by writing the majority opinion therein but dissented in the *PATH* litigation.

In an advisory report rendered to the bankruptcy court, recommending approval of a proposed reorganization plan as fair and feasible, the Securities and Exchange Commission noted:

> The report concluded that the Debtor, as a private enterprise, could produce no foreseeable return to its present security holders; consequently, the only value would be the salvage resulting from the liquidation, which is estimated as of December 31, 1959, at $2,573,800 for the railroad properties exclusive of the tunnels. In an earlier report on the liquidation value of the railroad assets, the engineers had arrived at a value of $525,000 for the tunnels on the basis of their use to carry telephone lines, resulting in a combined liquidation value of $3,098,800.

In re Hudson & Manhattan R.R., 39 S.E.C. 852, 865 (1960).

51 *Id.* at 465-66, 231 N.E.2d at 737, 285 N.Y.S.2d at 28. In arriving at a scrap or liquidation value standard for compensation, the Appellate Division rejected a market value test, on the ground that "properties of this sort are in a sense unique and are rarely if ever bought and sold in the open market." It also rejected the substitute facility doctrine and closely related reproduction cost tests, on the ground that neither could be applied where a claimant failed to show that replacement was necessary or that reproduction was reasonable "as a good commercial investment." 27 App. Div. 2d at 40-43, 276 N.Y.S.2d at 290-93.

52 20 N.Y.2d 457, 231 N.E.2d 734, 285 N.Y.S.2d 24.

53 *Id.* at 468, 231 N.E.2d at 738, 285 N.Y.S.2d at 30. "A condemnor should not be permitted to tell [the owner]: 'It's only worth scrap or less.'" *Id.*

54 *Id.* at 468, 231 N.E.2d at 738, 285 N.Y.S.2d at 30-31 (emphasis in original). We will later discuss the dissenting opinion of Judge Burke with respect to the standard of compensation applied by the court in the *PATH* case. In Judge Burke's view the majority improperly applied a "value to the taker" standard for compensation. *Id.* at 481, 231 N.E.2d at 746, 285 N.Y.S.2d at 41.

55 22 N.Y.2d 613, 241 N.E.2d 717, 294 N.Y.S.2d 502 (1968).

value, "willing buyer-willing seller" standard for determining compensation.[56] The court characterized the trial court's failure to make awards for route layout and development, operating systems, records and procedures (for accounting, maintenance, and personnel), and franchises, operating rights, and permits, along with certain categories of trained personnel, including maintenance and janitorial help and executive personnel, as conflicting with both the evidence and the initial directive of the court.[57] The court's rationale in the second opinion, as in the first, was that each of these items contributed to and was an essential component of the entity.[58] Accordingly, the development cost for each of these items should be an item of damage to the owner of a condemned utility. The court also rejected the trial court's reliance on the percent method for checking going concern value.[59] The *Fifth Avenue* case is again in the hands of the trial court for the formulation of a decree in accordance with the two Court of Appeals opinions.

II

Principles of Valuation and Methods of Compensation

The Court of Appeals has clearly disapproved of the generally applied market value, "willing buyer-willing seller" standard for

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[56] In footnote three of its opinion, the Court of Appeals indicated that on remand the trial court recognized that the property should be valued by the reproduction cost less depreciation method but nonetheless proceeded to apply the market value test, and improperly at that: "Were the 'willing buyer' rule applicable to this case, it is nevertheless improper, even under this rule, to endow the 'hypothetical buyer' with all the powers of a sovereign, as the court did when it valued claimants' franchises." *Id.* at 620 & n.3, 241 N.E.2d at 720 & n.3, 294 N.Y.S.2d at 505 & n.3.

[57] *Id.* at 621-27, 241 N.E.2d at 720-24, 294 N.Y.S.2d at 506-12.

[58] *Id.* at 619-20, 241 N.E.2d at 719, 294 N.Y.S.2d at 504-06. It is significant that the majority indicated in a footnote to the opinion that the *PATH* case pushed the rule for compensation even further. The Court of Appeals there held that compensation should be paid even though it was "clear that the condemned facility is 'inherently incapable' of operating at a profit." *Id.* at 619 & n.2, 241 N.E.2d at 719 & n.2, 294 N.Y.S.2d at 505 & n.2.

[59] Were we to bind ourselves to such a mechanical jurisprudence, these utility rate cases would in any event be inapplicable. As the city's expert testified, a proper rule (should one be employed) for bus companies would require an award for going concern of 20% of the tangible assets. In this case, that would be $6,070,708. Thus, by properly employing the verification test suggested by Special Term, it becomes apparent that an award of only $2,577,500 is indeed inadequate.

Id. at 627, 241 N.E.2d at 724, 294 N.Y.S.2d at 511-12. Implicit in the court's holding in this regard is its recognition that using the conventional 10% of tangible assets to reflect the value of intangibles is inappropriate for an omnibus line in which, unlike conventional utilities, operating expense rather than capital investment is the primary risk to investors. *See, e.g.*, E. Nichols, Ruling Principles of Utility Regulation: Rate of Return 438 (1955).

compensation in utility condemnations. Absence of a free market for privately owned utilities,[60] due in part to monopoly factors, subsidies, and government regulation of utilities, supports the court's position.[61] If the hypothetical perfect market is not the standard for compensation, what rule did the courts apply in the *Fifth Avenue* and *PATH* cases?

The condemnors argued in both cases that since the businesses were in fact not making a profit, the owners were entitled only to scrap value for the tangible assets. This argument was rejected in *Fifth Avenue* by the Court of Appeals which permitted compensation to be based on a capability of profitable operations rather than actual profitable operations.[62] The Court of Appeals's analysis in *Fifth Avenue* does not focus on factors showing the gain to the taker,[63] such as the reason for condemnation, special adaptability for public use, alterations necessary to permit the public use, and whether the taking was simply to improve public service or was a vehicle, like taxing, to increase public revenues.[64] Rather, the court simply eliminated the artificial restraints—unreasonable regulation—making impossible an equitable valuation of the assets of the claimants. The court thus, to a certain extent, set up a "market in a vacuum," free of governmental restraint, to determine the owner's loss.[65] May we then conclude that the standard applied was what the owner would have lost in the taking had there not been extraneous market factors, including severe rate regulation?

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60 *See, e.g.*, 1 J. BONBRIGHT, VALUATION OF PROPERTY 431-47 (1937) [hereinafter cited as BONBRIGHT]; 2 ORGEL §§ 202-03, at 65-67, § 205, at 79.

61 Monopoly factors in the regulatory context are discussed in Onondaga County Water Auth. v. New York State Water Serv. Corp., 285 App. Div. 655, 662, 139 N.Y.S.2d 755, 763 (4th Dep't 1955), and City of Omaha v. Omaha Water Co., 218 U.S. 180, 202 (1910). The question of subsidies was discussed in the second lower court opinion in the *Fifth Avenue* case, specifically in terms of the contracts entered into between the company and various public authorities for the transportation of school children. *In re* City of New York (Fifth Avenue Coach Lines, Inc.), 47 Misc. 2d 734, 736-37, 263 N.Y.S.2d 96, 99 (Sup. Ct. 1964).

62 18 N.Y.2d at 220-21, 219 N.E.2d at 412-13, 273 N.Y.S.2d at 55-57. This aspect of the *Fifth Avenue* case and an interesting side issue—the propriety of collaterally attacking the reasonableness of a rate structure in the condemnation proceeding when the owners have failed to directly attack the rate structure before the public service commission of competent jurisdiction or by statutory review procedures—are discussed in Note, *Going Concern Value in Condemnation of Unprofitable Public Utilities*, 52 CORNELL L.Q. 752, 756-61 (1967).

