REGULATION OF KANSAS PUBLIC UTILITIES

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Instructor in charge

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June 1, 1929.
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PREFACE

Before entering upon a discussion of the subject before me, it may be well to offer some explanations to any critical reader whose expectations may be abused in examining the following pages.

My first plea for leniency and charity of judgment is based upon the fact that the subject of my thesis represents a novel part of the science of economics. Not more than forty years ago, the concept of a public utility in the modern sense was unheard of in the history of economics. Even economists had to face a situation where chaos rather than harmony prevailed. Of course in respect to inn-keepers and the ancient common carrier, whose only lawful plea for default in performance was the acts of God and the King's enemies, economic authority was fairly well harmonized. But from the law governing the inn-keeper and the common carrier of primitive times, it is a long way to the concept of a twentieth century utility. But even after the notion of a public utility had become more fixed and certain in its economic meaning, there still existed much confusion and uncertainty regarding its legal aspects.

Disputes arising between state commissions and public utilities were necessarily referred for settlement to the state courts. Since there are forty-eight of these state courts, it would not have been reasonable or according to human experience to expect a high degree of unity in their decisions. There are marked differences in the laws of the several states in respect to supervising public utilities and also between the commissions in the exercise of their delegated authority. Hence it has been no small part of the task, in view of these many decisions, whether state or federal, to determine in a given case what
decision was applicable.

In order to avoid this difficulty, I began with the United States Supreme Court and worked downward. In this way it was possible in a reasonable length of time to learn the extent of the state authority in respect to public utilities. It appears that this was the courts' game rather than that of the economists, who more than once dissented from the rulings of the judges. Hence the task resolved itself largely into ascertaining the controlling law.

Notwithstanding the tedious work involved in the preparation of the thesis, the task has been both interesting and pleasant. I attribute this largely to my worthy preceptors. Among others I wish especially to name Dean Frank T. Stockton, whose kindly interest I shall long remember. To Dr. Jens P. Jensen, I wish also to express my genuine regard and my sense of obligation, for his patience in advising and explaining to me the mystery of economics, and also the technic of thesis writing. Words, however, fail to express my sense of appreciation; so I can only say "virtue is its own reward!"
INTRODUCTION

Regulation of public utilities by a public service commission has been established in a large majority of the several states. Such regulation, resulting from the police power of the state, was established in Kansas early in the twentieth century. The Kansas Commission has been organized into the engineering and accounting, railroad and legal departments. Definite work has been assigned to each of these.

The discretionary power of the Commission comprises the granting or withholding of certificates of convenience to public utility companies and the regulation of rates and services of such companies. In order to prevent confiscation of property, the lawful scope of the Commission's orders concerning rates and services is checked by statutory and constitutional inhibitions and guaranties. In the granting and withholding of certificates of convenience, the public utilities act gives the Public Service Commission a broader power than the Commission exercises over rates and services. For instance, a utility organized since the enactment of the law must procure a permit from the Commission before installing its system. Thus the Commission has power to determine whether a community already occupied and served by one utility may be invaded by another utility giving a similar service, and whether such duplication would be a burden upon the community and result in economic waste disadvantageous alike to the public and the utility.

The Kansas Supreme Court has favored the Commission's authority in all cases where the utility's business is not confined principally to one town or city. Thus municipal utilities are exempt from the Commission's authority, but corporations that are creatures of the law and have delegated authority only, must obey the law under which they ex-
istent and operate. They must refrain from obtaining a monopoly of the products which they sell.

The Kansas law provides that any city may apply to the secretary of the Public Service Commission for technical service and advice, pertaining to any public utility operating in that city, no matter whether the utility is publicly or privately owned. The cost of the service must be borne by the city.

Kansas having but a few large cities, the greater part of its population lives in five hundred or more incorporated places. About fifty per cent of these municipalities have water systems which they own and operate; eighty per cent have electric light and power service from plants the majority of which is municipally owned; twenty-one per cent have gas service, though only a few own the plants that supply them. All of these cities have telephone service.

**Water Systems.** - Although the water systems are municipally owned, the Commission has received a considerable number of calls for technical service. For example, the city of Wakeeny was given assistance with respect to the source of its water supply. Again, the city of Harper was helped with respect to the pumps supplying its water. Similarly, a valuation of a private water plant was made on the instigation of Yates Center.

**Electric Companies and Service.** - The privately owned electric utilities in the State of Kansas are now with a few exceptions consolidated into six large companies, namely, The Kansas Gas and Electric Company; The Kansas Electric Power Company; The Kansas Power and Light Company; The Kansas Power Company; The United Power and Light Corporation; and The Kansas Utilities Company. All these cor-
Corporations are holders of Kansas franchises and are operating under the supervision of the Public Service Commission of the State.

Most of these companies are related to the Illinois Power and Light Corporation, the most extensive public service corporation in the central states. This corporation was organized May 28, 1928, for the purpose of obtaining and consolidating all the properties previously owned by the Illinois Traction Company and the Light and Power Companies of Southern Illinois. This corporation owns over forty companies, among them The Kansas Public Service Company, incorporated in 1910. This Kansas Company owns the capital stock of the Topeka Edison Company, the common stock of The Kansas Power and Light Company, and The Atchison Railway, Light and Power Company. The auxiliary companies own the street railway and the commercial electric light and power and state heating properties in the city of Topeka and the suburb of Oakland, Kansas.

A report of the Public Service Commission shows that during the last few years the Kansas commissioners have approved the construction of over one thousand miles of new transmission lines and that with the growth of these lines there has arisen a greater demand for the extension of electric service into rural communities.

The Kansas Service Commission has undergone considerable work in rendering assistance to either corporations or consumers; in making valuations on properties and in adjusting rates and services for the best interest of all the parties concerned.

A few examples of electric rates paid by the residential consumers of various municipalities follow:
<table>
<thead>
<tr>
<th>City or Town</th>
<th>Price in Cents per K.W.H</th>
<th>Minimum Price per Month</th>
</tr>
</thead>
<tbody>
<tr>
<td>Atchison</td>
<td>10</td>
<td>$1.00</td>
</tr>
<tr>
<td>Fort Scott</td>
<td>10</td>
<td>$1.00</td>
</tr>
<tr>
<td>Leavenworth</td>
<td>10.5</td>
<td>$1.00</td>
</tr>
<tr>
<td>Abilene</td>
<td>10</td>
<td>$1.00</td>
</tr>
<tr>
<td>Bonner Springs</td>
<td>12.5</td>
<td>$1.00</td>
</tr>
<tr>
<td>Columbus</td>
<td>8 for the lst 30 hrs; 5 for any excess</td>
<td>$1.00</td>
</tr>
<tr>
<td>Concordia</td>
<td>13 for the lst 20 hrs; 12 for any excess</td>
<td>$1.00</td>
</tr>
<tr>
<td>Dodge City</td>
<td>10 for the lst 30 hrs; 9 for any excess</td>
<td>$1.00</td>
</tr>
<tr>
<td>Emporia</td>
<td>10 for the lst 100 hrs; 9 or less for any excess</td>
<td>$1.00</td>
</tr>
<tr>
<td>Garden City</td>
<td>10 for the lst 50 hrs; 9 for any excess</td>
<td>$1.00</td>
</tr>
<tr>
<td>Galena</td>
<td>8 for the lst 30 hrs; 5 for any excess</td>
<td>$1.00</td>
</tr>
<tr>
<td>Garnett</td>
<td>10 for the lst 20 hrs; 9 or less for any excess</td>
<td>$1.00</td>
</tr>
<tr>
<td>Goodland</td>
<td>16 for the lst 30 hrs; 15 for any excess</td>
<td>$1.00</td>
</tr>
<tr>
<td>Great Bend</td>
<td>11 for the lst 30 hrs; 6 for any excess</td>
<td>$0.75</td>
</tr>
<tr>
<td>Hays</td>
<td>15 for the lst 50 hrs; 12 or less for any excess</td>
<td>$1.00</td>
</tr>
<tr>
<td>Kinsley</td>
<td>13 for the lst 50 hrs; 12 or less for any excess</td>
<td>$1.25</td>
</tr>
<tr>
<td>Brookville</td>
<td>16 for the lst 15 hrs; 15 or less for any excess</td>
<td>$1.39</td>
</tr>
</tbody>
</table>

Although the foregoing rates show considerable variations, yet
the Kansas Commission has found them to be neither discriminatory nor
wholly unjust. Investigations showed that some companies were sel-
ing scarcely enough energy to make fair returns on their investments.
and that they could sell additional amounts of energy at only slightly increased cost. This was due to the fact that certain costs to the companies remain almost stationary, though the amount of energy sold may go down. For this reason the Kansas Service Commission encourages the adjustment of rates in proportion to the cost of rendering the service.

Gas Service. - Kansas is served by the Kansas Natural Gas and Wichita Natural Gas Companies, which obtain their product from the natural gas and oil fields in the eastern and southeastern counties of Kansas. The gas from these counties, supplemented by gas from Oklahoma, is used in the State of Kansas by over one hundred thousand consumers and four hundred industries. Natural gas leaves these fields in large pipe lines and though in this transportation there is a great amount of waste, yet the Public Service Commission has but little authority to prevent it.

A study of one hundred and sixteen Kansas cities using gas shows that twenty-two of these cities are served with gas by the Western Distributing Company; six are served by the American Gas Company; five are served by the Kansas Gas and Electric Company, and five others by the Hale Gas Company; seven are served by municipal plants; and the remaining seventy-one cities are served by nearly sixty different companies.

A survey of these cities with reference to rates shows a wide difference in the minimum rate of gas per thousand cubic feet.

<table>
<thead>
<tr>
<th>Number of Cities Reporting</th>
<th>Price of Gas per Thousand Cubic Feet</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>$1.00</td>
</tr>
<tr>
<td>1</td>
<td>$0.95</td>
</tr>
<tr>
<td>21</td>
<td>$0.80</td>
</tr>
<tr>
<td>7</td>
<td>$0.75</td>
</tr>
<tr>
<td>Number of Cities Reporting</td>
<td>Price of Gas per Thousand Cubic Feet</td>
</tr>
<tr>
<td>---------------------------</td>
<td>-------------------------------------</td>
</tr>
<tr>
<td>3</td>
<td>$0.70</td>
</tr>
<tr>
<td>1</td>
<td>$0.65</td>
</tr>
<tr>
<td>8</td>
<td>$0.60</td>
</tr>
<tr>
<td>14</td>
<td>$0.58</td>
</tr>
<tr>
<td>1</td>
<td>$0.56</td>
</tr>
<tr>
<td>9</td>
<td>$0.50</td>
</tr>
<tr>
<td>5</td>
<td>$0.45</td>
</tr>
<tr>
<td>6</td>
<td>$0.40</td>
</tr>
<tr>
<td>3</td>
<td>$0.38</td>
</tr>
<tr>
<td>5</td>
<td>$0.35</td>
</tr>
<tr>
<td>4</td>
<td>$0.30</td>
</tr>
</tbody>
</table>

During recent years the gas-distributing companies of Kansas have brought many rate cases before the Commission. The Kansas Natural Gas and The Wichita Natural Gas Companies were given by the Commission a raise of five cents on the city-gate rate. The increased cost of gas to the local distributing plants of course lowered their profits, and, though some cities wished to adhere to the current rates, the companies applied to the Commission for an increase in rates in order to shift the five-cent city-gate rate to the consumer.

The Kansas Commission has made many accounting investigations in connection with rate cases to determine whether or not certain towns and cities may be placed on the basis of local gas rates which would result in a reduction of rates.

**Telephone Service.** — A study of the telephones of five hundred and seventy-one Kansas towns and cities shows that one hundred and thirty-nine are owned by The Mutual Telephone Company; that three hundred twenty are owned by The Independent Company; that seventy-three are owned by The S. W. Bell Company; that twenty-nine are owned by The United Company; and that ten are owned by The Consolidated Company.

