

STATE PUBLIC SERVICE COMMISSIONS.¹

HISTORICAL DEVELOPMENT.

When I came to prepare this paper, I had difficulty in beginning. The audience all being members of the legal profession, expects to have the subject treated from a legal viewpoint. The subject, however, is primarily not a legal but an economic one. Public service commissions deal more with facts than with legal principles. Yet while the problems we have to solve are usually problems of fact, nevertheless these problems are controlled and governed by rules of law. The interesting things of any work are not the bare facts, or the bare principles that control the combination of facts, but are the problems to be solved. I shall discuss one or two of the legal problems involved in regulation that have heretofore been at least practically solved, and the principles of law which were developed and applied in the solution. At the same time I will try to interweave an historical sketch of the work, as well as some economic principles and practical situations necessary to elucidate the legal side of the discussion.

The field of administrative law has been materially enlarged in recent years. A few years ago the legislative branch of government enacted laws concerning many subjects which are now dealt with by an administrative body to which the legislature has delegated regulatory powers formerly exercised by it. Not long ago, in a search for authorities on a legal point pertaining to the functions of public service commissions, I discovered that Cyc. contained no separate article on the subject of public utility regulation. Reference was

1. Address delivered before the St. Louis Bar Association, April 9, 1923, by Hon. John A. Kurtz, Chairman of the Missouri Public Service Commission. (Mr. Kurtz died suddenly in June, 1923.)

made by it to such general subjects as that of Constitutional Law. I predict that when *Corpus Juris* is finally completed, it will have a separate article on this subject. Many new principles of law pertaining to the control and regulation of public utilities by commissions, are now in the formative state.

The development of a new body of law, however, is a leisurely process. Many of the fundamental principles of regulation and control of public service companies were established by the old common law. In one of the leading cases, *Munn v. Illinois*,² Chief Justice Waite quotes from Lord Chief Justice Hale's *De Portibus Maris* as follows:

“A man, for his own private advantage, may, in a port or town, set up a wharf or crane, and may take what rates he and his customers can agree for crantage, wharfage, houselage, pesage; for he doth no more than is lawful for any man to do, viz.: makes the most of his own If the king or subject have a public wharf, unto which all persons that come to that port must come and unlade or lade their goods as for the purpose, because they are the wharfs only licensed by the queen, or because there is no other wharf in that port, as it may fall out where a port is newly erected; in that case there cannot be taken arbitrary and excessive duties for crantage, wharfage, pesage, etc., neither can they be enhanced to an immoderate rate; but the duties must be reasonable and moderate, though settled by the king's license or charter. For now the wharf and crane and other conveniences are affected with a public interest, and they cease to be *juris privati* only; as if a man set out a street in new building on his own land, it is now no longer bare private interest, but is affected by a public interest.”

Again, in the same case, pages 129-130, it is stated that common carriers were subjected to regulation as early as the

2. 94 U. S. 113.

reign of William and Mary, and in support thereof the opinion quotes the preamble of a statute,³ to-wit:

“And whereas divers wagoners and other carriers, by combination amongst themselves, have raised the prices of carriage of goods in many places to excessive rates, to the great injury of the trade,” etc.

If a careful search were made of the files of the Missouri Public Service Commission, I believe resolutions couched in practically the language as the foregoing could be found. Anyway, I have a recollection of having heard the same idea expressed. However, the quotations show that centuries ago some of the fundamental principles of the law were developed around which we are now extending a body of new principles.

Since the reign of William and Mary there have been tremendous developments in the public utility industry. The age of invention at that time had not yet arrived. The modern industrial machine was then beyond the imagination. The complex organizations and great aggregations of capital known as the modern public service corporations have developed during the last fifty years, with the emphasis on the last half of that period. What the advance will be in the near future none can foretell.

Any radical change in the activities of society necessarily is followed by the development of new rules and principles of law to fit the changed conditions. A new invention or the discovery of a hitherto unknown force creates new material for the legislative mill, new problems for judicial analysis and solution. Every period of material advancement is accompanied by changes in law and government. So long as the public service was rendered by an individual or by a simple business organization and was accomplished by a means readily understood by the layman, so long the governmental

3. 3 W. & M., p. 12, Sec. 24.

machinery necessary to regulate that service could remain simple in its nature. The regulation of the hackney coach, the wharf, the warehouse, the turnpike, the bridge and the ferry could be satisfactorily accomplished by the legislative body, whether state or municipal, then existing; but when the stagecoach and hackney coach were superseded by the steam railroad and the street railway, aggregating billions of invested capital and millions of employees, and accomplishing the transportation of millions of tons of freight and likewise millions of people; when the candle was superseded by the electric plant, furnishing light not only to an entire city but, by means of transmission lines, to many towns and cities widely separated; when the post messenger was superseded by the telephone and telegraph, as they in turn are possibly to be superseded by the radio and aeroplane, then there was created a condition that is not simple either in organization, means or effects, but is so complex, so large, so tremendous and so interlaced with the entire social fabric, that its comprehension is beyond the man of the street and is beyond intelligent regulation by a legislative body. To intelligently regulate the modern utility requires the employment of technical men and experts who are familiar with the machines used in manufacturing or supplying the product and who are able to ferret out the true facts by investigation.