63 It is a basic principle of condemnation law that the taker's peculiar use of a condemned property should not be considered in fixing the award for the taking. 1 ORGEL § 81. *But cf. id.* at ch. 8.

64 Note, however, the difference in approach in the *PATH* opinion. 20 N.Y.2d at 464-72, 231 N.E.2d at 736-41, 285 N.Y.S.2d at 27-33.

65 18 N.Y.2d at 220-21, 219 N.E.2d at 412-13, 273 N.Y.S.2d at 55-57. *Cf.* 1 ORGEL § 87.

Unfortunately, the Court of Appeals's analysis in *PATH* defies this tidy analysis.[66] The unprofitability of the Hudson Tubes was not attributable to unreasonable rate regulation.[67] Continued private ownership promised bankruptcy and receivership.[68] Under these circumstances, the resolve of the Court of Appeals in *PATH* to compensate the owner for going concern value cannot be explained by any determination that the business was capable of profitable operation.

The court considered two factors in finding going concern value. First, "[t]his owner has developed its property at a cost of millions of dollars and operated it for more than 50 years."[69] Second, "[i]t [the tubes] is admittedly of great usefulness in the daily transportation of thousands of commuters."[70] On the basis of these findings, the Court of Appeals rejected the award below of scrap value:

> Can it be said by any objective standard that an award of scrap value—*nothing*—is fair and just for the tunnel property, an essential part of an essential public facility, which cost some $32,000,000 to construct, which would cost in excess of $400,000,000 to reproduce and which, with some minor expenditures, will function as good as new for an indefinite period? We think not.[71]

This analysis appears at first blush to be contrary to the "value to the owner" standard promulgated in *Fifth Avenue*; in *PATH* the court found it inequitable to award an owner scrap value for a facility with

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66 For the sake of simplicity, the *PATH* case is discussed in terms of "value to the taker" and "loss to the owner;" but the terms are inappropriate to describe the true nature of the property of which claimant was deprived. In *PATH* "value" to the taker was acquisition of an antiquated, financially debilitated railroad which required the expenditure of tens of millions of dollars and which would produce nothing but financial losses for the indefinite future; "loss" to the owner was an eagerly sought opportunity to rid itself of commercial property incurring mounting losses, which could not have continued in private operation for very long.

67 As was stated by Judge Burke in dissent in the *PATH* case:

> Today, however, we are told that the claimant owner of a decrepit, financially hopeless transportation system, tailored to the measurements of an ancient, badly mended tunnel is entitled, by reason of the decision of the public authorities to take over its operations, rehabilitate it at a cost of about 80 million dollars, and assume its losses, to a special dispensation from this basic rule.

In re Port Authority Trans-Hudson Corp., 20 N.Y.2d 457, 475, 231 N.E.2d 734, 742, 285 N.Y.S.2d 24, 36 (1967).

68 *See* Official Transcript of Proceeding before Mr. Justice Quinn, July 14, 1962, at 43-45 (read in part in evidence on the trial of the *PATH* proceeding). It was because lack of funds promised imminent cessation of private railroad operations that the legislatures of New Jersey and New York enacted concurrent legislation in 1962 directing the acquisition of the railroad. 20 N.Y.2d at 465, 231 N.E.2d at 736, 285 N.Y.S.2d at 28.

69 20 N.Y.2d at 468, 231 N.E.2d at 738, 285 N.Y.S.2d at 30.

70 *Id.*

71 *Id.* at 470, 231 N.E.2d at 739, 285 N.Y.S.2d at 32.

substantial utility for the public. But is it proper to conclude that the court adopted a "value to the taker" test?[72]

To focus *solely* on the issue of profitability at the date of taking would have made determination of the owner's loss in *PATH* pointless. The Court of Appeals requires a broader inquiry. In addition to capability of profitable operation, the amount of expenditures necessary to develop the facility must also be determined.[73] This "development cost" theory results in compensating the owner for his loss in terms of the history of expenditures in developing the business.[74] Of course, "but for" its usefulness to the public, continuance of private operation would make inevitable the permanent loss of these development costs.[75] The court in *PATH* may also have overlooked the owner's previous compensation for development cost through amortization and tax writedowns.[76] In terms of the analysis of the Court of Appeals in the *Fifth Avenue* and *PATH* cases, it can be concluded that the owners were paid for physical plant, all tangible assets, in the broadest sense, and for all of what the court characterized as the intangible, going concern assets of the business. Note, however, that claims for consequential damages were rejected by each court passing upon the question in the *Fifth Avenue* case.[77]

Certain tentative conclusions about New York's valuation standards can be drawn from the *PATH* and *Fifth Avenue* cases. First, while a market value, "willing buyer-willing seller" standard was rejected as the exclusive measure, the Court of Appeals certainly applied a part of that standard in hypothesizing a regulation-free market in *Fifth Avenue* before proceeding to valuation of the intangible assets. Second, a partial reliance on a "value to the taker" theory may be inferred, insofar as the valuation arrived at in *Fifth Avenue* is admittedly hypothetical and reflects only the promise of future operations unhampered by governmental restraints. Similarly, the emphasis by the court

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72 *See* text accompanying note 66 *supra*. At least one writer has so criticized the *PATH* case. Note, *Eminent Domain—Depreciated Original Cost Held To Be Just Compensation for Unprofitable Railroad*, 43 N.Y.U.L. REV. 788, 799-91 (1968).

73 20 N.Y.2d at 470-71, 231 N.E.2d at 740, 285 N.Y.S.2d at 32-33; 1 ORGEL § 92.

74 Cynics might say that on the facts of the *PATH* case, the result compensates the railroad's creditors many times in excess of the value of their loss.

75 *See* note 103 and accompanying text *infra*.

76 In proceedings before the New York State Tax Commission a few months prior to the condemnation proceedings, the railroad protested an $8 million valuation as excessive, claiming that its properties had "no value on a going concern basis."

77 *See* pp. 424-28 *infra*. If a pure "value to the owner" standard for compensation had been applied, would it not have been necessary for the courts to make an award for each and every item of the owner's loss, including provable consequential damages?

in *PATH* on the public usefulness of the property must be noted. Third, either standard may be subject to the court's conclusion that the owner cannot be compensated for any items of consequential damage.[78] Perhaps what the Court of Appeals did in *Fifth Avenue* and *PATH* defies precise classification in terms of either the "owner's loss" or the "taker's gain" formula. The common denominator may simply be equity balancing—"a result which is 'just' both to an owner whose property is taken and to the public that must pay the bill."[79]

A. *Formulas for Compensation*

The Court of Appeals's use of a development cost theory[80] to calculate the value of going concern assets requires computation of the "cost" of each item classified by the court as a going concern asset.[81] An item so classified is included even if, like the outmoded tunnels in *PATH*, it would not be reproduced by anyone today.[82] This rule seems clearly inequitable.[83]

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78 *See* pp. 424-28 *infra.*

79 *In re* Port Authority Trans-Hudson Corp., 20 N.Y.2d 457, 470, 231 N.E.2d 734, 739, 285 N.Y.S.2d 24, 32 (1967), *quoting* United States v. Commodities Trading Corp., 339 U.S. 121, 123 (1950). One of the authors vigorously dissents on the "justness" of the *PATH* decision. For one who participated in the case on behalf of New Jersey, the feeling is inescapable that the case resulted in a windfall for speculators.

We commend to purists intent upon fitting the holdings of these cases into a single category Professor Hale's article on value to the taker, which may provide a categorical classification that we have not discerned. Hale, *Value to the Taker in Condemnation Cases*, 31 COLUM. L. REV. 1 (1931).

80 The development cost theory applied by the Court of Appeals encompasses not only the traditional elements of that theory but also elements of the comparative plant theory or business reproduction method and the accumulated deficits or unrequired costs theory. *See generally* 2 ORGEL § 216; Lewis, *Going Value and Rate Valuation*, 26 MICH. L. REV. 713 (1928). This theory is distinguishable from the somewhat similar substitute facility doctrine.