A study of a few city telephone rates shows the following re-
results:

<table>
<thead>
<tr>
<th>Business</th>
<th>Residence</th>
<th>Price per Month</th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td>1</td>
<td>$4.00</td>
</tr>
<tr>
<td>12</td>
<td>2</td>
<td>$3.00</td>
</tr>
<tr>
<td>27</td>
<td></td>
<td>$2.75</td>
</tr>
<tr>
<td>125</td>
<td>3</td>
<td>$2.50</td>
</tr>
<tr>
<td>107</td>
<td>18</td>
<td>$2.00</td>
</tr>
<tr>
<td>70</td>
<td>35</td>
<td>$1.75</td>
</tr>
<tr>
<td>63</td>
<td>172</td>
<td>$1.50</td>
</tr>
<tr>
<td>12</td>
<td>146</td>
<td>$1.25</td>
</tr>
<tr>
<td>17</td>
<td>53</td>
<td>$1.00</td>
</tr>
</tbody>
</table>

The telephone department takes inventories of all telephone properties, determines the condition of such property, fixes its value and the per cent of depreciation that should be allowed before rates are determined for telephone service. Many of the small telephone companies of the State have obtained the legal, engineering and accounting advice given by the Commission and its expert help. Where it seemed expedient to do so, attorneys, engineers and accountants have gone to towns and met with the companies and their subscribers, thus aiding in adjusting differences which might otherwise have resulted in losses to the companies and communities.

Some idea of the Kansas Service Commission's work may be obtained from a study of the number and kind of cases that have come before that body is a stated period of time. For example, during a period of two years there were filed with the Commission over a thousand railroad cases. A very large majority of all these and other complaints made to the Public Service Commission have been successfully adjusted by fostering a policy of co-operation between the service corporation and the public. However, all matters pertaining to valuation and rate-making are subject to review in higher courts whenever the acts of the commissioners are not satis-
factory to the parties concerned.
CHAPTER ONE

THE EVOLUTION OF THE KANSAS UTILITY LAW

In Europe prior to 1776, when Adam Smith published his "Wealth of Nations," most countries followed a policy known as mercantilism. By the exercises of this policy not only utilities but enterprises of a more private nature were subject to governmental regulations.

In England during the Middle Ages common carriers, inn-keepers, warehousemen, ferrymen and similar occupations were subject to governmental regulations. There was a statute against forestalling the market, i.e. buying victuals on their way to the market, with the intent of selling them again at higher prices; one against em-grossing, i.e. buying up such large quantities of an article as to obtain a monopoly of it for the purpose of selling at an unreasonable price; still other statutes prevented persons from controlling the market. In 1773 this principle of mercantile regulation by the government was questioned by Adam Smith in "The Wealth of Nations", in which he advocated and defended a principle known as \textit{laissez-faire}. This principle maintains that trade relations shall be fettered by a minimum regulation of the government.

1. FEDERAL REGULATION

In the United States the \textit{laissez-faire} doctrine was favored by the framers of our Constitution and especially by the followers of Thomas Jefferson. Their doctrine was that the best governments are those that impose the fewest restrictions upon trade and industrial relations. Yet the absence of power to secure uniformity in commercial regulations was a source of weakness in the Articles of Confederation and was one of the causes for the adoption of the Constitution. In Article 1, Section 8 of the Constitution is delegated to
Congress "power to regulate commerce with foreign nations and among the several states and with the Indian tribes." It was early held by the Supreme Court in the case of Gibbons vs. Ogden, in which Chief Justice Marshall discussed the clause, that the object of Congressional action is not limited to regulating traffic - the mere buying and selling, or interchange of commodities - but that the clause comprehends the means of transportation, and that therefore acts of the New York legislature granting to Robert Fulton and Robert Livingston the exclusive right of navigating the waters of that State with steamboats, were void.

Under this clause Congress may exercise control over highways, railroads, and navigable waters, whenever they form avenues for commerce not wholly within a single state. The authority extends also to rivers wholly within a single state, provided such rivers, together with other bodies of water, form a continuous route for commerce to other states or foreign countries. That the United States has such an interest in these highways that it may secure an injunction to prevent their construction, was held by the Supreme Court in 1894.

Congress has power to regulate the equipment employed in interstate commerce; for example, the Safety Act of 1869 required the use of automatic couplers and air brakes on all railroads engaged in interstate commerce. By the limitations of the Constitution Congress has no right to interfere with commerce carried on wholly within the state, or with the manufacture of such goods as are sold and consumed within the state of manufacture.

In 1906 the inspection of meat, which was to become a factor of 1) 158 U. S. 564.
interstate or foreign commerce, was made the duty of the Interstate Commerce Commission by an act of Congress. But Congress cannot regulate contracts which merely relate to commerce. For this reason, it has been held by the Supreme Court that fire and marine and life insurance do not fall within the scope of interstate commerce, one of the chief obstacles to a federal control of insurance.

It has been questioned whether the power to regulate commerce includes the power to prohibit it. The constitutionality of the Embargo Act of 1807, prohibiting all commerce with Great Britain and France was sustained by the lower courts but never authoritatively passed upon by the Supreme Court. This court, however, decided in 1908 in the lottery case that lottery tickets are objects of commerce and that their transportation could be prohibited. Four of the nine justices of the court dissented from the decision.

The Sherman Anti-Trust Act, passed in 1890, is an important enactment under the commerce clause. It provides that "every contract, combination in the form of trust or otherwise, or conspiracy in the restraints of trade or commerce among the several States or with foreign nations, is hereby declared to be illegal." A combination relating merely to the manufacture has been held not to be within the scope of this act. The statute is applicable where there are provisions in the agreement to destroy competition or to increase the price of articles when the same is a factor in interstate commerce. An important decision under this statute is that of the Northern Securities Company vs. the United States, in which it was held in 1908 by a nearly evenly divided court that the act of the stockholders of the Great Northern and Northern Pacific Railway Companies of creating
the Northern Securities Company as a holding corporation which was to own the majority of the stock of the two railroad companies, was an illegal combination in restraint of interstate commerce.

The act of 1887 was amended in 1906 by what is popularly known as the Railway Rate Bill, which directed the Interstate Commerce Commission to fix rates for the transportation of person or property.

Congress cannot discriminate as "no preference shall be given by any regulation of commerce or revenue to the ports of one State over those of another," nor shall "vessels bound to or from one State be obliged to enter, clear, or pay duties in another."

The regulation of the railroads was first attempted by the states but state legislation of this character did not correct the evils which were complained of by the patrons of the roads. On account of the lack of uniformity of the laws which were passed by different states, the situation grew worse instead of better, so that Congress was almost compelled to assume control of the roads. Hence since 1887 state supervision has been only nominal. State regulation had to submit to the decisions of the Interstate Commerce Commission on account of its superior jurisdiction.

The assumption of national jurisdiction over the roads has in some instances led to a conflict between federal and state laws, as it was held by the Supreme Court that the State of Iowa could not prohibit the sale of intoxicating liquors by an importer so long as such liquors remained in the original package and had not been mingled with the mass of property within the State. To counter--

1) 244 U. S. 574.
act the effect of this decision, Congress, in 1890, passed the Wilson Act, providing that intoxicating liquors transported into any state shall upon arrival be subject to the laws of such state, enacted in the exercise of the police powers, in the same manner as domestic liquors. Similar statutes have been enacted by Congress to render effective state laws as to game and oleomargarine.

The Expediting Act passed in 1906 and amended in 1910, gave precedence to appeals from the Interstate Commerce Commission's rulings and provided that an appeal from a District Court shall be direct to the Supreme Court of the United States.

The Safety Appliance Acts, passed in 1893 and amended in 1919, prescribed certain forms of equipment, such as automatic couplers, etc. In 1908 an act was passed which made the railroads liable to their employees for injuries or deaths resulting from negligence of the employers.

The Hours of Service Law, passed in 1907, provided severe penalties for requiring or permitting employees in train service to remain on duty more than sixteen consecutive hours, while train dispatchers were limited to nine hours.

Regulation both by the states and by the federal government was the sequel to very extensive aid, both local and national, to railway construction. This aid took the form of land grants, surveys, remission of duties on iron and guarantee of railway securities by the government. It is important because of the fact that it hastened the government regulation of railways. State and federal regulation was in part the extreme reaction from the liberality of the government aid and local aid to railways of the two previous decades. From
1850 to 1860 aid to the railways was predominant. For instance, "2,600,000 acres were voted in 1850 to Illinois for the Illinois Central Railroad and large amounts other states to build the Mobile and Ohio Railroad. In the next fifteen years 20,000,000 acres of public lands were disposed of in the interests of western railroads."

From 1860 to 1870 aid was still being freely given, but there was also considerable regulation, largely of a negative character.

From 1870 to 1880 the volume of railway bills in Congress increased tremendously. In 1875 there was a law which permitted land grant roads to receive but eighty per cent of regular rates. The first comprehensive regulation of railway practice was the passage of laws regulating live stock shipments. The so-called Granger legislation followed the panic of 1873. The Granger movement had for its aim the improvement and construction of inland waterways, and the regulation of existing lines, but this consisted chiefly in an attempt to force the passage of laws securing cheaper transportation.

The railways turned to the courts for protection and the basis on which they asked for relief from state and federal laws was that their property was being taken without due process of law. The courts finally upheld them in the Smythe vs. Ames case, in which the Supreme Court of the United States held that a state legislature could not fix railway rates so low as to fail to yield a fair return on the value of the property devoted to public service. This decision of the Supreme Court has been the keynote of public policy in regard to the regulation of railways and public utilities in general ever since.

From the time of the passage of the acts to regulate commerce

in 1887 down to the passage of the Elkins Act in 1903 federal regulation failed to obtain its primary object, which was the elimination of discrimination between different shippers and the practice of giving rebates. Competition rather than government regulation brought rates down. There has been a series of decisions which have established the principle that wherever the Interstate Commerce Commission has taken jurisdiction in matters involving even indirectly interstate commerce, the state legislatures and state commissioners cannot interfere.

In a decision handed down in 1925 the United States Supreme Court held that each class of service rendered by a railway company has a legal right to earn a fair return on the value of the property used in that service, and that, while railway managements may charge lower rates for certain services than would yield a fair return on the value of the property used in that service, it is not within the power of the state legislatures and presumably of the Interstate Commerce Commission to compel continuous adoption of this policy.

The Interstate Commerce Commission, in attempting to fix reasonable rates, has deemed it essential to make physical valuations of the railways; hence Congress passed a law for the valuation of railways, though not without much agitation and discussion.

II. STATE REGULATION

One of the first attempts of state regulation grew out of the case of Hurn vs. Illinois. In 1872 an information was filed in the Criminal Court of Cook county, Illinois, against Hurn and Scott, alleging that they unlawfully transacted the business of public
warehousemen. The record showed that Hunn and Scott had not taken out a license as required by the statute, nor had they charged the lawful rates, nor given a bond. They were found guilty and fined, and the Supreme Court of Illinois having affirmed the judgment, they assigned error, relying on the federal Constitution.

The court opinion is as follows: "It matters not in this case that these plaintiffs in error had established their business before the regulations complained of were adopted. What they did was from the beginning subject to the power of the body politic to require them to conform to such regulations as might be established by the proper authorities for the common good."

This case is important because it is one among the first cases to declare the right of the state to regulate public utilities.

It may fairly be said that, aside from the pioneer work in Massachusetts, modern regulatory methods through state commissions had their beginning in 1907, when the States of Wisconsin and New York established commissions having very broad jurisdiction and authority over all forms of public utilities. From the beginning the Wisconsin Railroad Commission has rendered decisions which, for thoroughness of investigation, soundness of reasoning, and impartiality of findings, have commanded universal respect. At the present time every state in the United States, except Delaware, has a regulatory commission exercising supervision over a part or all of the public services within the state. The extent of their regulatory activities is generally as follows:

(A) To adopt rules to govern their proceedings.

1) 94 U. S. 113
(B) To regulate the manner of investigations and inspections.
(C) To regulate the rates and services of the utilities.
(D) To enforce the provisions of the law against discrimination.

The scope of public utility supervision, in the various states, would include all business enterprises which are affected with a public interest, such as telegraphs and telephones, pipe lines and street railways, and plants for providing heat, light, water and power. These are strictly public utilities, while railroads, stage lines, and interurban lines are classified under the law as common carriers.

III. KANSAS REGULATION

A. RAILROAD COMMISSION

In Kansas it seems that the laissez-faire principle was strictly observed until the year of 1883, when the Kansas legislature established a Railroad Commission, giving it power of regulation and supervision of all railroads then operating in the State.

The law of 1883 empowered the executive council to elect three competent persons to constitute a Board of Railroad Commissioners, whose terms of office were to be for one, two, and three years. The executive council each year was to elect a commissioner to hold the office for a term of three years, and, in case of a vacancy, was to elect a commissioner to serve the remainder of the term. The executive council had power of removal but was required to keep a public record of the votes cast by its members in the election of the commissioners or of the votes cast for the removal of a commissioner.

The executive council was privileged to employ a secretary who held his office at their pleasure. The commissioners and their secretary were required to possess the same qualifications. The rules
further provided that the commissioners could not have or acquire any interest in railroads under their supervision; that each commissioner should be qualified as elector of the State and that only two of the commissioners could belong to the same political party; that each should take the prescribed oath of office and also furnish a bond in the sum of $10,000 conditioned on the faithful performance of his duties.