The regulation of public utilities being a legislative function, was adequately accomplished by legislative bodies so long as the service was furnished by simple organizations. Originally Congress and state legislatures enacted statutes pertaining to railroads, while city boards of aldermen enacted ordinances prescribing the rates and practices of local utilities. The first commissions created were railroad commissions. New Hampshire and Rhode Island created railroad commissions as early as the year 1844, Vermont in 1855, Maine in 1858, Ohio in 1867 and Massachusetts in 1869. All, however, had very limited jurisdiction. Their powers were largely inquisitorial to gather information for the use of the legisla-

tive body in enacting regulatory statutes. They had none of the broad powers now lodged in public service commissions.

After the Civil War railroad development made great strides. The problems became more complex. A demand arose for not only the regulation of the practices, but also of the rates of these companies. Legislatures began to pass statutes fixing maximum fares. Congress created the Interstate Commerce Commission to regulate interstate carriers. However, on account of the unwieldy nature of legislative bodies, the technical inexperience of their members, the short term of their sessions and the political features that invariably were forced into their deliberations, it was found that the subject needed a more scientific treatment. The more advanced thought of the land began to advocate the idea that the legislative arm of the government should do its regulating through a special body created for that purpose. This idea gained such force that the last decade of the 19th century was characterized by extending the jurisdiction of the existing railroad commissions to include the power to regulate rates. Not until the 20th century, however, was the jurisdiction of State commissions extended to the regulation of local public utilities. This idea was ushered in by the recreation in 1907 of the Wisconsin Commission giving it jurisdiction over railroads, telephones and telegraphs, water and electric companies. New York and other States followed soon thereafter, until at the present time practically every State in the Union has a public service commission, with full power to regulate not only the practices, but also the rates and security issues of both State wide and local utilities. Nine States of the Union have established their commissions by constitutional provision, and thereby placed these quasi-judicial bodies beyond the pale of the legislative power to destroy.

We are prone to forget the reasons for this change. It was apparent to those who carried on the affairs of the State at the time, that the practices and rates of these recently developed and powerful corporations could not be fairly and

intelligently regulated by technically inexperienced bodies like legislatures or city boards of aldermen; that on principle at least it appeared necessary to create a body which would become expert in its knowledge of the subject and which would be in continuous session to act at any time that it appeared from investigation to be necessary to protect the rights of the public. These bodies were given wide powers and were authorized to employ the necessary engineers, accountants, rate experts and other technical men to make investigations and ferret out the true facts. To these commissions, by statute or constitutional provision as the case may be, has been delegated the legislative power to regulate.

In 1913 the general assembly created the Missouri Commission. Prior to that time the regulatory power of the State was exercised by numerous authorities. The Railroad and Warehouse Commission had limited jurisdiction over railroads. The legislature itself at every session had under consideration railroad rate and other regulatory statutes and several rate statutes were enacted. In addition to the jurisdiction exercised by the legislature and the Railroad and Warehouse Commission, municipalities regulated the use of local facilities of railroads and the speed of trains within the confines of the municipality. The regulation of local utilities, such as water, gas, telephone and electric plants, was lodged in the local municipal authorities, subject, of course, to the exercise of any power which the legislature might see fit. The general assembly in 1907 passed an act delegating to cities and towns the power to regulate the rates of their local utilities and authorizing such cities and towns to create utility commissions. In 1909 the general assembly created local commissions for the larger cities and such commissions were in existence at the time of the creation of the Public Service Commission in 1913. These city commissions, however, could not and did not build up strong investigating forces. Most of the cities were unable to give the financial support that was necessary to continuously keep in their employ accountants,

valuation engineers, rate experts and other technical men. In some instances, of course, efficient commissions could be maintained. The city of St. Louis had the means of giving the proper financial support. In general, however, these local commissions employed technical men only when a particular investigation was to be made and paid the regular professional fees for such services. Not only was this course expensive, but the experts so employed were quite often without previous experience in this particular field of their profession. Any way many of these cities advocated and assisted in the enactment of the Public Service Commission law in 1913.

In a general way the foregoing covers the historical development of the regulation of the public utilities.

ORGANIZATION AND PROCEDURE OF THE MISSOURI COMMISSION.

On account of the unfamiliarity of the average lawyer with the work of the Public Service Commission, an outline of the organization and procedure of the Commission might be of interest to many of you. The Missouri Commission consists of five members, one of whom has been with the Commission since its organization, first as General Counsel and later as Commissioner. Another has been with the Commission six years, while the other three have been members thereof for about two years each. The Commissioner from this city, Mr. A. J. O'Reilly, is an engineer by profession.

The organization of the technical forces of the Commission is as follows: Valuation department, consisting of a chief engineer and six assistants; Accounting department, consisting of a chief accountant and six assistants; Railway and Transportation department, under the management of a railway transportation and rate expert; Telephone department, under the management of a telephone expert; Water, Gas and Electrical department, under the management of an electrical and mechanical engineer. In addition to the above departments, we have a legal department of two attorneys and a court reporting department with two reporters, and the

official publisher of the Commission's decisions, together with a secretary and clerical force.

The chief engineer, chief accountant and the chief of the Railway department have all been with the Commission since its creation. The length of service of the other technical men varies from six years to one year. In the employment of these technical men political affiliations have been disregarded. While I am Chairman of the Commission, yet I do not know the politics of some of these men. The Commission itself is a nonpartisan body, not by law but by custom. It now consists of three Republicans and two Democrats. While the majority of the Commission at the present time is Republican, yet we have in our employ men with such names as Murphy, Houlihan and Lysaght. These men are technical men in a special field of their profession. An ordinary certified accountant or a civil engineer does not become proficient in utility regulation until he has had at least one year's experience in the work. Until he becomes familiar with the laws and decisions on utility regulation he must act as an assistant to more experienced men. It is, therefore, essential for the good of the service that the State retain its efficient technical men until at least they can command larger salaries than the State will pay. During the last two years we have had several resignations because salaries were offered which the Commission for lack of funds could not meet.