81 *In re* City of New York (Fifth Avenue Coach Lines, Inc.), 22 N.Y.2d 613, 619-20, 241 N.E.2d 717, 719-20, 294 N.Y.S.2d 502, 504-06 (1968); *In re* Port Authority Trans-Hudson Corp., 20 N.Y.2d 457, 471-72, 231 N.E.2d 734, 740, 285 N.Y.S.2d 24, 33 (1967); *In re* City of New York (Fifth Avenue Coach Lines, Inc.), 18 N.Y.2d 212, 221, 219 N.E.2d 410, 413, 273 N.Y.S.2d 52, 56-57 (1966). Of the problems involved in this determination, that of classifying items as going concern assets is probably the most difficult.

82 *In re* Port Authority Trans-Hudson Corp., 27 App. Div. 2d 32, 41-42, 276 N.Y.S.2d 283, 291-92 (1st Dep't 1966); *cf. In re* City of New York (Fifth Avenue Coach Lines, Inc.), 22 N.Y.2d 613, 623-24, 241 N.E.2d 717, 722-23, 294 N.Y.S.2d 502, 507-09 (1968).

83 For example, because the *PATH* tunnels were originally intended to accommodate streetcars, the tunnels are smaller and contain sharper curves than modern tunnels. In spite of the $30 million awarded for the tunnels, all the New York courts considering the matter have recognized that neither the tunnels nor the railroad would be reproduced by anyone today. In fact, expenditures totaling $125 million have already been made by Port Authority to modernize the railroad's facilities.

Under the substitute facility doctrine, the award must be sufficient to finance a re-

Although easy to apply, because of the company's cost accounting records, the development cost theory may be based upon arbitrary assumptions and data having little or no relationship to going concern value at the date of taking. If the cost incurred in developing going concern assets was inflated by poor management, inefficient operation, and extravagant spending, the sum of these cost figures has no real relation to a present going concern value.[84] In applying this theory, courts should judge the propriety of the charges claimed to have been incurred in developing the going concern. The time factor may also introduce extraneous elements into the calculation, since a development cost incurred some time prior to the taking may have little or no relationship to the going concern value of the property at the date of taking.[85] Similarly, development costs may vary with the location of the property; such variance could completely upset the valuation equation, since an urban utility with low development costs should have a greater going concern value than a rural utility with higher development costs.

Closely related to the development cost theory is the broader "liquidation asset value" determinant. This method would have been particularly useful in the *PATH* case or wherever an entity has long been without earning power. In applying liquidation asset value, deductions should be made from gross liquidation asset value for the expenses of liquidating the assets. Each item of property should be given a detailed valuation, which may result in more money being paid for the entity than its worth as a going concern. Nevertheless, this method may be fairer to all parties concerned, and is generally adopted in railroad mergers. In the Pennsylvania and New Haven railroad merger, the Interstate Commerce Commission determined that even though "the total value of the New Haven sold as a going concern is less than its liquidation value,"[86] the liquidation value should be the price paid by the Pennsylvania. Nothing was added for going concern value.[87]

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placement. The rule is qualified, however, by the holding that it is applicable only if a replacement is "necessary." Note, *Just Compensation and the Public Condemnee*, 75 YALE L.J. 1053 (1966).

84 Kashman, *Going-Concern Value of a Public Utility in Condemnation by a Municipality*, 6 ARIZ. L. REV. 92, 97 (1964).

85 *Id.*

86 Pennsylvania Railroad Company—Merger—New York Central Railroad Company, Interstate Commerce Commission, Finance Docket No. 21989, at 62 (decided November 16, 1967). The Commission found that the New Haven had neither earning power nor the prospect of earning power. *Id.*

87 It is not realistic to assume that a potential buyer would pay the liquidated

A third formula is the market value of outstanding securities.[88] Assuming that a turnover of a substantial amount of a utility's outstanding stock could be projected, sale prices for this stock would reflect the value of the business. The total stock price could reflect a market estimate of the future net earnings of the operation and could constitute a rough index of an exchange price for the entire property. To be meaningful, these stock projections must be in a market volume sufficient to reflect the value of the entire business.[89] In most circumstances sole reliance on this method is questionable. Many factors that do not affect going concern value affect the market value of the company's stock. For example, if advance information were available regarding a prospective condemnation, quotations for the company stock would be influenced and thus lose their value as indicators of fair market value at the date of taking.[90] In addition, most utilities are closely held and do not provide a broad market base of recent actual sales sufficient to project a fair market value for the enterprise.[91] Prices of listed securities may fluctuate for social, economic, or political reasons having no bearing on the condition or operation of the subject utility;[92] the company may be overcapitalized or may pay unnecessarily large salaries.[93] On the other hand, efficient management may elect to put surplus earnings into capital improvements rather than declare dividends.[94] Subject to these limitations, however, the "security value" method of appraisal should be competent evidence in valuing utility assets. The lower court opinion in the *PATH* case indicated, on the facts of that case, that security valuation would have no validity in terms of fixing the fair market value of a condemned utility.[95] This statement may be erroneous to the extent that bond transactions might have shown speculators clamoring to buy in because of the condemnation. This method should certainly be used in a proper case in the future.

A fourth formula for compensation is capitalization of net earn-

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> value of the NH assets and then pay additional amounts representing elements of going concern in the face of NH past deficit operations and its bleak prospects for the future.

Id. at 61-62.

88 1 BONBRIGHT 444-46.

89 *Id.*

90 *Id.* at 446.

91 *Id.*

92 Kashman, *supra* note 84, at 98.

93 *See* Bardstown & Louisville Turnpike Co. v. Nelson County, 117 Ky. 674, 684, 78 S.W. 851, 855 (1904).

94 Kashman, *supra* note 84, at 97-98.

95 48 Misc. 2d at 531, 265 N.Y.S.2d at 971-72.

ings.[96] Assuming an accurate history of earnings properly reported, this method eliminates some of the shortcomings of the development cost theory's basis in early cost figures having no relation to present value. But since most utilities are regulated, earnings may not reflect their actual going concern value.[97] Also, reliance on a pattern of earnings requires projecting a future life for a company that as a regulated entity is subject to rate changes and discontinuance as a private enterprise by condemnation.[98] For these and other reasons, this approach has been uniformly rejected by the courts.[99]

Another method of valuation is the percent method, which involves the use of a percentage, usually ten percent,[100] of the tangible asset value of the company as the value of the intangible going concern assets. As the Court of Appeals pointed out in *Fifth Avenue*, this method is the most arbitrary. A percentage proper for a business of one size or kind may be improper for a business of another size or kind.[101] The method might be sound if a sufficiently large sampling of utility valuations were available so that "normal" percentages for different types of utilities and different size operations could be established, but at present we lack such experience. Reference to rate-making cases is inappropriate because rate-making is directed toward determining a fair return on investment for a regulated business rather than the calculation of exchange value.[102]

In applying any of these methods the position of those to be compensated should be considered. If the compensation is to be "just," then it should go to those who have a "real interest" that is being taken. There is no question that compensating the owners in *Fifth Avenue* was just. But in *PATH*, the *primary* beneficiaries of the award were speculators. All stockholder interests, both common and preferred, were wiped out during the bankruptcy proceedings and only secured

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96 1 BONBRIGHT 440-44.

97 *In re* City of New York (Fifth Avenue Coach Lines, Inc.), 18 N.Y.2d 212, 220-21, 219 N.E.2d 410, 412-13, 273 N.Y.S.2d 52, 55-56 (1966).

98 4 P. NICHOLS, EMINENT DOMAIN § 15.41(1), at 816 (rev. 3d ed. 1962) [hereinafter cited as NICHOLS].