As to the duties of the commissioners, the law provided that the Board of Commissioners should keep an accurate record of all its official acts; that each act should be attested by the official seal; that no member of the Board, while in office, should accept or use any free transportation; that the office of the Board of Commissioners should be maintained at the capital of the State; that the salary of each be fixed at $3,000 per annum, and that of the secretary at $1,500 per annum.

As to the extent of the power of the commissioners, they could require railroad companies to provide freight cars upon reasonable notice; they could fix the limitations of passenger fares to three cents per mile; they could make rules against discrimination in rates for service; aside from this they were to take notice that companies and individuals were served alike in providing cars; they also had the right to regulate switch and railroad crossings, and to prohibit pooling.

As to the jurisdiction of the commissioners, they had general supervision of all railroads in the State operated by steam, also of all express companies, sleeping car companies, and of all other persons, companies or corporations that engage in business as com-
mon carriers in the State.

The duties of the commissioners consisted in hearing and determining all complaints against persons, companies or corporations doing business as common carriers, for any neglect or violation of the laws of the State; in inspecting the books, papers and other documents of a common carrier operating within the State; in issuing subpoenas, administering oaths and imposing fines for violations of existing laws and regulations, and in reporting to the attorney general all failures to comply with the Commission's orders.

The commissioners had power to authorize individuals to construct spurs and switches, and to investigate unreasonable rates; they could not, however, grant positive relief, but merely recommend it; all fines assessed for violations of existing laws and regulations were to be paid by them into the school fund.

The annual report of the commissioners contained a statement of each railroad's amount of capital stock; also the amount of its preferred stock; the amount of its funded debt and the rate of interest, together with the amount of its floating debt; the valuation of the roadbed and equipment; the estimated value of all other property; the number of acres originally granted to aid construction; a list of all officers and directors together with their places of residence; and such other information as the Board deemed pertinent.

II. PUBLIC UTILITY COMMISSION

The rates and services of public utilities in Kansas have been regulated by the State since 1911, when the State legislature passed an act changing the Railroad Board of Commissioners into a Public Utility Commission, authorized to exercise jurisdiction over the
public utilities of the State and to make rules and regulations for
the enforcement of its orders.

The officers of the Railroad Commission were permitted to remain
as officers in the new Public Utility Commission during the remainder
of the unexpired terms to which they had been elected and until they
were succeeded by three other qualified officers of the new Commiss-
ion selected by the governor and approved by the senate. One of these
members was to be chosen for a term of one year, another for a term of
two years, and a third for a term of three years; a new member was to
be chosen each succeeding year thereafter; the length of term for
each was three years; the annual salary of each was placed at $4,500.

The law authorized the Commission to select a secretary and an
assistant secretary with annual salaries of $2,400 and $1,800 respect-
ively, and an accountant whose yearly salary was not to exceed $2,700.
The allowance for clerk hire was $6,500; for engineers, $9,000. The
combined salary of stenographers was not to exceed $5,700.

1. COURT OF INDUSTRIAL RELATIONS

The Public Utility Commission, as organized in 1911, was super-
seded by a Court of Industrial Relations, established in 1920. The
special session of the legislature that called this new organization
into being, aimed at the regulation of industrial relations by extend-
ing the functions of the Court in such a way as to bring under its
jurisdiction not only public utilities but also certain activities of
industries not generally affected with public interest. With reference
to changeful employment it was held that "it shall be unlawful for
any person, firm, or corporation engaged in the operation of any such
industry, employment, utility, or common carrier wilfully to limit
or cease operations. If it shall appear to said court that such
Suspension, limitation, or cessation shall seriously affect the
public welfare by endangering the public peace or threatening the
public health, then said court is hereby authorized and directed
to take proper proceedings in any court of competent jurisdic-
tion of this State and to take over, control, direct and operate
said industry, employment, public utility or common carrier during
such emergency, provided that a fair return and compensation shall
be paid to the owners of such industry, employment, public utility
or common carrier, and also a fair wage to the workers engaged there-
in, during the time of such operation under the provisions of this
section."

After a stormy career in which the Court attracted national
attention and was subjected to adverse criticisms on the one hand
and to praise on the other, the law creating the Court of Industrial
Relations was declared unconstitutional in the case of the Wolf
Packing Company vs. Court of Industrial Relations by the decision
of the Supreme Court of the United States, written by Chief Justice
Taft.

The case involved the validity of the Industrial Court Act of
Kansas, which had declared the following industries to be affected
with a public interest: first, manufacture and preparation of food;
second, manufacture of clothing; third, production of any substance
in common use for fuel; fourth, transportation of the products here-
tofofe cited; fifth, public utilities and common carriers. The act
empowered a court of three judges upon its own initiative or upon
1) Kansas Statute 1920, chap. 29. - 2) 267 U. S. 552.
complaint, to summon the interested parties and hear any dispute over wages or employment in any such industry, and if the Court should find the peace and health of the public imperiled by such controversy, it was required to make findings and fix the terms for the future conduct of the industry. At the expiration of sixty days, either party might ask for a readjustment of wages or employment, and after a decision the order was to be effective for a reasonable time subject to the will of the Court, or until all parties agreed. Such orders were subject to review by the Supreme Court of the State, and in case of disobedience to an order, the courts could be appealed to for enforcement.

The packing company appealed a case on the ground that the validity of the Industrial Court Act was in conflict with the provision of the Fourteenth Amendment which says "no state shall deprive any person of liberty or property without the process of law." It was pointed out that the statute does not operate alike upon all employers and employees because wages paid by employers operating a packing house are not affected with a public interest, or subject to regulation by the State; therefore, the Industrial Court's orders were in excess of constitutional power conferred upon any tribunal in this country.

In view of this it is apparent that the appellant relied on two points: first, that the law was confiscatory, and, second, that his business was not clothed with a public interest.

The highest tribunal ridiculed the idea that the state, representing the people, is so much interested in their peace, health and comfort that it could assume to compel those engaged in the manufacture of food and clothing and in the production of fuel, whether
owners or workers to continue in their business on terms fixed by
the state in case of a disagreement.

The Supreme Court of the United States called attention to the
fact that the supervision of the railroads furnished no precedent
for regulation of the business of appellant in error, whose classi-
fication as being engaged in an industry affecting public welfare,
was doubtful. The Court also stated that the rulings in the case
of Wilson vs. New went to the border line, although it concerned
an interstate common carrier in the presence of nation-wide emergen-
cy and the possibility of great disaster. But there was nothing to
justify the extension of the drastic regulation sustained in that
exceptional case to the one before the Court.

The Court then proceeded to define a public utility and divided
them into three classes: First, those which are carried on under the
authority of a public grant or privilege which imposes the duty of
rendering public services, as, for instance, railroads, other common
carriers and public utilities; second, certain occupations as those
of keepers of inns, cabs, and grist mills; and, third, business en-
terprises which, though not public at their inception, may be fairly
said to have become so through expansion.

It is manifest from an examination of the cases cited under
the third head that the mere declaration by a legislature that a
business is affected with a public interest, is not conclusive of
the question whether its attempted regulation on that ground is
justified. The circumstances of its alleged change from the status
of a private business and its freedom from regulation into one in
which the public have come to have an interest, are always a subject
of judicial inquiry.
The Court distinguished between ordinary business and one affected with a public interest by saying: "In a sense, the public is concerned about all lawful business because it contributes to the prosperity and well-being of the people. The public may suffer from high prices or strikes in any trade, but the expression (clothed with a public interest), as applied to a business, means more than that the public welfare is affected by a continuity or by the price at which a commodity is sold or a service rendered. The circumstances which clothe a particular kind of business with a public interest in the sense of Munn vs. Illinois and the other cases, must be such as to create a peculiarly close relation between the public and those engaged in it, and raise implications of an affirmative obligation on their part to be reasonable in dealing with the public; but an ordinary producer, manufacturer or shopkeeper may sell or not sell as he likes."

It is obvious that the thing which gave the public an interest in such businesses as included under the third head above, was the indispensable nature of the service and the extra high charges and arbitrary control to which the public could be subjected without regulation.

The opinion in substance said that this was not true in the preparation of foods in Kansas since the competition regulates the price of foods, which were as cheap in Kansas as elsewhere; and that it has never been supposed, since the adoption of the Constitution, that the business of butchering, chopping wood, tailoring, etc. was clothed with such a public interest that the price of the product or the wages could be regulated by the state.
It is not easy to distinguish between ordinary business and one clothed with public interest, for all business is more or less subject to some kinds of public regulation; but whether the public becomes dependent upon a business that its operator subjects himself to a more intimate regulation, is to be determined by judicial proceedings.

The decisive points in the case are: (1) The contested law would tend to abolish the right of private contract. (2) A mere declaration of a legislature is not sufficient to clothe a business with a public interest. (3) When a business is affected with a public interest, there is a close relationship between it and the public and an obligation on its part to be fair with the public. (4) An ordinary occupation is not affected with a public interest. (5) The right of the public to regulate a business devoted to public use does not extend to forcing to continue, as attempted by the Kansas Industrial Court Act. (6) The Kansas Industrial Court Act violates the Fourteenth Amendment by depriving citizens of their property without due process of law. (7) One whose business, by merely changed conditions, has become clothed with a public interest, may discontinue it at his pleasure, whether profitable or not.

D. PUBLIC UTILITIES COMMISSION REESTABLISHED

In the year 1923 the Public Utilities Commission was reestablished with but a few slight changes from its former rules. In the first place, the salary of each commissioner was advanced to $5,000 per year; in the second place, length of service was used as a basis for the choice of a chairman; and, in the third place, during their continuance in office members of the Commission were not permitted
to hold a seat in the legislature of the State.

**E. PUBLIC SERVICE COMMISSION**

In 1925 the Kansas legislature enacted a statute, amended in 1927, which, by creating a Public Service Commission and defining its powers and duties, abolished the Public Utilities Commission, the Tax Commission, and the Court of Industrial Relations, thereby conferring upon the Public Service Commission all the powers and duties of the abolished organizations.

A subsequent change was made during the session of the legislature, ended March 14, 1929. The Tax Department was segregated from the Public Service Commission and a law creating a State Tax Commission, composed of three members, was enacted. In addition thereto, the Labor Department, which had been a part of the Public Service Commission, was segregated and a law passed creating an Industrial Commission, composed of three members. The name of the Public Service Commission was not changed, but it is now composed of three members instead of five.

The members of the Public Service Commission are appointed by the governor and subject to approval by the senate; their term of office is four years. In case of a vacancy, the governor shall appoint a successor for the unexpired term. The Commission elects one of its own members as chairman.

In respect to qualifications, no person owning bonds, stocks, or property in any railroad company or other common carrier or public utility, or who is in the employment of, or who is in any way pecuniarily interested in any railroad company, other common carrier, or public utility, is eligible to the office of commissioner, attorney, or secretary of the organization.
Each commissioner receives a salary of $4,500 per year, and the commissioners are authorized to appoint the following officers who hold their offices at the pleasure of the Commission: an attorney and an assistant whose salary is $4,000 and $3,000 respectively; a rate clerk and a secretary with a salary of $4,000 and $2,700 respectively; a chief engineer and three assistants, whose aggregate salary is $15,000; three accountants with an aggregate salary of $7,200; seven clerks or stenographers, whose aggregate salary is $12,000; two factory inspectors, whose annual salary is $3,200. Aside from these, the Public Service Commission may employ such additional accountants, engineers, experts, deputy factory inspectors, deputy mine inspectors, and clerical force as is necessary to carry on its duties, but no person related by blood or marriage to any member of the Commission may be appointed or employed by said Commission.

F. RETROSPECT

In a retrospect of the Kansas legislation affecting public utilities, I find the following characteristics:

A public utility is an industry affected with a public interest. In 1911 the Kansas legislature enacted a law providing for the supervision of all public utilities within the State, and also defining the terms "public utility" and "common carrier". Accordingly, the term "public utility" is construed to mean every corporation, company, individual, association of persons, their trustees, lessees, assigns or receivers, that own, control, operate or manage, except for private use, any equipment, plant, generating machinery, or any part of such machinery, for the transmission of telephone messages, telegraph messages in or through any part of the State, also all
dining car companies doing business within the State, the conveyance
of oil and gas through pipe lines in or through any part of the State,
and all companies for the production, transmission, delivery or furnish-
ing heat, light, water or power.