In a rate case there are two principal things to be determined by the Commission. First, what is the fair value of the property used and useful in the public service? Second, what are the reasonable operating expenses incurred in rendering that service? When the fair value of the investment is found and the reasonable cost of operation is determined, you have the basis of calculating the revenue that must be raised and, having the amount of the product that can be sold, the rate may thus be built.

The valuation department of the Commission makes preliminary investigations for the Commission to determine the

true facts concerning value. The engineers by actual count and inspection determine just what property is owned by the utility and the condition thereof. They likewise determine as one element of value the cost the company incurred in erecting and installing the plant as and when constructed. In making up the valuations the engineers pay no attention to excessive bond issues or watered stocks. These are no criterion of value and the public is not required to pay thereon. The true facts concerning actual value are sought. The Commission is furnished the detail of every unit of property, namely: the quantity, size, age and condition of poles, wires, buildings, machinery, tracks, cars, etc., with the cost incurred by the company in installing same. The six assistants of the chief engineer are divided into two teams of three men each to do this field investigation. The Commission tries to keep one of these teams in the country towns while the other is usually employed in the larger cities.

In determining the operating revenues and expenses of the company the Accounting department audits the books and records of the company. They examine the detailed entries and verify each entry of expense by requiring a receipted voucher therefor. The organization of the Accounting department is on the same principle as that of the Valuation department. There are two teams of three men each. Many complicated questions arise in the accounting work which require experience, ability, energy, initiative and trustworthiness on the part of these men. They must see that capital expenditures are not charged to operating expense; that expenditures in making replacement of worn-out units are not charged to operations but to depreciation reserve and to capital account. The Commission requires the company to set up a depreciation reserve account for the purpose of replacing worn-out units. The original cost of the worn-out units must be charged to this reserve and cannot be allowed to swell expense of operations, while the excess in cost of the new unit

over the cost of the worn-out unit is charged to capital additions.

Again, many companies operate several utilities in the same town or city. In St. Joseph the street railway, the electric light and power and the heating plants are all operated by the same company. In some towns the utility operates private businesses in connection with the utility, such as creameries, ice plants, etc. The operating expense of each of these utilities must be kept separate and the overheads prorated to the different departments. The accountants must see that the expense in operating the private business is not charged to the expense of operating the public business which is paid for by the rates fixed by the Commission. There are hundreds of complicated questions which arise. The Commission's accountants ferret these out as impartial investigators with the idea of getting before the Commission the true facts, neither colored in favor of the public or the utility. The coloring, if any, is left to the representatives of the city and of the utility. You can readily see that this kind of work must be carried on by trustworthy, experienced men, and that politics should have no part therein. It is important that the work of the Commission and its employees be as impartial and non-political as that of the courts.

When the Valuation and Accounting departments have completed their field investigations, they then compile a detailed written report of their findings, which is filed with the Commission and copies mailed to the city and the utility. Thereafter a public hearing is held, at which time the Commission's accountants and engineers formally present their reports and findings in evidence and testify concerning the same. The city and the utility are thereby given an opportunity to cross-examine the Commission's experts and to present such evidence as they deem necessary. After the hearings are completed the Commission has the case before it from three viewpoints: that of the utility, that of the city and the

consumer, and that of impartial and experienced investigators in the employ of the Commission. It would seem, on principle at least, that the Commission would now have before it such evidence that it could make a finding fair and just both to the utility and to the public, not necessarily satisfactory to either party, but, nevertheless, fair. I desire to interpolate here that this method has generally been found by the courts to have resulted in such finding by the commissions that courts of last resort in many of the States have held that the findings of the commissions on questions of fact are prima facie reasonable and valid, and that a clear case must be made by an appellant to overthrow the prima facie case.

No decision of the Missouri Commission in reference to a rate has ever been overthrown by a decision of the Supreme Court of this State on the ground that the rate fixed was unfair to the public. On the other hand, several findings of the Commission in reference to rates have been set aside by the courts on the ground that the rates fixed resulted in the confiscation of the property of the utility. I do not state this fact for the purpose of reflecting credit upon the Public Service Commission, as I believe that the decisions of the Commission should be impartial. However, the Commission in making up its findings should decide the clearly doubtful questions against the party having the burden of proof upon the point. This means, of course, that since the burden of proof in a rate case is usually upon the utility to show the reasonableness of the rate, the clearly doubtful questions should be decided in favor of the public. This principle has no doubt led to a reversal in favor of the utilities of some of the Commission's decisions, since what is doubtful is a relative matter. Questions that may seem doubtful to the Commission on appeal may not seem doubtful to a court.