99 2 ORGEL §§ 216, 218.

Despite its problems, capitalization of net earnings might be useful where there is a stable pattern of regulation for utilities similarly situated. For example, if fares are uniform over most of the state, the problem of differing regulation for each utility is eliminated. Thus if the utility showed substantially greater earnings than other utilities similarly situated and subject to identical regulation, capitalization of income would reflect relatively higher going concern value for the subject.

100 *See, e.g.*, International Ry. v. Prendergast, 1 F. Supp. 623, 629-30 (W.D.N.Y. 1932).

101 New York & Richmond Gas Co. v. Prendergast, 10 F.2d 167, 178 (E.D.N.Y. 1925).

102 1 BONBRIGHT 436-40.

creditors remained to be paid off. The stockholders appealed to the Second Circuit to be allowed to participate in the newly formed corporations, arguing that the railroad possessed commercial value because is was likely to be condemned by a public agency for continued operation, but the court rejected the argument.[103] The Court of Appeals ignored this holding, and in so doing permitted awards to investors who had purchased the securities at heavily discounted figures. Its decision was ill-considered, since the decision could well force state and local governments to allow privately owned, insolvent transit facilities to grind to a halt rather than pay the owners of such facilities sums well in excess of the economic worth of their enterprises—sums predicated solely upon the public need. When the transit system ceases operations because of lack of funds, a public agency could acquire the physical assets of the defunct facility on a liquidation basis without paying a large windfall to speculators. The public, of course, would be the loser since it would suffer the discomforts of allowing a mass transit facility to run itself into the ground.

It should be apparent that the best approach to utility condemnation is to use each valuation method for whatever merit it may have.[104] New York courts appear to take the unreasonable position that the development cost theory should be used to the exclusion of any other valuation formula. In private condemnation cases it took a number of years to persuade courts to look at different appraisal techniques to value condemned property.[105] Only recently have the courts in private condemnations accepted evidence by way of comparable market sales, capitalization of income, and reproduction cost; the theory now, however, is that each method is competent for consideration by the court for whatever it is worth in terms of reflecting the value of the particular condemned property.[106] Similar reasoning should govern the use of

103 Spitzer v. Stichman, 278 F.2d 402, 409-10 (2d Cir. 1960). The court commented:

> The only invariable principle of valuation in condemnation proceedings is that the award should reflect what the owner has lost; the criterion is not what the taker has gained. In the absence of a market value, this may properly be determined by what the property "brings in the way of earnings to its owner." Where the property is incapable of producing earnings, "junk value" may be appropriate.

Id. at 410 (citations omitted).

104 *See* National Waterworks Co. v. Kansas City, 62 F. 853, 864-66 (8th Cir. 1894).

105 *Cf.* Aloi & Goldberg, *supra* note 10.

106 *In re* Huie, 2 N.Y.2d 168, 171, 139 N.E.2d 140, 142, 157 N.Y.S.2d 957, 960-61 (1956). The precise question of the applicability in the condemnation of a public utility of different methods of compensation—methods other than the development cost theory promulgated by the Court of Appeals in the *Fifth Avenue* and *PATH* cases—was considered in *In re* City of Rochester (Rochester Transit Corp.), 57 Misc. 2d 645, 648, 293 N.Y.S.2d 475, 478 (Sup. Ct. 1968), where the court commented:

> The answer, as I see it, to the contention that the *Fifth Ave. Coach Lines*

appraisal techniques in valuing utilities. Use of all these methods, properly limited and applied, is necessary to provide a court with the maximum assistance in determining fair market value for the condemned utility.

B. *Franchise As a Separate Valuation Component*

In valuing a transit system condemned by a public authority, the Court of Appeals characterized a franchise as "property," in the constitutional sense of the term,[107] for which the owner must be compensated. A franchise is the privilege of continued operation of a business at a particular location or, in the case of an omnibus line, over certain routes. It usually represents an excess of value over the market value of the tangible property employed in a business. Whether it is a separate valuation component or an element of going concern value is not important so long as some specific recognition is given it.

Examination of the principal arguments against compensating for the "franchise" provides an insight into the nature of this element of value. All franchises are subject to the inherent power of government to revoke them, and it can thus be argned that the condemning governmental authority is not gaining any asset vital to its operation of the utility.[108]Just compensation, however, is based upon loss to the owner, not value to the taker. To the owner, the franchise may be a valuable asset, as in *Rochester*,[109] or it may be the continuance of a net loss operation, as in *PATH*.[110] In one case, the right to do business is valuable and compensable; in the other, it is neither valuable nor compensable.

Another argument against compensation is that the "franchise" is not condemned; the only items taken are the tangible assets of the entity. Such an argnment is metaphysically sound but economically

and *Port Auth. Trans-Hudson Corp.* cases mandate a reproduction cost, less depreciation, plus "going concern" value rule is given by Judge BURKE in his dissenting opinion in *Matter of Port Auth. Trans-Hudson Corp.* (supra, p. 475), when he says: "The majority is correct in asserting that determination of the just compensation to which one whose property has been taken under the power of eminent domain is entitled, is, as the cases reveal, not subject to 'rigid rules.'"

107 *See* Kimball Laundry Co. v. United States, 338 U.S. 1, 12-13 (1949); Los Angeles v. Los Angeles Gas & Elec. Corp., 251 U.S. 32, 39 (1919).

108 "The city did not need to acquire these franchises in order to operate the buses over the routes theretofore used by claimants, since the city always had the right to do so." *In re* City of New York (Fifth Avenue Coach Liues, Inc.) (N.Y. Sup. Ct. April 17, 1967), in 157 N.Y.L.J., April 18, 1967, at 19, col. 4. *See also* 19 N.Y. JUR. *Eminent Domain* § 236, at 482 (1961). *But see* National Waterworks Co. v. Kansas City, 62 F. 853 (8th Cir. 1894) (utility awarded going coucern value for an expired franchise); 2 ORGEL § 216 and cases cited in n.117 therein.

109 The Rochester Transit Corporation, at the time of taking, had an operational profit of approximately half a million dollars per annum.

110 *See* note 49 *supra*.

untenable. Retention of a franchise without the means of exercising it amounts to a de facto condemnation of the privilege to do business[111] even within the rationale of the "no direct taking" argument.

When a franchise is viewed as a privilege of continuance, it is similar to another intangible asset, a compensable item in private condemnations—goodwill.[112] It is useful to distinguish the two concepts in order better to understand the nature of a franchise.[113] First, since a utility is a regulated business often conducted as a geographic monopoly, the impetus of competition is not present to force the conduct of operations in a manner likely to generate goodwill.[114] Second, in a private business goodwill is generated from within; in a regulated business, the franchise is a contractual right or license bestowed from without by a public authority. However, since it may be possible to hypothesize goodwill for a utility by recognizing regulation as a substitute for competition,[115] the analysis is imperfect.

In the regulated market, goodwill may be equated with an efficiency of operation[116] resulting in a maximum allowable return to investors and the best possible service to customers. In this case, the franchise is viewed as nothing more than the initially acquired license. In *PATH*, value to the public was an indispensable prerequisite to the taking and to the rationale that the owner should be compensated

111 Eighth Avenue Coach Corp. v. City of New York, 286 N.Y. 84, 35 N.E.2d 907 (1941); *In re* City of New York (Fifth Avenue Coach Lines, Inc.), 29 App. Div. 2d 638, 639, 287 N.Y.S.2d 454, 455 (1st Dep't 1968) (dissent). It is immaterial that any particular franchise is non-exclusive since we are focusing on the right which a particular claimant is deprived of by reason of the condemnation. Similar reasoning requires compensation for a franchise even if it is revocable at will.