The State of Kansas regulates its public utilities through a
Board of Public Service Commissioners. The official acts of said
Board are subject to the Kansas statutes and to the terms and con-
ditions of the operating companies.

The law constitutes the attorney-general as the legal adviser
of the Board of Commissioners, and said officer is required to give
the Public Service Commission or the attorney for the Commission
such counsel and advice as the Commission or its attorney from time
to time demand. It is also the duty of the attorney-general to aid the
Commission and its attorney in all hearings, suits and proceedings,
whenever the commissioners or their attorney request such assistance.

As to the origin and extent of the Commission's powers the
United States Supreme Court states them to be merely statutory. Ac-
cording to the highest tribunal, the Commission has no authority
save that which is given to it by the express provisions of the act,
and such implied authority as may be necessary "to carry into effect
that which is expressly given. And upon the other hand, the scope,
force, effect, and the limitations of the acts and rulings of the
Commission must be sought for in the same act of the legislature."

The Law of 1911 provided for a Board of Public Utility Com-
missioners to mediate between the utility company and its patrons with
1) Part of the Public Utilities Law of 1921, Section Four.
2) Part of the Public Utility Law of 1911. 3) 291 U. S. 551.
respect to the kind of service and the rate charged therefor. Thus
the law corrected two defects in the previous method of regulation:
First, the inelasticity of the franchise from the impossibility of
determining years in advance the character and the cost of service
needed in a growing community; and, second, the inefficient service
rendered by the legislature resulting from a division of interests.
Owing to a lack of the necessary technical knowledge on the one hand,
and the domination of political rather than economic influences on the
other, the legislators often found it difficult to formulate and
maintain laws which would result in good service at reasonable rates.
Moreover, since laws must be general in character and never special,
legislators are unable to meet the requirements of exceptional and
peculiar conditions arising in different localities.

The method of regulation by an administrative commission avoids
defects found in other methods. In this method regulation is effected
through general legislative acts and the supervision of the Public
Service Utility Commission.

Among the states there appears to be quite a divergence in re-
spect to qualifications of the commissioners. For example, the Wis-
consin statute requires that one of the commissioners, at least,
shall have a knowledge of railroad law, while the other commissi-
ners shall have general knowledge of matters relating to railroad
transportation. No commissioner shall devote his time to any other
business but is required to give his entire time to the duties of
his office. In Illinois the statute makes it unlawful for a com-
missioner while in office, to accept any gratuity, emolument or
employment from any person or corporation subject to the supervision
of the Commission or from any officer, agent, or employee thereof. In
New York no person is permitted to hold office or be appointed by
a commissioner to serve on the commission who has any official rela-
tion to any person or corporation subject to the supervision of the
Commission or who owns stocks or bonds of any such corporation.

The following is a tabulated statement showing the comparative
requirements in respect to number of commissioners, duration of
terms of office, salary, and manner of choosing chairman:

<table>
<thead>
<tr>
<th>State</th>
<th>No. of Com.</th>
<th>Term of Office</th>
<th>Annual Salary</th>
<th>Choice of Chairman</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kans.</td>
<td>Three</td>
<td>Four Years</td>
<td>$1,500</td>
<td>Com. Elects</td>
</tr>
<tr>
<td>N. Y.</td>
<td>Ten</td>
<td>Five Years</td>
<td>$15,000</td>
<td>Gov. Appoints</td>
</tr>
<tr>
<td>Ill.</td>
<td>Five</td>
<td>Six Years</td>
<td>$10,000</td>
<td>Gov. Appoints</td>
</tr>
<tr>
<td>Mass.</td>
<td>Five</td>
<td>Five Years</td>
<td>$7,000</td>
<td>Gov. Appoints</td>
</tr>
<tr>
<td>Wis.</td>
<td>Three</td>
<td>Six Years</td>
<td>Not fixed</td>
<td>Com. Elects</td>
</tr>
</tbody>
</table>

The members of the Kansas Service Commission, it is said, do
not rank as high in efficiency as those in some other states. This
may be due to the fact that the Kansas commissioners serve shorter
terms and receive smaller yearly salaries. The salaries are probably
too small to attract men of marked ability.

It is said that Massachusetts, Wisconsin, and New York have
led the way in efficient state regulation. The Massachusetts regula-
tion is a growth of many years. It vests control of gas and electric
light service, both private and municipal, in a Gas and Electric
Light Commission; steam and street railways, steamship lines, and
all other common carriers, in the Railroad Commission; telephone
and telegraph companies in the Highway Commission; and a limited
control of water-supply utilities in the State Board of Health. New
York has two Public Service Commissions. The one for the first district is confined to New York City, and besides supervising all privately owned public utilities (except the telephone and the telegraph), the Commission regulates a vast subway system, having inherited this task from the Rapid Transit Commission. The Commission for the second district controls utility companies outside of New York City and telephone and telegraph service throughout the entire State. Wisconsin was the pioneer in comprehensive scientific public utility control, and its laws are still typical of the advanced regulation of the whole country. In a rough way this is the general attitude towards the public utility problem beyond the limits of Kansas.
CHAPTER TWO
KANSAS LAWS AFFECTING MONEYS OF CAPITALIZATION AND THE CONSTRUCTION OF THE FRANCHISE

I. NATURE OF CAPITALIZATION

Capitalization may be defined as the sum of the par values of stocks and bonds. It is distinguished from the market values of the stocks and bonds. Capitalization is a fiction of accounting, the valuation of capital stock and bonded debt. It gives no infallible clue to the amount of physical capital goods owned by the corporation, nor to the amount of money in the business.

Capital stock represents the interest of the owners of properties of the business, but usually does not include the bonds or other permanent debts of the business. The capital stock is by no means a measure of the capital of the corporation. Therefore, neither capitalization nor capital stock gives a reliable measure of capital, for they must be checked and supplemented by estimates of actual invested capital, by market values of securities, by calculation of assets and by many other important considerations.

The era of corporate capital has given a special importance to those capital assets which are classed as intangible. Classical economics recognized only physical goods as capital. This modern intangible, invisible, and immaterial capital is distinguished by the term of good will. Good will may be defined as the value of an established business over and above the value of its material assets. It is the benefit or advantage which is acquired by an established business or profession beyond the mere value of the capital, stocks, funds, or property employed therein, in consequence of the general public pat
age and encouragement which it receives from constant or habitual customers, on account of local position, common celebrity, reputation for skill, affluence, punctuality or from other accidental circumstances, or even from old partialities or prejudices.

Overcapitalization as applied to public utilities refers to issues of stock and bonds for property or services valued in excess of actual cost—turned in for securities at inflated values. The term applied to industrials means security issued in excess of earning power as determined in a competitive market.

The mathematical device for ascertaining valuation is capitalizing the prospective net earnings of the property. The calculation involves two variables, the size of the earnings and the rate of capitalization. Thus, earnings of $1,000,000 capitalized at 10% would give a valuation of $10,000,000. A corporation is overcapitalized when it has set up an excess of inflated securities beyond its capacity to earn a fair dividend.

Among the causes which led to overcapitalization, in many instances, were the prospective operations of a large number of small independent properties at a cost exceeding the profits.

The principal evil in these earlier developments, aside from overcapitalization, were the excessive fixed charges placed upon the property in the shape of a disproportionate amount of stocks, and exorbitant rentals. Those companies which were experiencing overcapitalization have been driven invariably to skimp service, cut down on maintenance and keep up rates for services; therefore, the stockholders were not the only ones who had a reason to complain about sustaining a loss.
In respect to other causes of overcapitalization, it should be remembered that these combinations of various companies were largely effected by means of borrowed capital, or, in other instances, they were compelled to pay extortionate rentals; and often after consolidation the properties had to be substantially reconstructed or re-equipped; this resulted in too high a cost and, with these increased expenditures, had a tendency to check or decrease the earning capacity of the property below a fair rate of interest.

The excuse for overcapitalization, it must be conceded, was not entirely inappropriate as consolidation of the properties seemed to be the only way in which unified control and supervised utilities could be acquired. But aside from this inevitable cost of consolidation there were many unjustifiable financial manipulations; such as large issues of securities to the promoters; fictitious charges on construction contracts; the payment of unearned dividends; the creation of artificial market values for the stock; the unloading on the public of securities at excessive valuation; all of which resulted in the depreciation of the earning power of the corporate property.

As to the consequences of excessive fixed charges and a demand for a fair return, the following explanation is offered. No matter what may have been its cause, overcapitalization existed; and it was this excessive burden resting upon the properties that constituted one of the chief problems of regulation. Although consolidation may be justified on the ground of good economy, yet the financial burdens consequent have been quite excessive and frequently beyond the ability of the property to bear. The main question
of regulation has been how to treat overcapitalization inherited from the past. A more or less ruthless procedure would have disregarded the capitalization and attempted to establish only a net monetary investment in physical properties now used for public services. This of course was the general rule. However, the problem was by no means so simple, because, if rigidly carried out, the rule in many cases would have done away with the systems which in themselves rested upon solid economic bases.

If, for example, rates had been fixed so as to have brought only seven per cent upon the net investment in the properties, the consequences in many instances would have been insufficient revenues for the payment of interest upon outstanding bonds and of the fixed rentals upon leased properties. If, then, such rates had been continued for any length of time, the company would have been unable to pay its fixed charges and bankruptcy would have been inevitable.

The main question, therefore, has been in what degree the evils of overcapitalization inherited from the past could be reasonably eliminated through rate control, and to what extent some of the overcapitalization should be tolerated in order to avoid more serious consequences.

The utility corporations that have been organized since 1900 have not experienced in so great a measure the evils of overcapitalization as the earlier companies did. As in most cases, these later companies have grown up under the eyes of the Public Service Commission. Also, the business standards have advanced greatly so that many practices common to the history of the earlier companies have come under disapproval. They are no longer in vogue or countenanced by in-
overcapitalization for public utilities has little save academic significance these days. Utility rates are regulated by commissions. Rates are not based upon security issues but upon appraised or cost values (or a little of both) of actual operating properties used by the utilities.

The basis for valuing operating properties varies from one state to another. Some commissions favor actual investment in operating property as the main basis; others lean towards cost of replacement. There are variations in practice concerning allowances for appreciation of land, going concern values and other factors. The Kansas Public Service Commission has made reproduction-cost-new valuations for all companies that have sought a rate increase since 1922.

Once properties are valued, some consideration is given to whether the rates fixed to allow a fair return on such property values also allow the market rate of return on stocks and bonds outstanding. This is done on the belief that such rates of return should be large enough to encourage capital to flow into the industry as it needs new funds. But that does not permit rates to pay returns on "watered stock."

Again, overcapitalization merely punishes the utility and those holding "inflated" securities. It does not seem likely that it will affect customers. Issues of "overcapitalized" stocks and bonds cannot very well get by the utility commissions these days. Hence investors are very well protected on this score.

Utility holding (non-operating) companies may still water their security issues but such a procedure seems rather unlikely.

The more recent companies consist of public properties of various smaller communities brought together through leases and successive
stock control into larger systems. In this way widely scattered properties in several municipalities and in different states were brought together under a single management represented by the holding company. This movement has taken place more particularly in the production and distribution of electric power. From this it has been extended to other utilities more or less dependent upon electric power, particularly street railways.

The chief evil guarded against by the Kansas Public Service Commission is the old one of overcapitalization. These holding company groups are active in all sections of the country, since each group is competing with other groups in order to advance its holdings, to enlarge its properties to still larger units of production, and manage greater volumes of business, with the subsequent result of still greater economy and more profits, and finally to repeat the cycle of effort for greater size, bigger business and further economics, greater income, and more power. The competition in system extensions has come to be a tremendous one, so that the tendency is at every point for each holding company, in order to get possession of a local company, to issue securities for more than the local property is worth, with a result of overcapitalization in the holding company. Then, frequently, much of local property is immediately scrapped and new plant equipment, resulting in greater efficiency, is installed; further securities are issued to pay for the modern plant, with the result that a large proportion of the securities issued for acquisition may be without actual physical property to support them.

Overcapitalization seems to result inevitably from the holdin
company organization. In Kansas this is properly guarded against by the Public Service Commission so that the profits of operation will not be absorbed in supporting the capitalization. Kansas measures the rate of return by the capital costs of the organization, and capital charges made to cover interest, for the use of capital, whatever the nature of the securities issued for the property; there is an allowance for risk; and a sufficient amount in addition to attract capital. This plan allows a fair return, which is measured by an adequate compensation to capital raised by stock issues.

II. KANSAS CORPORATIONS

A. RULES AND CLASSIFICATION

Public utilities in Kansas are either incorporated under the Kansas law or must conform to the Kansas law in respect to their supervision. Hence the rules governing capitalization, valuation, depreciation, rates, and services are prescribed by the Kansas law.