In the early decisions of the Missouri Supreme Court the principle of presumption of right action on the part of the Commission was not adopted. In *Railroad v. Public Service*

Commission,⁴ *Lusk v. Atkinson*,⁵ and *State ex rel. v. Public Service Commission*;⁶ various opinions were expressed by the individual judges, the court, however, refusing to adopt the *prima facie* doctrine. But in the recent decision of *State ex rel. Southwestern Bell Telephone Company v. Public Service Commission*,⁷ Chief Justice Walker, who wrote the majority opinion, uses this language:

“The statutes declaring rates fixed by the Commission to be *prima facie* reasonable until that presumption is removed by one seeking their annulment are but a proper recognition of the power and purpose of the Commission, without which its acts would be mere empty declarations, whose effective operation would, in each instance, have to await judicial approval. Such a conception of the nature and powers of the Commission is wholly unauthorized. Organized, as the statute creating the Commission clearly declares, for the purpose of supervising and regulating public service corporations, the courts, in reviewing its actions, proceed upon the assumption that the experience of the members of the Commission has especially fitted them for dealing with questions concerning the powers and activities of such corporations; and, despite the fact that the entire evidence will be reviewed, much consideration is to be given to the findings of the Commission, which, if reasonable, and neither arbitrary nor capricious, will be deferred to. *N. Y. & Q. Gas Co. v. McCall*.⁸

Judge James T. Blair wrote a separate concurring opinion in which he expressed his opinion as follows, to-wit:

“The previous opinions of this court upon this question, in some of which the writer concurred, do not contain any

4. 266 Mo., *l. c.* 341.

5. 268 Mo., *l. c.* 118.

6. 271 Mo., *l. c.* 168.

7. 233 S. W. 425, 430.

8. 245 U. S., *l. c.* 347; 38 Sup. Ct. 122; 62 L. Ed. 337.

evidence of a real examination of the issue. Those decisions are opposed to practically all decisions in the country on the point, are obviously incorrect, and should be overruled without further delay. If the majority opinion is to be understood as reaffirming them, which matter its language leaves rather in doubt, I do not agree to that reaffirmance. If that opinion is to be understood as adopting the rule of the cases cited from other jurisdictions in support of the rule it states, then its language should be changed to adopt that rule in plain terms, and expressly overrule our former decisions upon this question."

THE POLICE POWER.

The right of the State to regulate the rates and practices of a public utility is referable to the police power of the State. The utility business is monopolistic in its nature. This is true for the reason that the investment necessary to furnish the service is so great in proportion to the annual income, that to offer the consumer a selection between the service of two companies would be too costly and would necessarily result in excessive rates. Unlike the merchant, the utility cannot make its product at a central plant where its customers may come to purchase, or from which the product is delivered by trucks remaining in service throughout the entire day. To deliver the product the utility is compelled to have a permanent investment in mains, lines or tracks extending to the door of the customer. These mains, lines and tracks remain there twenty-four hours a day, though the customer uses them only a fractional part of the time.

To put it in another way. Roughly speaking, the annual gross revenue of a utility is about one-fourth to one-half of the investment, so that it requires a period of two or four years for a company to make its "turnover." For instance, the gross sales of the Laclede Gas Light Company of St. Louis

for the year 1922 were \$6,863,930.00, while the investment of the company assumed by the Commission in fixing the rates was \$27,585,500.00. On the basis of the value assumed by the Commission the annual revenue of this company is about one-fourth of the investment, so it would receive a "turnover" in about four years. On the other hand, the merchant or other private business concern may, and often does, make a "turnover" of the investment once, twice and occasionally three times in one year. This is not invariably true but, in a general way, it illustrates the idea that I am endeavoring to convey. The investment per unit of revenue from sales is so much larger than is usually true in other businesses that it is uneconomic to have full competition in the business of furnishing gas, water, electric lights and power or street railway service. In the past there have been quite often several gas, water or electric systems within some of our larger cities. However, they have not been in complete competition with each other, but only to the extent of bidding against each other for extensions into new territory.

Two street railway lines have not been laid in the same street or adjacent streets, nor have two water or gas mains been found in the same streets so as to serve the same customers. To a very limited extent they may be, but generally they cannot be because of the disparity between the investment and the annual gross revenue from sales. Therefore, on account of the nature of the business and the heavy fixed investment, the utility is, in its nature, monopolistic.

The rule is less applicable probably to a telephone system than to any other, yet the principle applies to it in a more or less degree.

A business which is a monopoly is released to a large extent from the restraints of economic laws. The law of supply and demand does not control its prices for it itself controls the supply. The restraint of competition being absent, the principle of what the traffic will bear tends to pre-

vail. What is true of the rates and charges is likewise true regarding its usages and practices. Where the necessity of getting the business is absent, the selfish element in human nature is not restrained.

On the other hand, the product or service furnished is a necessity. The customer, except to a limited extent, can not forego the service. By reason of the fact that the business is a monopoly and the service a necessity, there is an incentive for the utility to resort to unfair practices and exorbitant charges if not restrained or regulated by the State. So the courts have held that the property of a utility though private in ownership is devoted to a public use and is affected with a public interest. To protect the rights of the citizen, the State, through the exercise of the police power, steps in and regulates the utility in its charges and practices.

As heretofore stated, one of the leading cases elucidating the principle of the constitutional right of the State to regulate property devoted to a public use is the case of *Munn v. Illinois*, *supra*, with which you are all familiar.