112 Goodwill is treated as property which may be sold in bankruptcy proceedings along with other tangible assets. *See* Mutual Life Ins. Co. v. Menin, 115 F.2d 975, 977 (2d Cir. 1940). *See also* Aloi & Goldberg, *supra* note 10, at 626-36.

113 The trial judge in the *Fifth Avenue* case appeared to equate goodwill with going concern value. *In re* City of New York (Fifth Avenue Coach Lines, Inc.), 46 Misc. 2d 14, 18, 259 N.Y.S.2d 313, 320 (Sup. Ct. 1964). The definitional problem of goodwill vis-à-vis going concern value is apparently shared by the United States Supreme Court. *Compare* Kimball Laundry Co. v. United States, 338 U.S. 1, 1-10 (1949), *with* Des Moines Gas Co. v. Des Moines, 238 U.S. 153, 164-65 (1915). *See also* Note, *supra* note 62, at 754 & n.17.

114 Omaha v. Omaha Water Co., 218 U.S. 180, 202 (1910).

115 This function of rate-making is illustrated by the often quoted maxim that in rate regulation the purpose is to determine what would be a fair return on the investment in the plant of the company. Without regulation or competition this inquiry would be moot; the company could earn whatever return was possible on the investment. *See, e.g.*, J. BAUER & H. GOLD, PUBLIC UTILITY VALUATION FOR PURPOSES OF RATE CONTROL (1934); J. GRAY & J. LEVIN, THE VALUATION AND REGULATION OF PUBLIC UTILITIES (1933).

116 *Cf.* the concept of marginal efficiency, Aloi & Goldberg, *supra* note 10, at 622-26 & nn.87-95.

on the basis of development cost. Should an additional increment be paid if a company is either profitable, as in *Rochester*, or, but for unreasonable rate regulation, capable of being profitable, as in *Fifth Avenue*? Is the additional increment really goodwill as ordinarily understood or is it simply another element of the owner's loss—a loss reflected in the public's acquisition of a healthy company?[117] Regardless, the courts have neither equated franchise value with goodwill nor made separate awards for goodwill in the condemnation of a utility.

Assuming that a franchise is recognized as a separate element of value, how is the value determined? The Court of Appeals paid scant attention to this problem. One method might be a cost approach based upon a present projection of the expenditures required to obtain operating privileges identical to those owned by the company. If a capitalization of earnings approach were used to value the going concern assets of the utility, the problem would disappear since any figure arrived at by that method necessarily would include a value for the franchise.[118] If regulation prevents the company from actually earning a profit, a pattern of hypothetical earnings could be constructed on the assumption that unreasonable regulation would be removed. The rate would remain in question. Another method might be "comparable sales." This would involve projection of a private sale value for a franchise by inquiring into any transfers of utility companies within a reasonable time of the date of taking which involved a transfer of franchise from one private owner to another.[119]

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117 This distinction was noted by Judge Burke in dissent in *PATH*. *In re* Port Authority Trans-Hudson Corp., 20 N.Y.2d 457, 474-75 (1967). *See also* Note, *supra* note 72.

118 "The value of the franchise may be reached by capitalizing the income which would probably be earned during its existence over and above a fair return upon the tangible property in the plant." 4 NICHOLS § 15.42(1). Nichol's method assumes the existence of income and also leaves unanswered the question of apportioning the income between tangible assets and the franchise.

119 In *Fifth Avenue* the owners attempted such proof. The trial judge rejected the data and argued that the allegedly comparable sales were of utilities operating under fare structures different than the subject's, despite a similar "average asset mix." *In re* City of New York (Fifth Avenue Coach Lines, Inc.), 46 Misc. 2d 14, 25, 259 N.Y.S.2d 313, 327 (Sup. Ct. 1964). This determination by the trial judge remained undisturbed on appeal. A comparable earnings standard has been suggested for rate regulation. Leventhal, *Vitality of the Comparable Earnings Standard for Regulation of Utilities in a Growth Economy*, 74 YALE L.J. 989 (1965). Given the continuing problem as to whether regulation, at least for purposes of condemnation, is "reasonable," it is unlikely that comparative earnings will be of any use in fixing the award in condemnation. *Cf. In re* City of Rochester (Rochester Transit Corporation), 57 Misc. 2d 645, 648, 293 N.Y.S.2d 475, 477-78 (Sup. Ct. 1968).

C. *Consequential Damages for Pension Liability*

The Court of Appeals's failure in the *Fifth Avenue* case to award compensation for items of damage, particularly pension liability, considered under the classification of "consequential damages" is unsatisfactory both as to results and reasoning. We are not concerned here with any novel class of items claimed to be compensable, but rather with specific items that would be compensated for under some methods of valuation. For example, pension liability could have been considered by the Court of Appeals in the *Fifth Avenue* case as a component of the utility's development cost under the category "trained personnel." Alternatively, separate consideration of pensions would be unnecessary if the owner were compensated by the capitalization of income method on the basis of earnings calculated before the deduction of pension payments. Thus the issue is not whether "consequential damages"—the term is used only because the courts have used it—are compensable in the abstract, but whether pension liability, if not taken into account by the method of valuation employed, should be separately accounted for.

It may seem that the company can be liable only for the pensions of employees who have already retired at the time of the condemnation. Under traditional contract rules, no pensions are owing to employees ineligible to retire at the time of condemnation, since employees seeking pension payments must as a condition precedent perform every condition in the collective bargaining agreement.[120] The same rule may prevent company liability to employees who are eligible for a pension but who have elected to continue services in order to retire at an increased pension; arguably one must not only perform the required services but also retire to become eligible for a pension.

There is, however, a line of cases imposing liability on the company, notwithstanding the failure to fulfill the conditions precedent of service for a given number of years and retirement.[121] Departing from strict contract law, these cases hold that where a pension plan is terminated by external conditions beyond the control of employees (as, for example, by private discontinuation of business or condemnation)

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120 *See* Burgess v. First Nat'l Bank, 219 App. Div. 361, 220 N.Y.S. 134 (2d Dep't 1927); Dolge v. Dolge, 70 App. Div. 517, 521, 75 N.Y.S. 386, 387 (4th Dep't 1902); McNevin v. Solvay Process Co., 32 App. Div. 610, 612-13, 53 N.Y.S. 98, 99-100 (4th Dep't 1898). *See also* Upholsterers' Int'l Union v. American Pad & Textile Co., 372 F.2d 427 (6th Cir. 1967); Bromberg v. United Cigar-Whelan Stores Corp., 19 C.C.H. Lab. Cas. ¶ 66, 203 (N.Y. Sup. Ct. 1951).

121 *See* Bernstein, *Employee Pension Rights When Plants Shut Down: Problems and Some Proposals*, 76 HARV. L. REV. 952 (1963).

failure of these employees to fulfill contractual conditions precedent to pension payments cannot be termed willful or a breach of their pension contract obligations; accordingly, they are entitled to a pro rata share of their pension benefits in relation to the amount of services they were able to perform.[122] This analysis views pension payments as a component of wages; to cut off all pension payments where the employee had at least partially performed the required services results in unjust enrichment to the employer.[123] To some extent, this view has been incorporated in those state and federal statutes that require the condemnor to continue active employees in the service of the new company and accord them their full pension benefits in terms of prior contracts.[124] In this limited instance, the employees will not be adversely affected by a finding that the private owner is not responsible for their pensions.

In *Fifth Avenue* the trial court ruled that regardless of the companies' liability for pensions,[125] no compensation need be paid for what amounts to a frustration of subsisting contractual liability.[126] The

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122 *E.g.*, Lucas v. Seagrave Corp., 277 F. Supp. 338 (D. Minn. 1967).