The law of Kansas provides for a State Charter Board composed of the attorney general, the secretary of state, and the state bank commissioner. This Board meets on the first and the third Wednesdays of each month in the office of the secretary of state. The attorney general is president and the secretary of state acts as secretary. Applications to form private corporations under the laws of the State of Kansas are addressed to this Board.

The application must contain the following information:

(1) The name desired for the corporation. (2) The name of the post office where the place of business is to be located. (3) The nature and character of the business in which the corporation proposes to engage. (4) The names and addresses of the proposed incorporators. (5) The proposed amount of capital stock.
All incorporators must subscribe to the application.

Under the Kansas law corporations are divided into two classes, namely, public corporations and private corporations; the former are corporations that have for their object the government of a portion of the State; the latter are divided into three varieties, viz., (1) Corporations for religious purposes; (2) Corporations for charitable purposes; and (3) Corporations organized for profit.

Under the third division all utility companies and common carriers are incorporated.

Public corporations are created by a majority vote of the electors of the political unit for which the corporation is organized. Private corporations on the other hand may be created by the voluntary association of five or more persons for the purpose and in the manner prescribed by law. Each stockholder of a corporation has the right to vote on all matters pertaining to the exercise of corporate power either in person or by proxy.

The general powers of a corporation are about the same in each of the several states. In Kansas the law provides that every corporation, as such, shall have power: (1) To have succession by its corporate name for the period limited in its charter and, when no period is stated, for fifty years. (2) To make and use a common seal and alter the same at pleasure. (3) To hold, purchase, mortgage, convey such real and personal estate as the purpose of the corporation shall require; and also to take, hold, and convey such other property, real, personal, or mixed as shall be requisite for such corporation to acquire in order to obtain or secure the payment of any indebtedness or liability due or belonging to the corporation. (4) To appoint
and remove such subordinate officers and agents as the business of
the corporation requires and to allow them suitable compensation.
(5) To make by-laws not inconsistent with the existing laws for
the management of its property, the regulation of its affairs and
for the transfer of its stock. (6) To enter into any obligation or
contract essential to the transaction of its ordinary affairs. (7)
To change its corporate name without in any wise affecting its rights,
privileges, or liabilities.

According to the Kansas statute, the directors shall have general
supervision, control and management of the corporate property and
its business transactions; they may declare dividends and dispose of
the residue of the capital stock in such manner as the by-laws may
prescribe. They are also required to cause a record to be kept of
all their proceedings.

Some purposes for which private corporations may be formed are
those constituting public utilities or common carriers, i. e. the
construction of railroads, telegraphs, telephone lines, stage lines,
and other purposes of a kindred nature.

The corporation has become the dominant form of business organ-
ization and has profoundly affected a number of ideas about capital.
For example, the corporation has brought to light the importance of
the concepts of corporate capital, capitalization, and capital stock.
These are three distinct, though closely related, things. Capital is
defined as net worth, or excess of assets over liabilities. Assets
are defined as tangible or intangible, and may be classified as fol-
lows:
(1) Fixed Assets:
   - Real Estate
   - Leaseholds
   - Lands
   - Equipment
   - Furniture and Fixtures

(2) Intangible Assets:
   - Good Will
   - Patents and Trade Marks

(3) Current Assets:
   - Cash
   - Investments
   - Notes Receivable
   - Accounts Receivable
   - Inventories

(4) Deferred Assets:
   - Organization Funds
   - Discounts on Stocks and Bonds.

In respect to the mode and extent of capitalization of corporations, the Kansas Law is explicit in its provisions, which, summarized, are as follows:

No corporation is authorized to issue shares of stock without nominal or par value or can begin to carry on business or to incur any indebtedness until the amount of capital stock with which it proposes to begin business, is fully paid, either in cash or in property.

**B. TERMS DEFINED**

Generally speaking, capital may be said to be either circulating or fixed. Fixed capital is a kind that is used only once in the fulfillment of its purpose, such as machinery. In this form it represents a certain amount of money invested, which will not be used a second time, since the machinery is supposed to be employed till it is worn out and must be replaced by new machinery. On the other
hand, circulating capital consists of those forms of wealth which require renewal after having served a certain time for a specific purpose, such as a loan made for a definite time or an investment in land.

Stated capital is the capital with which the corporation begins, increased by any addition or diminished by any net deductions; but stated capital does not include any net profits or surplus earnings until they are transferred to capital stock, and they are not to be larger in amount than the excess shown by the books of the corporation of the assets above the liabilities, not including liabilities that exist on account of shares of stock issued by such corporation. In case of a corporation having outstanding shares without a nominal or par value, according to this provision, the portion of the stated capital applicable to the shares without a nominal or par value is to be the excess of the stated capital over and above the total par value, of outstanding shares having a nominal or par value. Such a corporation may issue and dispose of its authorized shares having no nominal or par value for such consideration as is prescribed or authorized in the articles of association, or certificates of incorporation or the joint agreement of consolidation, for such consideration as is fixed by the stockholders of the corporation at any annual meeting or at any special meeting called and held by the Board of Directors.

C. STOCK, BONDS, AND OTHER PROPERTY

In reference to preferred stock the Kansas statute provides:

2) Condensed from Kansas R. S., 1923.
It is lawful for any corporation to issue preferred stock provided the holders of seventy-five per cent of the capital stock shall give their consent to such issue. However, no public utility or common carrier is to issue any stock of certificates except as authorized by the laws of the State of Kansas.

In respect to the issue of shares of stock, the law of Kansas provides under what conditions the commissioners may permit the issue of preferred stock, common stock, or stock without any nominal or par value. This may be effected by a provision inserted either in the articles of association, certificate of incorporation, or agreement of merger. The procedure requires a statement of the amount of capital stock and of the number and par value of the shares into which the stock is divided, i.e. the number of shares with nominal or par value, and the number of shares without such value; also of the classes into which such shares are divided, and further of the amount of capital with which the corporation may begin business.

Any incorporated city of the State of Kansas is authorized to subscribe to the capital stock of any company, electrifying or intending to electrify any line of railroad, or any part of such a line, owned or leased by it, which is to operate its road into or through that city. For this purpose a city may exchange its bonds for the stock of the company.

Railroad companies and also companies operating street cars or interurban lines in Kansas can acquire the use of private property necessary for the efficient operation of their roads, by petitioning the court for a writ of eminent domain. There might be instances where it would be impossible for the company to enjoy the full pro-
visions and meet the requirements of the franchise unless it had recourse to the law of eminent domain.

Special provisions are inserted in the Kansas law for holding bond elections. For example, when a majority of the electors voting at an election called and held, in any city of the second or third class, shall vote in favor of the city issuing bonds for the purpose of purchasing, extending, improving or constructing works, in order to supply the city and its inhabitants with natural gas, water, electric light, heating, street railways or telephone service, it shall be lawful for the governing body of the city, according to its ordinances, to direct the bond issue so voted, according to law.

D. CHECKS AGAINST OVERCAPITALIZATION

The danger in overcapitalization is that it calls for a return in excess of the real valuation, which, in turn, may lead to dishonesty. Therefore, the Kansas legislature, to guard against this evil, has enacted the following laws:

A public utility or common carrier may issue stocks, certificates, bonds, notes or other types of indebtedness, to be paid within twelve months, when necessary to acquire property, for the purpose of carrying out its corporate powers, the construction, completion, extension or improvements of its facilities, or for the purpose of improving or maintaining its service, or of refunding its obligations, or any other lawful purposes, provided, however, that there has been obtained from the Commission a certificate stating the amount, character, purpose and terms on which such stocks, certificates, bonds, notes or other indebtedness are to be issued. Proof of the truth of the statements contained in the application must also be furnished,
but this provision does not apply to any lawful issue of stocks or to a lawful mortgage, or to the lawful issue of bonds approved by the Board of Railroad Commissioners before this act.

The proceedings for obtaining such certificates from the Commission and the conditions on which they are issued, are as follows:

In case the stocks, certificates, bonds, notes or other evidence of indebtedness are to be issued for money, the public utility or common carrier is required to file with the Commission a statement, signed and verified by the president or chief officer of the company who knows the facts: (1) The amount and character of the proposed stocks, certificates, bonds, notes or other evidence of indebtedness. (2) The purpose for which they are to be issued. (3) The terms on which they are to be issued. (4) The amount of assets and liabilities of the public utility or common carrier; and, (5) That the capital secured by issuing stocks, certificates, bonds, notes or other indebtedness is needed and will be used for the purpose stated.

In case stocks, certificates, bonds, notes or other evidences of indebtedness are to be issued partly or entirely for property or for services or other considerations than money, the public utility or common carrier is required to file with the Commission a statement signed and verified by the president or chief officer knowing about the facts, showing: (1) The amount and character of the indebtedness that is to be issued. (2) The general purpose of such issue. (3) A general description and an estimated value of the security for the issue. (4) The terms of issue or exchange. (5) The amount of assets and liabilities of the public utility or common carrier. (6)
The compensation to be received for the services or other consideration. (7) That the capital sought to be secured for such indebtedness is necessary and will be used for the required purposes. The Commission may further require the public utility or common carrier to furnish other statements deemed necessary and reasonable, and has the power to ascertain the truth of such statements. When the applicant has complied with the required provisions, the Commission must issue a certificate stating the amount, character, purposes and terms upon which such stocks, certificates, bonds, notes or other indebtedness are to be issued. Any issue of indebtedness not payable within one year, or issued contrary to the foregoing provisions, is void.

To still further guard against overcapitalization, the Kansas law provided a fine of not less than $500 and not more than $5000, or imprisonment of not more than one year, or both fine and imprisonment, for the issuing of unlawful securities. Additional restrictions tend to keep the stock at par value and thus check any attempts at overcapitalization. In other words, the law forbids any public utility or common carrier, governed by its provisions, to issue any stock, certificates, bonds, notes, or other indebtedness for money, property or services, or to receive any money, property or services for payment unless there appears on the books of the corporation a record of the certificate of the Commission as required by law.

Prohibition against stock dividends is the final word against overcapitalization. No common carrier or public utility governed by this law is permitted to declare any stock, bond or script dividend or divide the proceeds of the stocks, bonds or script among its stock-
holders unless the Commission first authorizes the transaction.

II. GENERAL CHARACTER OF THE FRANCHISE

While the State makes the laws for capitalization and the prevention of overcapitalization, its authority as to franchises is limited. Generally speaking, the latter is merely a contract between the utility company and the unit served. Originally, it was a particular privilege or right granted by a prince, sovereign, or government to an individual, or to a number of persons. In politics, in regard to which the term is most commonly used, it is the right of voting upon proposed legislative measures, where such measures are accepted or rejected by the people generally; or for representatives to a legislative body or to a municipal assembly. A public utility franchise was originally a contract involving a consideration and under the law as sacred and binding as a contract of any other nature. At present it is, however, a contract binding only in certain of its provisions until such time as those provisions are declared void or inoperative by some agency of the state, that is supposed to represent the public interest. This change of attitude is due to a comparatively recent idea, holding that there may be three parties to any contract; that agreements between men, corporations and cities that involve important matters to the people of a municipality, are affected with a public interest, and become subjects to be scrutinized, and modified or curtailed by public authority, representing what has been called the party of the third part. A franchise is not what it used to be, and some authorities claim that a public utility franchise is not necessary at all, under the new conditions.

It is said that all contracts are made subject to the exercise
of the police power of the state, but in public utility relations the police power is very much more stressed than in ordinary cases. For illustrations, two persons may make a contract in respect to goods sold and delivered, and such agreement is subject to very few limitations, yet in case of a public utility the limitations might be hard to determine. In fact, they are of such a peculiar character as to place public utility contracts in a different category.

A. TYPES OF FRANCHISES

Two new types of utility franchises have been developed in recent years. They are the result of the conception of municipal utilities as being natural monopolies and also of the recognition of a public interest in the franchise contract. The first type is the indeterminate grant franchise and the second the service at cost franchise, the former being applicable to all the different utilities, the latter to urban transportation.

The main characteristic of the indeterminate franchise is that the grant is not limited to a fixed term but continues until it may be determined by action of the grantor, which action can be taken only after proper and timely notice and under conditions fair to the grantee. It is not a perpetual franchise as it contains a forfeiting clause and also an option of purchase in favor of the grantor. It avoids the uncertainties and interruptions which accompany the approach of the end of the term of a fixed term franchise. The danger of an indeterminate franchise from the standpoint of public interest is that, in case the grantor neglected to exercise his option to purchase the property, the franchise would become perpetual.