It will be remembered that the general assembly of the State of Illinois enacted a statute, approved April 25, 1871, fixing maximum charges for the storage of grain in warehouses located in Chicago. This statute was attacked on the ground, among others, that it was in contravention of rights guaranteed by the Fourteenth Amendment to the Constitution of the United States. Chief Justice Waite delivered the opinion of the court. He set forth the theory that the body politic is a social compact whereby each citizen has contracted with every other citizen, and with the whole body of citizens, that each shall be governed by rules and laws for the common good. This social compact theory as being the true theory of the State has since that time been denied by some authorities on political science. Be that as it may, the Chief Justice after setting forth the theory, continued on page 125 as follows:

“From this source come the police powers, which, as was said by Mr. Chief Justice Taney in the License Cases, 5 How. 583, ‘are nothing more or less than the powers of government inherent in every sovereignty, that is to say the power to govern men and things.’ Under these powers the government regulates the conduct of its citizens one towards another, and the manner in which each shall use his own property, when such regulation becomes necessary for the public good. In their exercise it has been customary in England from time immemorial, and in this country from its first colonization, to regulate ferries, common carriers, hackmen, bakers, millers, wharfingers, innkeepers, etc., and in so doing to fix a maximum of charge to be made for services rendered, accommodations furnished, and articles sold.”

After setting forth the facts showing that these warehouses were virtual monopolies, the opinion on page 132 continues:

“They stand, to use again the language of their counsel, in the very ‘gateway of commerce,’ and take toll from all who pass. Their business most certainly ‘tends to a common charge, and is become a thing of public interest and use.’ Every bushel of grain for its passage ‘pays a toll, which is a common charge,’ and, therefore, according to Lord Hale, every such warehouseman ‘ought to be under public regulation, viz., that he take but reasonable toll.’ Certainly if any business can be clothed ‘with a public interest, and cease to be *juris privati* only,’ this has been.”

The court finally concluded that the statute was a proper use of the police power by the State and, therefore, was not in contravention of constitutional rights. Since that decision the legal principles therein elucidated have been extended enlarged, and, in some respects, changed.

The exercise of the police power is primarily a legislative function; the legislature and not the judicial arm of the government prescribes rules and regulations circumscribing future action. Some of the earlier decisions of the Supreme Court of the United States seem to hold that the exercise of this power by a legislative body was unlimited and could be exercised at the whim of the legislature, and that the courts had no control over the legislative branch of government therein. In the *Munn* case, Justice Waite, in discussing the existence of this power, said:

“We know that this is a power which may be abused; but that is no argument against its existence. For protection against abuses by the legislatures the people must resort to the polls, not to the courts.”

Again, the same Justice, in the case of *Pick v. Chicago and Northwestern Railroad*,⁹ used this language:

“Where property has been clothed with a public interest, the legislature may fix a limit to that which shall in law be reasonable for its use. This limit binds the courts as well as the people. If it has been improperly fixed, the legislature, not the courts, must be appealed to for the change.”

The courts, however, soon abandoned the idea that the legislative power to regulate was unlimited, and adopted the principle which now prevails, namely, that the power to regulate is not a power to destroy; that the State under the guise of regulation cannot deprive a citizen of property without just compensation or without due process of law. While you as lawyers are all familiar with the present rule that the Fourteenth Amendment to the Constitution of the United

States protects the property of citizens from confiscation by an act of the legislature or by a commission to which the legislative regulatory power has been delegated, yet this rule did not spring forth full grown in the first instance in which it was asserted. The development of the rule was a process arrived at through the trial and argument of several cases.

The general assembly had this inhibition upon the exercise of the police power in mind when it enacted the Public Service Commission law. The provisions of the statute giving power to the Commission to fix rates provides: "The Commission shall with due regard, among other things, to a reasonable average return upon the value of the property actually used in the public service and of the necessity of making reservation out of income for surplus and contingencies, determine the just and reasonable rate," etc.

FRANCHISE RATES.

Turning now from general principles to a consideration of a particular subject, a brief outline of the Commission's duty regarding franchise rates may be of interest. I have found that a large per cent. of the members of the Bar are unfamiliar with the principles of law involved. Many, in fact, most lawyers who have not had occasion to give professional attention to the subject, view the matter in about the same light as does the layman, namely, that a contract is a contract. They view it from their knowledge of the law governing agreements between individuals, and not from the viewpoint that the fixing of rates by franchise was a means or manner of regulation. They fail to remember that the regulation of rates is the exercise of the police power which cannot be alienated or contracted away by the State or by such an agency of the State as a municipality; they fail to remember that the Constitution and laws of the States are part and parcel of the terms of the franchise.

It is interesting to note how, when and why the principle

was first enunciated that the States by reason of the police power had the right to change franchise rates. It is interesting to note that it was established at the behest and insistence of the representatives of the public and originally was as vigorously opposed by the corporations as it is now espoused by them. The rule was established in cases arising prior to the high price era and prosecuted upon the insistence of the consumers that the particular contract rate in controversy was exorbitant and should be reduced in protection of the inalienable rights and general welfare of the citizens. (See *Milwaukee Electric Railway and Electric Light Company v. The Railroad Commission of Wisconsin*.)¹⁰ This case was not the first one in which the question arose, but it is one of the leading cases often cited and was commenced prior to the abnormal price level and upheld a reduction in franchise fares. The fact that the courts had decided that franchise rates were not necessarily binding upon the State, and that when found exorbitant the same might be reduced through the exercise of the police power, is one of the reasons why the creation of public service commissions in the respective States was a popular movement, resulting in the establishment of these commissions in practically every State in the Union, and is likewise one of the reasons why the utilities originally opposed the creation of such commissions. It was realized by the molders of public opinion that a commission equipped with engineers, accountants and experts to ferret out and build up the facts to show that a rate was really exorbitant was necessary if any reduction made was on appeal to withstand the scrutiny of the courts. The enigma in the matter was, that the advocates who established this doctrine did not foresee the high prices that might and did come in the future; but when the era of high prices came the principles thus established were resorted to by the utilities to have franchise rates

10. 153 Wis. 592—affirmed in 238 U. S. 174.

increased. No doubt the irony of the situation as illustrated by the foregoing has been one of the outstanding causes for the recent opposition to public service commissions, not only in Missouri, but in all of the other States of the Union. However, time is a great healer. Many franchises or so-called contract rates have been entered into during the high price period, and our Commission has already reduced some of these franchise rates; and time, with reductions in the costs of operation, will bring more, together with a more favorable public attitude to the child of its creation.