123 Insofar as a pension can be said to be "wages" and a "condition of employment" under the Labor-Management Relations Act of 1947 and the Wagner Act, it is possible to argue a breach of statutory rights where pensions are cut off for whatever reason. Inland Steel Co. v. NLRB, 170 F.2d 247 (7th Cir. 1948), *cert. denied*, 336 U.S. 960 (1949).

124 *See* § 755 of the Wicks Act, N.Y. UNCONSOL. LAWS §§ 751-757 (McKinney 1949). Similarly, the applicable federal statutes condition federal assistance for municipal condemnation of utilities upon the guarantee by the municipal condemnor that pension rights for employees of the private corporation will be preserved at least at the level of existence under private collective bargaining agreements. 49 U.S.C.A. § 1609(c) (Supp. 1969).

125 In Scoville v. Surface Transit, Inc., 39 Misc. 2d 991, 242 N.Y.S.2d 319 (Sup. Ct. 1963), an action incidental to the *Fifth Avenue* litigation, the employees' union established that the company was liable for the pensions of retired employees after the date of taking. The court's assumption that the company would in any event be reimbursed for pension payments was dispositive, but the assumption proved to be false. Considering questions of liability and compensation in separate lawsuits has prevented full consideration of the issues.

126 46 Misc. 2d at 37-43, 259 N.Y.S.2d at 339-44. The case most often cited for the "no compensation for frustration" rule is Omnia Commercial Co. v. United States, 261 U.S. 502 (1923).

The trial court may also have considered that pension liability was an item of "damage" only because of Fifth Avenue's accounting methods. Like many utilities, Fifth Avenue paid pensions exclusively out of current operating revenues rather than setting up an annuity. The method is intended to make it difficult for employees' unions to argue that pension rights are vested and part of the wage package bargained for. The trial court said:

> These items might properly be chargeable to revenues as a bookkeeping matter while a corporation continues in business, but they are not obligations which a purchaser is required to assume.
>
> The city is paying all current operating expenses. It may not be charged

frustration doctrine is usually applied to defeat a claim against the condemnor by a third party having contractual rights against the condemnee, and it may be that the court was confused in applying the doctrine to a claim by the condemnee. But the court may instead have applied the frustration doctrine to hypothetical claims by the employees, using an unexpressed theory of subrogation; assuming the company is liable to the employees, whether the company has a right to compensation depends on whether the employees, had their rights against the company not survived the condemnation, would have had a right against the condemnor. If this was its reasoning, the court ignored cases holding that compensation can be paid for frustration of contract rights where the subject matter of the contract is part of the res taken.[127] Even in *PATH,* where the assets were otherwise without continuing value, pensions ensure development and retention of trained personnel and thus contribute to the going concern value of the business. In both *Fifth Avenue* and *PATH* the Court of Appeals stated that the utility property—the res—included the intangible going concern value of the business.

Not compensating the condemnee for pensions when the condemnee is liable for these items puts the condemnor in a preferred position. In a private transaction frustration is a defense to any action on the contract;[128] therefore, a private purchaser could not have pensions paid to his employees at no cost to him. Moreover, liability may be imposed on any citizen who induces a breach of contract—but not so where the wrongdoer is the public condemnor.[129]

The trial court did not approach the ultimate issue of who, the condemnor or the condemnee, is the superior risk bearer for pension payments. Where pension payments are funded from the fare box, as in *Fifth Avenue,* it is just and equitable that final responsibility for pensions follow the fare box into the hands of the public owner. With respect to employees already retired, the condemnor has the assets of the business, including going concern assets, to which each of the retired employees contributed in varying degrees. With respect to

with these deferred expenses attributable to obligations assumed by the condemnee prior to condemnation.

46 Misc. 2d at 41, 259 N.Y.S.2d at 343.

127 A.W. Duckett Co. v. United States, 266 U.S. 149 (1924); Brooks-Scanlon Corp. v. United States, 265 U.S. 106 (1924); Annot., 152 A.L.R. 307 (1944).

128 *E.g.,* Marks Realty Co. v. Hotel Hermitage Co., 170 App. Div. 484, 156 N.Y.S. 179 (2d Dep't 1915); RESTATEMENT OF CONTRACTS § 468(2) (1932). *See* Fuller & Perdue, *The Reliance Interest in Contract Damages: 1,* 46 YALE L.J. 52, 89-96 (1936).

129 *Cf.* Carpenter, *Interference with Contract Relations,* 41 HARV. L. REV. 728, 745 (1928); Sayre, *Inducing Breach of Contract,* 36 HARV. L. REV. 663 (1923).

employees still working, their collective knowledge, skill, and experience enable the condemnor to continue the transit facility without interruption.[130] Where pensions are funded, the condemnor need not pay pensions to employees already retired, since an independent fund, presumably amortized during the time of private ownership, exists for that purpose. For active employees, the condemnor need pay only the amount remaining to vest the funding for each employee who continues in his service. In this case the condemnor does not acquire a fare box encumbered by pension payments, but it does acquire tangible and intangible assets of the business to which these employees contributed during private employment as well as their continued service during public ownership.

Notwithstanding the language by the Court of Appeals that compensation must be paid for "[c]laimants' undeniably competent and efficient personnel . . . taken over by the city along with claimants' routes, franchises, operating schedules, accounting and maintenance records, etc.,"[131] the failure by the Court of Appeals to hold consequential damage compensable or to otherwise compensate for pensions now permits a condemnor to take the position that it will not in-

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130 Judge Shientag's comment in Felder v. Fullen, 27 N.Y.S.2d 699, 708 (Sup. Ct. 1941), is worthy of note in this regard:

> By virtue of the Wicks Act the City of New York was enabled to acquire much more than an aggregation of physical assets. It was enabled to take over going concerns aud to acquire the collective knowledge, skill and experience of the staff of great railroad systems, without which uninterrupted and efficient operation might well have been impaired, if not rendered impossible.

A question might be raised as to the propriety of imposing responsibility for pension payments on the condemnor for all employees not retired at the date of taking where many employees might have long periods of service remaining before qualification for pensions while others conceivably could qualify for retirement pensions the day after the taking. Is it not unjust to treat these classes of employees equally where the public owner obviously will derive little or no benefit from those employees who will qualify for an early pension after the date of taking? The answer is no—the fact remains that the private owner paying pensions from the fare box has given this means of payment to the condemnor. Any argument that the obligation for paying pensions to the active employees must be weighted in proportion to the years of service remaining after the taking ignores the fact that it is the employee with the shortest time remaining to qualify for a pension who in all probability had the opportunity to make the largest contribution to the tangible and intangible assets of the business—assets now owned by the public.

131 After the transfer to the public, the public condemnor may raise fares at will without restraint from the Public Service Commission. The private company, on the other hand, is no longer an operational entity; in all likelihood it will be in liquidation at the time payments must be made. If the company has funds on hand at the time of condemnation, it is improper to assume that these funds can be earmarked solely for pensions. Any number of liabilities such as personal injury claims, accrued vacations, officers' salary settlements, and trustees and consultants fees on liquidation, might be payable out of the funds. In addition, the company's final tax liability may also be payable therefrom.

demnify a utility for pension payments for which a court may later hold the utility responsible.[132] A court approaching the problem of fixing responsibility for pension payments between condemnor and condemnee has two choices to avoid this dilemma. The court could order the private company to continue pension payments for all retired employees although the condemnor acquired both the benefits of the fare box and the company as a going concern. Alternatively, the court could order the public condemnor to make these payments with the caveat that as to any payment so made, the condemnor apply for an offset from any award thereafter made for going concern value. If the second alternative were chosen, a court fixing a going concern value for the trained personnel component should discount the award by the payments made after determining personnel development costs not only in terms of placement and wages but also pensions. The second alternative is superior to the first because the condemnor is in a position to make a present payment by virtue of its possession of the fare box.[133]

D. *The Role of the Public Service Commission in Utility Condemnation*

Since neither the omnibus lines in *Fifth Avenue* nor the Hudson tubes in *PATH* were under the jurisdiction of the New York State Public Service Commission,[134] the litigation did not consider the propriety of the role reserved to the Public Service Commission in the condemnation of a public utility by section 5-a of the Condemnation Law.[135] The principles developed in those cases demand a re-

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132 *In re* City of New York (Fifth Avenue Coach Lines, Inc.), 18 N.Y.2d 212, 219, 219 N.E.2d 410, 415, 273 N.Y.S.2d 52, 58 (1966).