The popularity of the indeterminate franchise is seen in the
following: The report of the St. Louis Public Service Commission to
the municipal assembly stresses the importance of indeterminate and
short term franchises, or franchises which grant the public utility
corporation the right to continue so long as it shall furnish suit-
able and adequate facilities and services at reasonable rates in the
territory over which its rights extend or until such a time as the
municipality shall elect to exercise its option to buy. Indeterminate
franchises are especially good since they have a tendency to keep the
utility corporation out of politics and to obviate the necessity of
a sinking fund to retire the bonds with the franchise limit. Such a
contract was given to the District of Columbia by Congress. It was
afterwards duplicated by the State of Wisconsin which selected a
franchise terminable with purchase, the State paying a determined sum
to the utility at the time of purchase. This transfer of franchise
was allowed by the famous Milwaukee Rate Case.

In respect to the service-at-cost franchise, this franchise, as
applied to street railway corporations, is a development of the older
scheme of determining gas rates and dividends of gas companies, known
as the "London sliding scale", whereby profits to stockholders and
operators could be increased only to a limited maximum and then only
by a reduction of rates to consumers.

Its advocates see in this proposal a means of getting good ser-
vice at reasonable rates without injustice to the investor, and of
retaining to some extent that private initiative and incentive to
efficient management which they believe essential to successful oper-
ation and in conformity to the doctrine of individualism, while its
opponents contend that service-at-cost will be understood as "cost
plus."

Reference may also be made to what is termed the franchise-at-will. Whenever a public utility or common carrier continues operations after the original franchise given for a fixed period, has expired, the corporation operates under a franchise-at-will, which is terminated either by the renewal of the old or the granting of a new franchise, or perhaps by the corporation ceasing operations.

**B. JURISDICTION PERTAINING TO THE FRANCHISE**

Subject to the laws in force, the municipal councils and the Public Service Commission of Kansas stipulate the character of service and the rates to be charged. By reason of this authority the commissioners and city councils are invested with authority to grant franchises to any public utility company that is a resident or may become a resident of any town or city in Kansas and is operating a public utility for the benefit of the city and its people, and to determine the character of the product and services to be rendered by the public utility; and to fix the maximum rates and charges to be paid to the public utility serving the municipality. Under the provisions of the franchise the public utility is usually permitted to occupy the streets and generally required to make extensions to its plant when these are necessary to serve the public adequately.

In the case of Landon vs. Lawrence, Kansas, the court held that a franchise ordinance requiring gas companies to furnish service free to cities in consideration for use of the streets does not interfere with the power of the Public Service Commission to fix proper rates, since ordinances are not contracts which are protected against impairment by the Federal Constitution.

1) 0. 7. 4. 1915 3. 763.
Usually there are provisions in the contract to determine the location of the plant, its nature, time of completion and condition of construction, but all grants and privileges shall be limited to a period of twenty years and during such time are not to be transferred or leased without the approval of the Public Service Commission.

At the expiration of such franchises the mayor and council of second class cities may cause the removal of the poles and wires of the plant from the streets, alleys and public grounds, without the consent of the Public Service Commission as was held in the case of the City of Wilson vs. Electric Light Co.

In respect to the extent of the jurisdiction of the Commission to construe and make authoritative orders relating to franchises limited to one city, the court holds in the Street Lighting Co. vs. Utilities Commission, that there was no relation between the public service rendered by the Weisbach Company in Scammon and public service rendered by that company elsewhere, and therefore the supervision of the plant was vested within the governmental and corporate control of the city, except as cases might come before the State Commission by proceedings in the nature of appeal or review. With like effect the court held in the Street Lighting Co. vs. Utilities Commission case, that, where it is hard to determine whether the utility's business is or is not confined principally to one town or city, the Public Service Commission has jurisdictions. In the case of the City of Winfield vs. the Court of Industrial Relations, it was pointed out that the city is a creature of the state whose destiny as to its public utilities has been intrusted to an agency of the state, i.e. P. U. R. 1916, 783.
the Public Service Commission.

Companies applying for permission to operate their utilities in the State of Kansas are required to satisfy the Commission, before it will issue the permit, that public convenience will be subserved by permitting them to transact business. Thus commissioners may refuse or restrict the operation of a utility company on the ground of wasteful competition, as in the case of the Janicke vs. Telephone Co., in which the court held that two telephone systems serving the same constituency place a useless burden upon the community by increasing the cost of service to consumers. The regulation is an exercise of the police power which the state retains for the protection of public safety and welfare.

It has been held by the court that the Public Service Commission may in its discretion approve or disapprove plans and specifications submitted to them, but its action must be the result of its exercising its best judgment as to the merits of the application, arrived at after careful consideration, and is not lawful if determined by its mere volition or arbitrary opinion. Such provisions are considered just, since the utility, legally speaking, is a public enterprise, and should serve the members of the municipality impartially and for the best interest of all served.

If we compare the laws of Kansas in relation to franchises with those of the States of New York, Illinois, and Wisconsin, we shall find both similarities and differences. The Kansas municipality may provide reasonable and lawful penalties for failure to comply with the provisions of the contract; it may also provide that thirty days elapse after the ordinance is published, before the contract granting
privileges or extending any right may be in force; nor may the ordin-
ance be in effect while proceedings to review it are pending. In ad-
dition to this the ordinance may be set aside by a court of competent
jurisdiction because of its unreasonableness or illegality. The laws
of both Kansas and Illinois provide that no franchise granted to a
public utility may be transferred or leased without the approval of
the Commission, and in Kansas the grant is not to extend for a longer
period than that stipulated in the franchise. New York has a splendid
provision in its franchise contract which deprives the Commission of
all power to authorize the capitalization of any franchise or the
right to own, operate or enjoy any franchise whatever in excess of
the amount, exclusive of any tax or annual charge, actually paid to
the State or to a political subdivision as the consideration for the
grant of such franchise. Companies may merge or consolidate, but the
New York law provides that the capital stock of a corporation formed
by the consolidation of the corporation is not to exceed the sum of
the capital stock of the corporation so consolidated at par value. An
additional amount may be paid in cash, but bonds may not be issued
against or as a lien upon any contract for consolidation or merger.
New York laws further provide - and in this respect they differ from
the Kansas law - for a system of profit sharing. The franchise allows
any equitable plan for surplus division which the Commission will
approve. Examples of this are found in the sliding scale and in the
distribution on a percentage basis of any surplus funds to stock-
holders, patrons and employees.
CHAPTER THREE

EVALUATION AND ITS APPLICATIONS

Value is the worth of an object estimated by any standard of purchasing power, such as the market price or the amount of money considered equivalent to the utility or cost of it. It has been defined as the estimate or the amount of sacrifice necessary to attain an object that may be desired. However, utility and scarcity are two fundamental factors that enter into the matter of determining the value of any object, and when they are considered together they constitute the so-called law of supply and demand. By utility is meant the qualities in objects that make them desirable. Any object that does not possess utility is not considered of value, since no one would care to make a sacrifice unless the object gratifies some desire. Scarcity may be defined as the absence of an abundance, or as a limited supply when the demand is great, and under such conditions the value becomes proportionately higher.

In the search for the value of a public utility property an effort is made to determine what its earning capacity should be rather than what its earning capacity is. In rate making it is not the value at all that is required but rather a statement of the amount of capital upon which a utility is entitled to earn a fair return or, in other words, the reasonable capital cost of the public utility property represented.

I. EVALUATION THEORIES

In respect to the evaluation of properties devoted to public

1) Compare, Edie, Principles of Economics, p. 234; also, Gregory, New Political Economy, chap. II.
utilities, one of two theories may be adopted.

The first theory of evaluation considers the amount of actual investment as the basis for its determination. The second theory of evaluation takes for its basis of determination the established cost of reproduction, or the cost of replacement of the property.

A. ACTUAL INVESTMENT THEORY

As to the first theory the following cases have been used to support its adoption. The first of these is the case of Smythe vs. Ames, decided May 7, 1898. The opinion stated that in fixing reasonable rates a fair return must be allowed on the value of the property. In estimating the value of the property, the company has a right to ask a fair return on the value of that which it employs for the public convenience.

In the case of the Utilities Commission vs. Springfield Gas Co. it appears that the task of the State Commission in valuing public utility properties is really to find the capital cost of furnishing the service, because the economists generally agree that in a state of free competition there is a persistent tendency of prices to equal the expense of production. Therefore, the actual capital cost of furnishing public utility service, plus operating cost, should furnish the standard for a reasonable rate.

The first important case before the Supreme Court, following the sharp increase in prices, was that of the Galveston Electric Railway Co., decided in 1922. In this case, the issue of actual cost versus reproduction cost was definitely presented. The basic valuation:

1) 169 U. S. 466.
2) 291 Ill. 209.
as adopted by the lower court was actual investment plus thirty-three and one third per cent in recognition of the higher price level. The original cost of the properties less depreciation was taken to determine the actual investment. On this basis the Supreme Court sustained the rates fixed by the Board of Commissioners, but it did not indulge in discussion of principles. The question then is, What light did the decision and the opinion by the court throw upon the issue?

While substantial allowance for the higher level was made in the valuation by the lower court, prices had risen about one hundred and ten per cent above those of 1913, and the company's reproduction figures were based on the assumption that the new level would settle around sixty or seventy per cent above 1913. Since the adjustment allowed was only thirty-three and one third per cent, reproduction cost was given a weight of less than one-fourth in the valuation.

The important point, however, is that the rates in question were upheld. While the judgment was directly based upon a valuation that added thirty-three and one third per cent to actual cost, there is nothing in the opinion to indicate that the rates would not have been upheld if a smaller percentage of adjustment had been made for the one hundred ten per cent increase in prices, or if, indeed, six per cent had been realized upon the actual property investment. The court did not discuss price changes. The rates were simply upheld.

B. REPRODUCTION COST THEORY

Supporting the reproduction theory, the following facts are adduced. The Supreme Court of the United States took but little, if any, cognizance of this theory until it heard the arguments pre-

1) 358 U. S. 388.
sented in the case of the Southwestern Bell Telephone Co. vs. The Public Service Commission of Mo., in 1923. The court criticised the Commission because it attempted to value the property without giving any attention to the increased cost of material, labor, supplies, etc. over that prevailing from 1913 to 1916. It is difficult to determine what will amount to a fair return upon properties devoted to public service without giving consideration to the cost of labor, supplies, etc., at the time the investigation is made. An honest and intelligent forecast of probable future values, made upon a view of reliable circumstances, is essential. If the present costs are disregarded a forecast of this nature becomes impossible. In making estimates for tomorrow prices of today must be considered.

The decision was held by the companies to be a confirmation of their claims that they are entitled to a return upon reproduction cost of the properties instead of actual cost. The opinion apparently recognised that reproduction cost must be given weight in the valuation, especially with regard to the future price level.

Two points in the above decision should be criticised. The first point is the fact that the court added only about twenty-five per cent to the investment in order to determine a valuation on which to judge the adequacy of the rates. The court made no explanation why it took only twenty-five per cent when the increase in prices was over one hundred per cent. At most, therefore, only one-fifth as much weight was given to reproduction cost as to the actual cost of the property. Hence the court apparently erred as its theory of weight is inconsistent with the facts in the case.

1) 262 U. S. 277.
In regard to the second point, Justice Brandeis in a minority opinion set forth the principle that actual and prudent investment is the only proper basis for determining the adequacy of a return, yet by this test, however, the rates were found to be confiscatory.

This minority opinion of Brandeis, according to economists, is the clearest judicial reasoning which, from the standpoint of definite and effective rate regulation, has ever been made.

In the opinion of many this decision is not favorable at all to the reproductive theory, for what the court said, they claimed, was in effect that the rates in the case were confiscatory on any reasonable basis of valuation. Consequently the strong language in the majority opinion in favor of reproduction cost comes under the category of dictum. This contention finds support when this case is considered in conjunction with the Bluefield Water Case and the Atlanta Case.

Bluefield Water Works and Improvement Co. vs. Public Service Commission of W. Va., decided in 1923. This case involved water rates fixed by the Public Service Commission and attacked by the company as confiscatory. The Commission had made a valuation of the properties on the basis of actual cost less depreciation. The company obtained from the federal court an injunction against the enforcement of the rates. An appeal was taken by the Attorney General of the State to the Supreme Court of the United States, which confirmed the degree of the lower court.

On the matter of valuation, the majority opinion by Justice Butler referred with full approval to the Southwestern Bell Co.