But I started out to discuss the principles of law involved in cases where franchise rates have been set aside. I will deal with the subject as it has been ruled upon under our Constitution and laws. The same principles, with variations due to different constitutional and statutory provisions, have been followed in other jurisdictions.

Section 5, Article 12 of the Constitution of this State, adopted in 1875, provides that "the exercise of the police power of the State shall never be abridged," etc. In many of the other States, there exist constitutional or statutory provisions similar in effect to our Constitutional provision concerning the abridgment of the police power. It is interesting to note the reason advanced by some writers for this solicitude concerning abridgment of the police power. The reasons given by one writer are two: one, the Federal Constitutional inhibition that "No State shall . . . pass any . . . law impairing the obligation of contracts;" the other, the decision of the United States Supreme Court in the Dartmouth College case, decided in 1819. (See editorial notes, advance sheets P. U. R. Vol. 1922C No. 4.) In the Dartmouth College case the court held that the State, by granting a charter to a corporation, had entered into a contract, and that a statute subsequently enacted which undertook to recall some of the powers lawfully granted constituted an impairment of the contract within the meaning of the Constitution. Thereafter

the States in granting charters to corporations have been solicitous to reserve the right to subsequently change the charters or to enact laws in furtherance of the general welfare as the exigencies may from time to time demand without being restrained by the constitutional inhibition covering the impairment of contracts.

It would seem that the well established rule that the police power is an attribute of sovereignty which cannot be alienated or abridged would make such solicitude on the part of the State unnecessary, and such seems to have been the attitude prior to the Dartmouth College case. But on analysis it will be seen that the line of demarcation of what is and is not within the police power is not clearly defined. In fact, the courts have held that the field within which the power may be exercised is so broad and, to keep pace with the advance of civilization, so changeable, that it is impracticable as well as impossible to make an all inclusive or all exclusive definition of the power. Thus, while it is held that the regulation of utility rates is an exercise of the police power which cannot be bartered away, yet it has also been held that a city ordinance fixing rates for a *limited period of time* binds the parties thereto if the city making it has been *legally authorized by the legislature to contract concerning rates*; and that such a contract for a limited period is not an alienation of the police power. (See opinion of Chief Justice White in *Southern Iowa Electric Company v. Chariton*.)¹¹

Whether or not the editor of the P. U. R. notes has given the true reason for the solicitude of the States in reference to the police power, nevertheless State constitutions and statutes do quite often expressly provide that the exercise of the police power to control corporations shall not be abridged or contracted away.

What is known as the "Sedalia" case,¹² is probably the

11. P. U. R. 1921 D, *l. c.* 277 and cases cited.

12. 275 Mo. 201.

one from this jurisdiction most often cited in support of the doctrine that the State cannot contract away its regulatory power over rates. The controversy in this case arose as follows: A complaint was filed by citizens of Sedalia against the water company of that city alleging inadequate service. After hearing and investigation the Commission ordered the company to build reservoirs and certain other improvements, which cost the company about \$100,000. After making the improvements as ordered, the company applied for an increase in its rates, including those for fire hydrant rental which had been fixed by a franchise ordinance and accepted by the company. After investigation of the value of the property and the operating expenses of the company in rendering the service, the Commission granted an increase in rates, including the fire hydrant rental. The city brought the case to the Supreme Court for review on the ground that the Commission had no power to change the fire hydrant rental fixed by the ordinance as it constituted a binding contract between the city and the utility. The court found that no serious contention could be made that the rates fixed by the Commission were unreasonable and that, therefore, the only question involved was the jurisdiction of the Commission to set aside the contract rate. Judge Graves wrote the opinion, in which all concurred. It is so concise and states the law so clearly, that I shall take the liberty of quoting it at length.

After stating that the Public Service Commission Act is to be liberally construed, the opinion on page 206 continues as follows:

“Not only so, but we have traced the Public Service Commission Act to the police power of the State. In the Gas Company case, *supra*, 254 Mo. l. c. 534, in speaking of this law we said: ‘that act is an elaborate law, bottomed on the police power. It evidences a public policy hammered out on the anvil of public discussion. It apparently recognizes certain

generally accepted economic principles and conditions, to-wit, that a public utility (like gas, water, car service, etc.) is in its nature a monopoly; that competition is inadequate to protect the public, and, if it exists, is likely to become an economic waste; that State regulation takes the place of and stands for competition; that such regulation, to command respect from patron or utility owner, must be in the name of the overlord, the State, and to be effective must possess the power of intelligent visitation and the plenary supervision of every business feature to be finally (however invisibly) reflected in rates and quality of service. It recognizes that every expenditure, every dereliction, every share of stock or bond or note issued as security is finally reflected in rates and quality of service to the public, as does the moisture which arises in the atmosphere finally descend in rain upon the just and unjust willy nilly.' ”

* * * * *

“We have further recognized that the Legislature can delegate to the Public Service Commission the power to ascertain and fix reasonable rates for services rendered to the public by the divers public service corporations. (State v. Public Service Commission, 194 S. W. l. c. 291.) In this case Faris, J., has aptly said:

“It is also settled beyond doubt or cavil that this power of prescribing maximum rates for common carriers, which, as we have seen, legislatures possess pursuant to an untrammelled grant of the power to pass laws, may be delegated to a railroad commission or to a public service commission. To this rule, unless inhibited by express constitutional provision, there is not a reputable exception.’