133 This in fact occurred in Rochester, New York, immediately after the condemnation of the Rochester Transit Corporation's omnibus line by the City of Rochester. *See* Case No. 24794, before the New York State Public Service Commission: Proceeding re the Condemnation by the City of Rochester of Properties of Rochester Transit Corporation (1969). *See also* note 125 *supra.*

134 The omnibus lines were regulated by the City of New York; the Hudson tubes were subject to an interstate compact.

135 This section provides in relevant part as follows:

> In any proceeding to condemn substantially all of the property owned by a person or corporation subject to the jurisdiction, supervision and regulation of the public service commission, or any portion of such property constituting an operating unit or system, a copy of the petition and notice of time and place of presentation must be served on the public service commission at least thirty days prior to the presentation. Such commission shall certify to the court after a hearing by such commission on notice to all of the parties to such proceeding, the following: (1) the annual earnings which might reasonably be anticipated by the present owner thereof pursuant to just and reasonable rates, with due regard among other things to a reasonable average return upon capital actually ex-

examination of New York's statutory procedure;[136] in fact, the *Fifth Avenue* and *PATH* principles may make the Commission's statutory role in condemnation actions an unconstitutional anachronism.[137]

Enacted in 1952 as a legislative response to a number of scandal-ridden condemnation cases where excessive awards had been improperly paid to condemnees,[138] section 5-a provides for the use of capitalization of earnings in the valuation of a condemned utility. The legislation was designed to eliminate lump-sum awards based on cost by directing

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> pended and to the necessity of making reservations out of income for surplus and contingencies; and (2) the rate base and the rate of return from which its estimate of earnings is derived. Such certification shall be served upon the court and the commissioners of appraisal if theretofore appointed. The commissioners of appraisal in such proceeding shall not ascertain and determine the amount of compensation to be made by the plaintiff to the owners of the property appraised by them, until thirty days after such certification has been so served, and, in the event that a proceeding pursuant to article seventy-eight of the civil practice law and rules is commenced within such thirty-day period, until after it has been finally determined.

N.Y. CONDEM. LAW § 5-a (McKinney Supp. 1969). In addition, § 18 provides in relevant part:

> In any proceeding in which certification by the public service commission as provided in section five-a of this chapter is required, if the final order directs the payment of any amount as compensation to the owners which is (1) not a capitalization of the anticipated earnings of such company as certified to the court by the public service commission; or (2) is, in the opinion of the public service commission, so excessive or insufficient as to be not in the public interest, such commission shall, within such time and upon such notice, apply to the court for such an order [pursuant to article seventy-eight of the civil practice law and rules].

Id. § 18.

136 It is likely that the Public Service Commission statute will be applied in most subsequent utility condemnations. A recent example is the Rochester Transit Corporation litigation, note 133 *supra*.

137 A collateral issue raised by the continuing role of the Public Service Commission is whether the security (undertaking) provision of the Condemnation Law, § 24, which entitles an owner to indemnification for any damage incurred by reason of the discontinuance of a condemnation by the municipality, applies to a condemnation commenced under special enabling legislation. If the enabling statute is silent on the question of security or discontinuance but reserves to the Public Service Commission the prerogative to certify earnings under § 5-a of the Condemnation Law, the Commission's power under § 18 of the Condemnation Law to veto an award, with the possible consequence of the return of the property to the owner, arguably requires the municipality to post an undertaking to indemnify the owner for any damage to his property while under municipal possession and control. On the other hand, it may be that property condemned pursuant to special enabling legislation must remain in public ownership and cannot be returned to the private owner, notwithstanding the Commission's disapproval of the award; this is apparently the view taken in City of Rochester v. Rochester Transit Corp., 31 App. Div. 2d 787, — N.Y.S.2d — (4th Dep't 1969). If this view is correct, Commission disapproval must result in a new trial, and if the court and the Commission cannot agree on the amount of the award, the court, the parties, and the Commission may be thrust into a circular process of continuous relitigation.

138 N.Y. Laws 1952, ch. 508, § 1; N.Y. Laws 1952, ch. 515, § 1.

"the attention of the courts and commissioners of appraisal to the general desirability of the result derived by capitalizing the income which the private company could be expected to earn while subject to regulation as a public utility."[139] Section 5-a may also have been prompted by the then-obtaining rules for valuing public utilities in condemnations. Condemned utilities were at that time valued by a fragmented approach; the total value was calculated by taking the sum of the component elements of tangible property.[140] The rules were unsettled regarding valuation of intangible property—goodwill, franchise value, and going concern value. Awards for each of these components of the utility's intangible property were either not made or sloughed off as some undefined component of an over-all lump-sum award.[141]

Section 5-a is unsatisfactory in view of *Fifth Avenue* and *PATH*, in that it applies principles of rate-making to condemnation valuation. In public utility rate-making the Commission makes two findings: a rate base is determined, and a rate of return is calculated on this rate base.[142] The utility's permissible earnings are then determined by multiplying the rate base by the rate of return.[143] Presumably, the rate of return employed in the formula is calculated by comparison with the average rates of return in comparable businesses, *i.e.*, enterprises with risks similar to that of the utility in question. The rate base—the cumulative value of the assets of the business upon which the private owner will be permitted to earn a return (profit)—is calculated on the basis of the original investment cost of the utility, nominally the book value of the tangible assets.[144] Statutory certifica-

139 N.Y. Laws 1952, ch. 508, § 1.

140 *See, e.g., In re* City of Redding, 1919 P.U.R. 415, 420 (Cal. R.R. Comm'n).

141 Appleton Water Works Co. v. Railroad Comm'n, 154 Wis. 121, 148, 142 N.W. 476, 484 (1913), is illustrative.

142 *See, e.g.,* N.Y. PUB. SERV. LAW § 61 (McKinney 1955) outlining the Commission's powers with respect to omnibus lines.

Unlike an electric utility, the tangible assets of an omnibus line may be fully depreciated but still be serviceable. In this circumstance, the Public Service Commission has indicated that neither rate-making nor a § 5-a proceeding may be based on certification of a rate base; instead, the Commission determines what it considers a fair operating ratio between operating expenses and operating revenues. 1962 REPORT OF THE PUB. SERV. COMM'N TO THE N.Y. STATE LEGISLATURE 85. *See generally* Comment, *Operating Ratio—A Rate Base For The Transit Industry*, 51 IOWA L. REV. 417 (1966). This alternative method is not described in the statute.

143 *See* Note, *Condemnation of Public Utilities: A New York Statute And a New Approach*, 54 COLUM. L. REV. 916, 919 & n.20 (1954).

144 *In re* New York Tel. Co., 91 P.U.R. (n.s.) 231 (N.Y.P.S.C. 1951). The statutory provisions include N.Y. PUB. SERV. LAW §§ 49, 72, 85, 89, 97 (McKinney 1955).

Commissions in other states employ what is called a "fair value" approach, based upon tion in a condemnation action is like rate-making in that it calls for the calculation of estimated future earnings,[145] which are then capitalized. The variables in the equation are the earnings thus certified[146] and the capitalization rate.