1) 262 U. S. 679
case. He pointed out that no weight was given to cost of reproduction on the basis of 1920 prices, and that this resulted in a valuation considerably and materially less than would have been reached by a fair and just consideration of all the facts. The valuation could not be sustained. This seemed to confirm the claim to reproduction cost.

This decision taken in connection with the Southwestern Bell Co. case made a strong position in favor of the reproduction theory; for it recognized the fact that consideration should be given to the higher price level. In this opinion Justices Brandeis and Holmes concurred in the decision but in explanation of this referred to the minority opinion in the Southwestern Bell Co. case. While agreeing that the rates were confiscatory, they arrived at this fact that there was not a fair return on actual investment, while the majority opinion leaned towards the reproduction theory. Yet in this case as in the preceding one, the remarks about reproduction cost have the characteristics of dictum.

6. ACTUAL INVESTMENT THEORY VS. REPRODUCTION THEORY

The Atlanta case, Georgia Railway and Power Co. vs. Railroad Commission of Georgia, decided in 1923, on the same day with the Bluefield, will therefore be considered with it in determining the position of the court of valuation.

In this case the gas rates for the City of Atlanta had been reduced by the Railroad Commission of Georgia and attacked by the company as confiscatory. They were reviewed by the federal court and sustained. Then the company appealed to the Supreme Court of the

1) 262 U. S. 625
United States, and, contrary to the Southwestern Bell and Bluefield cases, the rates were upheld.

The valuation, as in the other two cases, was based by the Commission practically on actual investment. The properties in existence on January 1, 1914, were valued substantially at their actual cost, or reproduction cost as of that date, and apparently with deduction for depreciation; and properties installed since January 1, 1914, were taken at their actual cost. There was a further allowance of $125,000, compared with $95,000,000 claimed by the company on the basis of reproduction cost. The Commission's findings and the approval of the district court were sustained by the Supreme Court with the statement that "the refusal of the Commission and of the lower court to hold that, for rate-making purposes, the physical properties of a utility must be valued at replacement cost, less depreciation, was clearly correct."

In this case, therefore, the Court definitely declared that as a matter of law a company is not entitled to a return based upon reproduction cost less depreciation. Furthermore, this seems clearly to transcend the realm of dicta and to constitute a decision, because it was determinative as to whether the rates were upheld or found to be confiscatory.

While $125,000 was specifically allowed for increase in land values, this was insignificant in the total valuation and would be a negligible recognition of the reproduction cost factor. The valuation rested as definitely as could be expected upon net actual investment in the properties, and yet was approved despite the strong contrary statements in the other two cases as well as against
a strong dissenting opinion.

The dissenting opinion was delivered by Justice Brandeis, who practically ignored the discussion in the Southwestern Bell on reproduction cost. He did point out that "here the Commission gave careful consideration to the cost of reproduction, but refused to adopt reproduction cost as a measure of value."

The inference might be drawn that in the other cases reproduction cost was not considered at all, and that the absence of consideration was the defect in the valuation. But mere consideration without giving actual weight to reproduction cost, would hardly be a distinction on which the Court would rest an approval or a rejection of rates. A decision upholding rates or declaring them confiscatory must presumably rest upon the facts, as viewed by the Court, whether or not there was actual confiscation.

The Atlanta case, in the discussion of value, was clearly in conflict with its companion, the Bluefield, and the somewhat earlier Southwestern Bell case. This conflict was pointed out by Justice McKenna, who dissented in a minority opinion. He viewed the Atlanta case as a complete contradiction of the other two cases and stated that "the contrariety of decision cannot be reconciled."

In regard to harmonizing these conflicting cases I find that the decisions, in the first three cases, can be readily harmonized. In the Southwestern Bell and the Bluefield cases the rates were so low that they did not bring a fair return on any reasonable valuation, and Justices Brandeis and Holmes found them confiscatory even on actual investment. In the Atlanta case, however, the rates were adequate to bring a fair return on the actual investment and were
sustained, while on the reproduction cost claimed by the company the return would have amounted to only about four per cent and would have been confiscatory.

These three decisions indicate that the final measure of confiscation is whether or not a fair return is realized upon the actual net investment, as in the Atlanta case, in which the rates were upheld, even if no allowance is made for the higher reproduction cost. If, however, the rates do not bring a fair return even on actual investment, as in the Bluefield and Southwestern Bell cases, they are confiscatory.

In view of these decisions it is evident that the court will not interfere with rates fixed by public authorities unless they are clearly unfair to investors and result in confiscation. It is also obvious that the ultimate basis for determining this fact is not reproduction cost on a higher price level but the actual net investment in the property. On the theory of actual net investment the fact must appear clear that returns are not sufficient before the rates are declared void.

While it is true that probably the majority of the Supreme Court believe in making a valuation, some consideration should be paid to the cost of reproduction on account of the great rise of the price level and the decreased purchasing power of money. Notwithstanding this, in view of the recent cases to which attention has been called, the court will not nullify rates unless they fail to bring a fair return on actual investment; or, as Justice Brandeis says, "capital embarked in the enterprise;" therefore, we must adhere to the theory of actual cost of investment as the base for determining rates.
In support of this theory is inserted a portion of the Minnesota rate cases in which the Court says: "The ascertainment of value is not controlled by artificial rules. It is not a matter of formulas but there must be reasonable judgment having its basis in proper consideration of all relevant facts."

All facts pertinent to valuation except one are said to be contained in the case of Smyth vs. Ames, and now this is considered the leading case in respect to actual value theory.

According to the general rule, there must be a fair return upon the property at the time it is being used for the public. If the property, which legally enters into the consideration of the question of rates, has increased in value since it was acquired, the company is entitled to the benefit of such increase.

II. SOME GENERAL FACTORS OF EVALUATION

For the purpose of evaluation, where it is necessary according to the general rule which makes the basis for evaluation the actual amount invested, there is a tendency of the courts to include other factors in addition to the original aggregate amount of the investment. Accordingly the following items are generally included as being objects of evaluation.

As an illustration of this the decisions of the courts have also required the commissioners to take into consideration in valuing the property of utilities not only the value of the separate items of physical property but also the value of the physical properties linked together and operating as a going concern; therefore, it has been customary in determining both original cost and reproduction

1) 230 U. S. 253
cost to include sums representing the overhead expense involved in
the construction of a public utility plant, pertaining to such items
as, engineering, interest during construction, and legal expenses
and other expenditures necessary to produce the entire property to
the day of operation.

In support of the theory of going value is cited the case of
Wilcox vs. Consolidated Gas Co. Going value, or going concern value,
i. e. the value which inheres in a plant where its business is estab-
lished, as distinguished from one which has yet to establish its
business, has been the subject of much discussion in rate-making
cases before the courts and commissions. "That there is an element of
value in an assembled and established plant, doing business and earning
money, over one not thus advanced, is self-evident. This element of
value is a property right, and should be considered in determining
the value of the property, upon which the owner has a right to make
a fair return when the same is privately owned although dedicated to
public use."

Included in going value as usually reckoned is the cost of ac-
quiring customers and the losses in capital return suffered by the
company during its early days of operation. Some authorities hold
in respect to such an allowance that, if a commission is seeking to
ascertain original cost, these expenses may be investigated as ques-
tions of fact. It has also been found that in many instances the
development of a public utility enterprise exhibits a lagging behind
demand rather than an insistent demand, but there will be no showing
of actual losses as many companies have been prosperous from the

1) 212 J. S. 19,52.
start. It is commonly proven by records that the cost of acquiring customers and developing the business has been charged into operating expense and therefore, if there has been no period of loss of fair return on investment, there is no plausible basis for capitalizing this so-called development expense. When going concern value is properly established by the evidence, in any case, it is allowed.

In the case of the Des Moines Gas Co vs. Des Moines, the court distinguishes between going value and good will in the following language: "Good will, in the sense in which that term is generally used as indicating that element of value which inheres in the fixed and favorable consideration of customers, arising from an established and well-known and well-conducted business, has no place in the fixing of valuation for the purpose of rate-making of public service corporations of this character. This was established in Wilcox vs. 1) Consolidated Gas Company."

In regard to the market value of stocks and bonds the Supreme Court of the United States in Smyth vs. Ames stated that the amount and market value of bonds and stocks should be considered in ascertaining the value of the property. Commissioners are sometimes required by law to report these facts and sometimes do so of their own volition, but it cannot be ascertained that the market values of securities have any particular weight with the commissions in fixing the value of property. The rate-making bodies and the courts have long since recognized that the market value is determined by the earning power under existing rates. If the apparent earning power is large, the value of the securities is high, on the other hand, if it is 1) 238 U. S. 153
low, the value of the securities is low, although it is sometimes apparent that the amount of outstanding securities has had an unfortunate influence.

III. THE KANSAS METHOD OF EVALUATING UTILITIES

In respect to the rule that the actual investment is the basis of evaluation, the Kansas Commission has held adversely, as shown by the following. In preparing their cases before the Kansas Commission, many applicant companies based their cases on valuation computed on reproduction cost less depreciation. Prior to 1922 the Commission's engineers rarely made any valuation other than historical cost, but with court decisions compelling the Commission to give weight to reproduction cost new depreciated, the Commission decided that it should not be compelled to rely on valuation put in evidence by the various utilities themselves, and decided to have their department make reproduction-cost-new valuations for all companies seeking a rate increase.

The Commission decided to evaluate the property in this manner regardless of the fact that it nearly doubled the amount of valuation work in the department. Therefore, the Commission does not have to rely entirely on the valuation made by the engineers, whose interest is to secure the largest possible value in order to provide a high return in rates to the utilities. Since the policy of making both reproduction-cost-new and historical cost calculations has been adopted, the utilities have materially reduced their claims as to the value of their properties. In the few cases in which companies have presented evidence of exorbitant valuation, the Commission's 1) Condensed from U. P. R. (1926) 19.
engineers, by reason of having a valuation made on the same cost basis, were able to so discredit the valuation as to leave the department's valuation almost indisputable as to the evidence showing the value of the property.

Further illustrations of these points will be found in the historical and reproduction-cost-new valuations of ten gas properties, made by the Commission. The total reproduction-cost-new value of these properties amounted to $3,300,000; the reproduction-cost-new depreciated value was $3,950,000, while the historical cost found was $2,625,000. In each of the ten cases observed either the historical cost or the reproduction-cost-new-depreciated was found to be smaller in amount than a corresponding value of the property of reproduction-cost-new. Thus the work of the Commission in the valuing of property has been of general benefit to the consumer of public utility products.

Under the head of operating expenses the following items are usually included: (1) Operating expenses proper, (2) Taxes or other governmental levies; and, (3) Payments which represent the distribution of returns to lessors, creditors, bondholders and stockholders.

In dealing with operating expenses, the Supreme Court of the United States in the case of Smyth vs. Ames said that consideration in valuing a property of the sum required to meet expenses should always be given in regard to this, but in this case the Kansas Service Commission, notwithstanding the fact that they always considered operating expenses in allowing reasonable rates, yet they have seemingly given but little regard to these expenses in estimating the value of property. It does appear unreasonable, however, that persons
who are successful in developing an efficient utility property in which the operating cost is below the average, on account of their wise management and prudent supervision, should be penalized by a reduction of rates.

IV. TAXES

In distinguishing taxation values from value set upon utilities by regulatory commissioners, there have been numerous efforts made to obtain consideration by regulatory commissions of the value set upon public utility properties for the purpose of taxation in connection with fixing the values of such properties as the basis for rates. The fact that assessed values of properties usually bear little relationship to their real values has prevented much practical use of such taxation values.

However, there is a distinction between the two values which must be borne in mind. A finding of values for rate making purposes is a statement of the amount of capital upon which a utility is entitled to earn a fair return. A statement of value for taxation purposes is, on the other hand, intended to be a statement of true pecuniary value, that is, what, on the basis of actual earning capacity, the value of the property is. Since these two values are not necessarily the same, except when actual investment is the basis for the rates, it is unfortunate that the commissions, directed by the courts, are required to find a value as the basis for rates, rather than being required, as they should be, to ascertain the reasonable capital cost of furnishing the service.

Since the coming of federal income taxes there has been an effort on the part of many utilities to obtain an inclusion of such
taxes in operating expenses, or at least the effort has been made to deduct in some manner the amount of income taxes from the net operating income. Under the holding of the Supreme Court of the United States in the Georgia Power case it appears that in the future commissions will be required to deduct the federal corporate income tax before finding the probable net income, but on the other hand, the court holds that "since dividends from the corporation are not included in the income on which the normal federal tax is payable by stockholders, the tax exemption is in effect an additional return on investment."