“Other Missouri cases might be cited, but these suffice for the thought now in mind. First, it is made clear by these cases that the ascertaining and establishing of reasonable rates for public service is one falling within the police power

of the State. Let us stick a peg here, because this becomes important later. Second, it is likewise made clear that the fixing of reasonable rates may be delegated by the Legislature to the Public Service Commission, subject, of course, to a court review upon the question of reasonableness.

“With these two questions made clear and conclusive by our own rulings we will take up later the real question of the instant case. In its discussion there should be kept constantly in mind the two questions, *supra*: (1) That the fixing of reasonable rates for public service is traceable to the police power of the State, and (2) that within proper bounds and limitations the fixing of such reasonable rates can be committed to a body, such as our Public Service Commission.

“II. It is claimed by relator that under the last proviso of Section 9239, Revised Statutes 1909, the city was authorized to contract for water service to the city without having such contract submitted to a vote of the people. This we think is true. Such is the statutory provision. The question really is to what extent such contract is affected by a subsequent law by and through which the Legislature asserts the sovereign power of the State relative to regulating rates for public service.

“In reality the question is deeper than suggested above. Going to our Constitution, the real question is, can the Legislature authorize a municipal corporation or a public service corporation to make a contract as to rates which contract will preclude the sovereign power of the State from fixing reasonable rates irrespective of the contract? We use both the terms ‘municipal corporation’ and ‘public service corporation’ purposely, because they are usually the opposing parties to the contract. In the instant case the municipal corporation is the party to the contract upon one side, and a public service corporation is the party upon the other side.

The two corporations are the two parties which stood at arms-length in the making of the contract here involved. So that we are forced to answer the question, 'Can the State of Missouri divest itself of the right to exercise its police power?' This court has held, and we think rightfully so, that the fixing of reasonable rates for service to be rendered to the general public (which general public includes municipal corporations, as well as the citizens thereof) is an exercise of the sovereign police power of the State. Section 5, Article 12, of the Missouri Constitution reads: 'The exercise of the police power of the State shall never be abridged, or so construed as to permit corporations to conduct their business in such manner as to infringe the equal rights of individuals, or the general well-being of the State.'

"Note the language, 'the exercise of the police power of the State shall never be abridged.' Under such a constitutional restriction the Legislature would be powerless to enact a valid law by the terms of which the right of the State in the exercise of its sovereign police power in the fixing of reasonable rates for public services could be limited or abridged. This court so held in *Tranbarger v. Railroad*, 250 Mo. l. c. 55.

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"Some of us thought the pronouncement a little broad and dissented, but the case was taken to the United States Supreme Court and there affirmed. (*Chicago & Alton Railroad Co. v. Tranbarger*, 238 U. S. 67.)

"The United States Supreme Court was even more explicit in this *Tranbarger* case than was the majority opinion in this court. To its rule we must bow. At page 76 of 238 U. S., in this *Tranbarger* case, it is said:

" 'It is established by repeated decisions of this court

that neither of these provisions of the Federal Constitution has the effect of overriding the power of the State to establish all regulations reasonably necessary to secure the health, safety, or general welfare of the community; that this power can neither be abdicated or bargained away, and is inalienable even by express grant; and that all contract and property rights are held subject to its fair exercise. (Atlantic Coast Line v. Goldsboro, 232 U. S. 548-562, and cases cited.) And it is also settled that the police power embraces regulations designed to promote *the public convenience or the general welfare and prosperity* as well as those in the interest of the public health, morals or safety. (Lake Shore & Mich. Southern Ry. v. Ohio, 173 U. S. 285, 292; C. B. & Q. Ry. v. Drainage Commissioners, 200 U. S. 561, 592; Bacon v. Walker, 204 U. S. 311, 317.)'

“The italics in the above quotation are ours. It was under similar definitions of ‘Police Power’ that this court held that the fixing of reasonable rates for public service is the exercise of the sovereign police power of the State. Such power cannot be contracted away, nor can the Legislature of the State authorize a municipal corporation to contract away this police power of the State. It is clear that the Legislature cannot confer more power upon one of its creatures (a municipal corporation) than it possesses itself. The Legislature is prohibited by the Constitution from abridging the police power of the State, and it cannot legally authorize any creature of the Legislature to abridge this sovereign power. So that we care not what the literal meaning of Section 9239, Revised Statutes 1909, may be. If it be construed so as to abridge or limit the exercise of the sovereign police power of the State, the Legislature overstepped constitutional limitations in enacting it. If it be construed as simply authorizing a contract until such time as the State saw fit to assert its police power, as it did in the Public Service Commission

Act, then it would be at least harmless in the instant case. It is, however, clear that under our Section 5 of Article 12 of the Constitution of 1875 (a section not theretofore found in our Constitution) the Legislature itself cannot abridge the police power of the State. Nor can it authorize a municipal corporation to make a contract abridging or limiting such police power. So that if, as we have held, the fixing of rates for public service is an exercise of the police power, then under other rulings cited above the Public Service Commission had a right to fix reasonable rates irrespective of the alleged contract. The great weight of authority so holds."