If the rate of return is the capitalization rate, the rate base must equal the capitalized valuation. The result, therefore, will be a valuation that does not take into account the intangible assets of the utility, since original investment cost, by definition, excludes the intangibles of going concern value, goodwill, and franchise value. In addition, the utility is deprived of compensation for the difference between the reproduction cost and the original cost of the assets.[147] Both *Fifth Avenue* and *PATH* mandate payment for intangible assets of the condemned utility and the use of appraisals based upon new or original reproduction cost, rather than salvage or scrap value.[148] If the owner is left with no more than the original cost of its tangible assets, the necessity for a hearing before the Public Service Commission is obviated; the only material required is a certified statement setting forth the original cost of the tangible assets. Such a procedure is obviously repugnant to the principles of *Fifth Avenue* and *PATH*. Suffice to say that reliance upon rate-making principles in condemnation proceedings

an estimate of the total present worth of the utility in terms of the reproduction cost of tangible assets, including the value of intangibles but excluding those attributable in theory to the utility's monopoly position. *See* Rose, *The Hope Case and Public Utility Valuation in the States*, 54 COLUM. L. REV. 188, 195 (1954).

145 N.Y. CONDEM. LAW § 5-a (McKinney Supp. 1969).

146 In arriving at future earnings, the Commission is likely to consult the filed records and reports of the subject company. This was the procedure relied upon in the recent 5-a hearing held in the condemnation of the Rochester Transit Corporation by the City of Rochester. *See* Case No. 24794, before the New York State Public Service Commission: Proceeding re the Condemnation by the City of Rochester of Properties of Rochester Transit Corporation (1969). If the reports show a depressed earnings pattern and the Commission selects from these reports an average figure for certification as future earnings, the procedure conflicts with the first *Fifth Avenue* opinion; the court there held that the owners were entitled to compensation based upon a capability of profitable operations where low earnings in the past were directly related to severe rate regulations by the city. *In re* City of New York (Fifth Avenue Coach Lines, Inc.), 18 N.Y.2d 212, 221, 219 N.E.2d 410, 413, 273 N.Y.S.2d 52, 56 (1966).

147 *See* Note, *supra* note 143, at 922-23.

148 This, of course, is the clear thrust of the Court of Appeals's opinions in *Fifth Avenue*. *In re* City of New York (Fifth Avenue Coach Lines, Inc.), 22 N.Y.2d 613, 241 N.E.2d 717, 294 N.Y.S.2d 502 (1968), and 18 N.Y.2d 212, 219 N.E.2d 410, 273 N.Y.S.2d 52 (1966); *cf*. *In re* Port Authority Trans-Hudson Corp., 20 N.Y.2d 457, 231 N.E.2d 734, 285 N.Y.S.2d 24 (1967). The original cost formula adopted in *PATH* may be closer to the book value rule applied by the Commission. However, even the Commission has recognized that data which are proper in rate-making may be improper in condemnation. *In re* Western New York Water Co., 97 P.U.R. (n.s.) 428 (N.Y.P.S.C. 1952).

is unsound because of the generic difference between the two procedures.[149]

Perhaps a more fundamental defect in the section 5-a proceeding is that it enables an administrative body to exercise a final veto over the judicial determination of just compensation. Notwithstanding the obvious inadequacy of the 5-a procedure in light of the new cases, this administrative veto is itself unconstitutional.[150]

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149 In enacting § 5-a, the legislature arguably intended to impose on the courts, the Public Service Commission's rate-making policy of approving utility sales at cost only. *See, e.g., In re* South Bay Consolidated Water Co., 92 P.U.R. (n.s.) 90-92 (N.Y.P.S.C. 1952); *In re* Deer River Power Co., 80 P.U.R. (n.s.) 20-22 (N.Y.P.S.C. 1949); Note, *supra* note 143, at 922. But the courts have recognized the impropriety of equating rate-making principles with rules governing condemnation awards. Onondaga County Water Authority v. New York Water Serv. Corp., 285 App. Div. 655, 662, 139 N.Y.S.2d 755, 763 (4th Dep't 1955).

Concededly, in the early phases of government intervention, there was some legal basis for equating rate-making with condemnation. Thus, Smyth v. Ames, 169 U.S. 466 (1898), *discussed in* Note, *supra* note 143, at 927 & n.56, held that rate regulation could be a "taking" subject to constitutional protections developed in the law of eminent domain. The regnlatory body's computation of a utility's rate base was constitutional only if it reflected the "fair value" of the utility's property, a value computed on the basis of both tangible and intangible assets. McCardle v. Indianapolis Water Co., 272 U.S. 400 (1926); Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n, 262 U.S. 679 (1923); Misssouri *ex rel.* Southwestern Bell Tel. Co. v. Public Serv. Comm'n, 262 U.S. 276 (1923). But this view was repudiated in FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944), and with it went any identity between rate-making and condemnation. Although it implicitly recognized that regulation could destroy value, the Supreme Court there approved computation of rate base according to the book value of the utility. Further, the Court permitted use of any valuation method, subject only to the condition that the end result be reasonable. *Id.* In response to *Hope Natural Gas,* most states discontinued inclusion of going concern value in computing the rate base and relied exclusively on an original cost rate base. Rose, *supra* note 144, at 212. *Hope Natural Gas* also implied that reproduction cost and appreciated value could be excluded from the rate base for purposes of regulation. 320 U.S. at 602; *cf.* ICC v. New York, N.H. & H. Ry., 287 U.S. 178, 201-02 (1932); Brooks-Scanlon Co. v. United States, 265 U.S. 106, 125 (1924). Once appreciation is excluded, it is impossible for the utility owner to profit from it during the operation of the business. Nor can he realize gain from appreciation upon a sale of the utility, since the purchaser presumably will not pay for a "value" excluded in computing the utility's reasonable (permissible) earnings. Exclusion of intangibles and emphasis on original cost, while arguably appropriate in rate regnlation, have no place in condemnation, where the law is now clear that the owner must be compensated for what he has lost, including all intangible assets. *Cf. In re* Port Authority Trans-Hudson Corp., 20 N.Y.2d 457, 231 N.E.2d 734, 285 N.Y.S.2d 24 (1967), applying an original cost principle for valuation to tangible property.

150 *See In re* Keystone Associates v. Metropolitan Opera Ass'n, Inc., 19 N.Y.2d 78, 89, 224 N.E.2d 700, 703-04, 278 N.Y.S.2d 185, 190 (1966), where Judge Keating, in commenting on another statute, stated

> Whether the Legislature intended it or not, the practical effect of the statute is to set a limit on the amount of recovery. The law of this State is clear that

The 5-a procedure should be repealed and its function returned to the courts. Alternatively, an amendment to the Condemnation Law could empower a court or commissioners in their discretion to make the determination called for by section 5-a as revised for consistency with the new valuation rules. The Public Service Commission might well have a role to play as an assistant to a court but certainly should have no veto power over the final award as determined by the court.

CONCLUSION

The *Fifth Avenue* and *PATH* cases represent a significant step by the New York courts in isolating principles applicable to value utility property upon condemnation (although these principles were misapplied in the *PATH* case). The emphasis upon the standard of the owner's loss and the classification of certain intangible assets as part of going concern value should clear the way for application of these newly defined principles. It is regrettable that the Court of Appeals emphasized a development cost theory to the exclusion of other formulas for compensation, any number of which might be of use to a court faced with valuation problems depending upon the particular facts before it. Moreover, the failure of the Court of Appeals to break with the traditional view on consequential damages, particularly in terms of pension liabilities, leaves the formulation of rules of compensation for utility condemnations incomplete. Finally, the new rules make obvious the shortcomings of section 5-a of the Condemnation Law which, with its companion provision, section 18, should be repealed or amended.

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the determination of just compensation is a *judicial* function and that the Legislature cannot set the maximum figure on the amount of compensation that will be paid.