To summarize the law in Missouri as construed by this decision, which has since been consistently followed, certain fundamental principles may be stated. First. The regulation of rates is an exercise of the police power by the legislative branch of the State. Second. That this power has been delegated by the legislature to the Public Service Commission. Third. That our Constitution prohibits the abridgment of the police power by the legislature or a municipality. Fourth. That the legislature cannot confer upon a municipality the power to make a contract to fix rates that would be binding either upon the municipality or upon the State.

While the Sedalia case does not so hold, it would seem to follow as a corollary to the last mentioned principle that if the Public Service Commission had not been created, the utilities, by resorting to the courts, could nevertheless have increased their franchise rates over the protest and without the consent of the cities where it could be shown that the rates fixed by the franchise constituted a confiscation of their property. This is at least what happened in some States where the commissions were not given jurisdiction over certain local utilities, and where cities had not been expressly authorized to contract concerning same. In the State of Iowa the power to fix electric rates is not lodged in the Railroad

Commission of that State. Their statute confers jurisdiction upon the municipalities in about the same manner as the Missouri statute provided prior to the creation of the Public Service Commission. In the case of *Southern Iowa Electric Company v. Chariton*, *supra*, the franchise of the company fixed a maximum schedule of rates. By reason of the rise in prices resulting from the World War, these rates became unremunerative and the company, under the Fourteenth Amendment to the Constitution of the United States, brought injunction suits in the Federal courts restraining the city officials from enforcing these rates and from interfering with the company in collecting higher ones. The case went to the Supreme Court, Chief Justice White writing the opinion, in which it was held that the city had no authority under the statute to make a contract fixing permanent rates; that its power to fix rates was a continuing power to fix reasonable rates, and that when a rate became confiscatory by reason of changed economic conditions it became the duty of the city to fix new ones that would be remunerative, and upon a failure or refusal to do so the utility could then fix its own rates and the courts would restrain the city from interfering. A similar situation would have existed in Missouri if the Public Service Commission Act had not been enacted.

In a general way the foregoing sets forth the fundamental principles of law which make it the duty of the Commission to set aside franchise rates, when and where it clearly appears that such rates have become either exorbitant or confiscatory as the case may be. I use the phrase "duty of the Commission" advisedly, for that is exactly what the law casts upon the Commission. So much so, that in the case of *Missouri Southern Railroad v. The Public Service Commission*,¹³ the Supreme Court issued a mandamus directing the Commission

13. 259 Mo. 704.

to investigate and fix railroad rates regardless of the fact that the legislature had fixed them by statute. I use the phrase "duty of the Commission" for another reason: it certainly has never afforded the Commissioners any personal pleasure to set aside franchise rates; but on the contrary such action has always been an unpleasant task and the Commission has sought ways and means, where possible, to avoid doing so; however, where the duty clearly appeared, the Commission has not willfully shirked its responsibility in the matter.

I have discussed some of the legal principles involved in franchise rate cases. In addition, it may be said that rules of law do not stand alone, separate and apart from all other rules and motives that guide our daily actions. Correct rules of law are based upon and supported by moral and economic principles. The query naturally arises, since the regulatory power is exercised to promote the public convenience and prosperity and the general welfare, in what manner are these promoted by the setting aside of contract rates? The answer, of course, is apparent when the setting aside is to result in a lowering of the rate. The advocates of the people were able to convince the courts that if the consumer had no recourse through the police power to change franchise rates then he was at the mercy of the corporation in cases where, through fraud or political manipulation, unfair or unjust rates had been fixed for a long period of time, or where, through science and invention or falling prices, the cost of rendering the service had been materially reduced so that the rates fixed became unreasonable and exorbitant. The public readily understood the foregoing argument in favor of subjecting franchise rates to regulation under the police power.

On the other hand, it is more difficult to convince a consumer that increasing franchise rates in any way promotes the public convenience, prosperity or the general welfare. This, however, in a measure at least, is true, and for this reason: the service is necessary, likewise the quality and the

continuity of the service is necessary. It requires capital to render the service and unless the business is remunerative or has a good prospect to be remunerative, capital will avoid the business, so as to make it impossible for the company to make extensions and improvements required by the community served. Further, if economic conditions have so radically changed that the rate fixed by a franchise has become confiscatory and there appears no immediate relief therefrom except by an increase, then the company on failure to receive an increase will either go into receivership, cease operation, or reduce the quality of the service so as to continue to operate under the rates. A receivership would result in added expense to be paid out of rates; cessation of operation would entail untold loss to a community, and a reduction in the quality of service could only redound to the detriment of the consumer. Where an increase in rates is necessary to attract capital to make extensions and improvements or to protect the continuity or quality of the service, the granting of such an increase may reasonably be said to promote the general welfare.

But aside from these reasons, it would seem that if the State is to exercise the police power to decrease established rates when they have become unreasonably high, then, in equity, the State should likewise exercise the same power when the rate, on account of changed conditions, has become confiscatory. So it would seem that the rules of law casting the duty upon the Public Service Commission to increase or to decrease so-called contract rates as the exigencies of the times may demand are founded upon sound moral and economic principles.