V. DEPRECIATION

"Depreciation in its simplest form represents the wear and tear of plant and equipment used in operation. With the exception of land and property analogous to land, like grading and excavation, all physical units wear out in use and must be replaced sooner or later to maintain the properties."

A comprehensive concept of depreciation, however, embraces all forms of impaired usefulness of property, regardless of its cause. Other factors of depreciation besides wear and tear are obsolescence, inadequacy and shift in demand for the use of the properties. In a broad sense, all three categories may be included in the term obsolescence.

The terms wear and tear being sufficiently understood, further expatiation on the foregoing factors of depreciation may seem superfluous. It may, however, be well to refer to what is termed obsolescence depreciation, due to the growing out of date or becoming obsolete of machinery, buildings, etc. on account of improvements.

new designs and inventions, which make available more improved facilities, and, at the same time, lead to more economical operations. Economy demands these implements and facilities, even though existing parts are not worn out.

Inadequacy, in connection with depreciation, means that, because of changed conditions, such as an increase in the demand of a greater output, the existing machinery proves insufficient or unsuitable for the requirements of service. As an illustration, originally a two-inch main may have been adequate for its primary purpose, but with an increase in population a two-inch main would no longer render adequate service.

The third item of depreciation is called a shift. This resembles a special form of inadequacy, the required replacement of equipment being due, not to a growth, but to a change in the demand from a particular service to a substitute. For an illustration of this there is now throughout the country a rapidly growing competition between bus lines and existing electric street railways.

According to this view depreciation comprehends all factors which are connected with the expiration of the economic life of plant and equipment. It is an important cost element in business. On the side of operation it is the portion of expired property, or capital cost which belongs to operating expenses, or cost of output during a stated period of time. From the standpoint of capital investment, it constitutes at any point of time the proportion of original cost of existing plant and equipment whose economic life has expired and has been or should have been included in the past cost of production of service. It represents the aggregate distribution of original capital
expenditures to the operating account during the past economic life of the different units of the property.

In addition to the foregoing analysis of depreciation a further distinction is made by some economic writers in which they discriminate between accrued and functional depreciation. By accrued depreciation is meant the value that has disappeared by reason of wear and tear, decay, obsolescence or inadequacy. Accrued depreciation includes not only depreciation that lessens the present operating efficiency of a particular unit, but also all depreciation that lessens the useful life of the existing unit as compared with a new unit. By functional depreciation is meant the lack of adaptation to function. It results from changed conditions and surroundings which render the structure ill adapted to its work, from growth of the business.

In respect to depreciation charges, many authorities refer them to the expense account. Whitten says: "The depreciation charged to operating expenses represents the part of the property costs which properly belong to the year's cost of operation, while the depreciation reserve shows the total of all such past charges made in connection with the existing property in service. The periodical charges are credited or added to the reserve, while the cost of plant and equipment retired is debited to or deducted from the reserve.

Systematic provision for depreciation is primarily a matter of cost accounting in reference to expenditures which are not directly chargeable to operation or output of the business. An expenditure for property involves an outlay which is entered as a capital charge but is gradually transferred to operating costs as the economic life of the property disappears in service."
For example, the cost of a street railway car is $5,000 and is charged to the appropriate capital account; but subsequently $250 is charged each year to operating expenses during the twenty years the car is supposed to be in service and the same sum is subtracted from the capital account. This accounting determines the cost of the service or product as compared with the amount realized from the sale, and finally shows the profitableness of the business. In this way accounting is conveniently subdivided by periods which in the example cited is assumed to be a year.

In the case just cited the capital charge or investment in the property, represents the amount expended which is to be included in successive periods in the cost of operating the street railway. While the car is in service, its original cost is gradually charged off to the cost of operation or production on the basis of relative periodical use. When it finally becomes useless, the full cost has been conveyed from the original capital charge to the operating costs in conjunction with other operating charges to determine the total cost of the project to the consumer.

This view follows from the rulings of the Supreme Court of the United States in the case of the City of Knoxville vs. Knoxville Water Co., decided January 4, 1909. The court points out that such a plant as was there in question begins to depreciate in value from the moment of its use, and that before coming to the question of profit at all the company was entitled to earn a sufficient sum annually to provide not only for current repairs but for making good depreciation and replacing the parts of the property when they should come to the end of their life. "If, however," the court proceeded
to say, "a company fails to perform this plain duty and to exact sufficient returns to keep the investment unimpaired, whether this is the result of unwarranted dividends upon over-issues of securities of or omission to exact proper prices for the output, the fault is its own." In view of the foregoing decision it is evident that, if the depreciation is not charged up yearly, the company cannot ask afterwards to have an allowance for its former neglect.

Courts recognize the distinction between functional and accrued depreciation. In regard to its accrued depreciation the Supreme Court of the United States holds in the Knoxville vs. Water Co. case, decided January 4, 1909, and in the Minnesota Rate case, decided June 9, 1918, to the principle that there shall be a deduction from cost-new on account of accrued deterioration due to wear and age, as well as to the depreciation affecting the present efficiency of the plant. This same principle is also stated by Justice Hughes in the Minnesota Rate cases. In these cases the lower court had based the valuation on cost-of-reproduction-new without deduction for depreciation. It was held that the increase in value due to adaptation and solidification of the roadbed was more than adequate to fully offset all existing depreciation in the physical structures. On appeal the Supreme Court rejected this contention, holding that items of appreciation and depreciation should be estimated separately and stated separately in the appraisal and that an appraisal was manifestly incomplete that included structures at cost-new when in fact they had depreciated, owing to the ordinary wear and tear or other causes. Justice Hughes in delivering the opinion of the court discusses this 1) 212 U. S. 1.
question and in substance says as follows: The cost-of-reproduction-new was allowed without deduction for depreciation. It was not denied that there was depreciation in fact, as the master said, "everything on and above the roadbed depreciates from wear and weather stress."

A tie lasts from eight to ten years only. Structures become antiquated, inadequate and more or less dilapidated. As time goes on, cars, locomotives and equipment are worn out or discarded for newer types. Ballast must be renewed, and tools and machinery replaced by new ones.

It has been determined, however, that depreciation is more than offset by appreciation; that the roadbeds constantly become more valuable; that they become solidified; that the embankments and slopes or excavations settle and become stable and are in a better condition to resist the effects of rain and frost; that they finally become adjusted to surface drainage and are made permanent by concrete structures and riprap; and that there are other respects in which a road long in use is more valuable than one newly constructed. It was claimed that a large percentage of the depreciation was taken care of by constant repairs, renewals, additions and replacements, an adequate amount being annually set aside for this purpose, so that this, with the application of roadbed and the adaptation to the needs of the county and of the public served, together with working capital, fully offsets all depreciation and makes the properties of the road equal in value to their cost-of-production-new. When particular physical items are estimated as worth so much new, and if in fact they are depreciated, this amount should be found and allowed for. If this is not done, the physical valuation is manifestly incomplete, and is

1) 230 U. S., 352
The uniform system of accounts prescribed by the commissions are, in general, based on the theory that the annual allowance for depreciation will create a reserve which will at all times equal the accrued depreciation. It is not a question of maintaining operating efficiency, but of maintaining unimpaired the capital of the company.

As an illustration of functional depreciation is cited the case of the Kansas City Southern Railway Co. vs. United States, decided April 21, 1918. In this case the company reconstructed the road-bed in order to reduce the grade. The difference between the original cost of the old roadbed and the new was charged by the company to the valuation account, but the Interstate Commerce Commission would not allow this and charged it to the expense account. The company appealed to the Supreme Court of the United States. The court said that the reconstruction cost could not be added to the capitalization of the company and that the Commission had made the correct ruling in charging the reconstruction cost to the expense account.

A. METHODS OF ESTIMATING DEPRECIATION

The following are the prevailing methods of estimating depreciation: (1) The straight line method of measuring depreciation. (2) The sinking fund method. (3) The actual inspection method.

The straight line theory assumes that the wearing value decreases uniformly each year during the assumed life, i.e., if the assumed life is twelve years and four years of such life have elapsed, the amount of existing depreciation is one third of the total wearing value.
value. This is the favorite method of appraisals for all purposes. It has the merit of simplicity. An application of what is known as the fifty per cent method makes it especially simple. This point is illustrated by the following example. If the life of a street car is twenty years and the ages of the cars to be appraised vary all the way from one to twenty years, and the number of cars of each age is the same, the average age of the total car equipment is ten years, and this is just one-half of the total life. Assuming that the cars in question have a uniform cost—new, the depreciation would be fifty per cent of the total wearing value.

The sinking fund method assumes that an amount is set aside each year which invested at compound interest will equal the total wearing value at the end of the assumed life. The depreciation at any time is said to exactly equal the amount that is or should be in a sinking fund method; the existing depreciation fund is always less than it would be under the straight line method. The degree to which it varies will depend largely on the rate of interest at which the fund is assumed to accumulate. The higher the rate of interest assumed, the smaller will be the existing depreciation under the sinking fund method as compared with what it would be under the straight line method. The difference between the two methods is not great for a unit with a short life, but for a unit having a fifty year life the excess of the existing depreciation as shown by the straight line method over that shown by the sinking fund method may be enormous.

The first two methods are often modified by the actual inspection method, i. e., the appraiser by actual inspection determines the probable useful life of each particular unit and then applies
either the straight line method or the sinking fund method, or he may simply rely on his own judgment as to what is the actual worth of the worn unit without the aid of any formal method.

VI. LAND VALUATION

In valuating land the present value seems to be the decisive factor. Valuations of railroads and other public utilities for the purpose of rate making or purchase, have always been based on present values, and not on the original cost to the company.

VII. MANNER OF DETERMINING VALUATION AND DEPRECIATION IN KANSAS

In Kansas the law pertaining to the mode and manner of determining valuation and depreciation has the following statutory provision:

For the valuation of property of a utility, the Public Service Commissioners have the power and it is their duty to ascertain the reasonable value of all property of any common carrier or public utility governed by the provisions of this act used or required to be used in their service to the Kansas public, whenever they deem the ascertainment of such value necessary, in order to enable the Commission to fix fair and reasonable rates and charges, and in making the valuations they may inspect any reports, records or other things available to them, in the office of any national, state or municipal officer or board.

As to the examination of accounts, the Kansas law provides that the Commission has authority to examine and audit all accounts, and all items are allocated to the accounts prescribed by the Commission. The agents, accountants, or examiners representing the Commission have authority under the direction of the Commission to examine any and all books, accounts, papers, records, property and memoranda kept
by such public utilities and common carriers.

In proof of this the case of the State vs. Railway Co. is cited. In this case the court held that a writ of mandamus will compel an interstate railway company to submit its books, accounts, etc. to the Public Utilities Commission for the purpose of obtaining information to be used in a proceeding before the Interstate Commerce Commission, wherein the Public Utilities Commission is a petitioner and the railroad company is respondent. The rule held by the court in this case has been applied, not only to railroad companies, but to Kansas public utility companies in general.

The Kansas Supreme Court in discussing the question of evaluation holds, in the case of the Gas and Fuel Co. vs. Public Utilities Commission, that on an appeal from a judgment setting aside a rate because it is confiscatory, it is unnecessary to inquire as to the elements entering into a valuation of the plant of a utility as a rate base, where there is an agreement of the parties as to such valuation.

In regard to depreciation the report of the Kansas Public Service Commission says in substance: The matter of depreciation and the means of taking care of the same are one of the most important features of rate regulation. The necessary annual allowance may vary from less than one per cent to more than a fair return on the property. In every rate case there is a controversy over what amount should be allowed as an annual charge to take care of depreciation. Some companies contend that depreciation should be accrued to replace the property units themselves, while on the other hand, many hold that 1) 96 K. 608. 2) 102 K. 504.
the depreciation should be accrued so as to refund to the owner his investment in the property units when it becomes time to retire them. The National Association of Railroad and Utilities Commissioners has cleared the situation by not using the term depreciation, but instead they provide for a retirement reserve which is to retire the original cost of the plant units at the end of their useful lives.

In the case of the Gas and Electric Co. vs. Fort Scott the court holds that a reasonable sum to be set aside annually for depreciation upon the property of an electric and street railway is found to be four and one half per cent of the value of the property, on the assumption that the fund thus created would be invested and the accruing interest compounded annually or at shorter intervals.

Since 1923, when the Kansas Commission adopted the system of accounting used by the National Association of Railroad and Utility Commissioners, the labor of the Kansas Commission has been greatly simplified.

In the history of Kansas utilities it has been necessary to rely largely on engineering estimates to fix the lives of plant units and to greatly shorten those estimated lives in order to take care of inadequacy and obsolescence. For entirely new types of equipment it will probably always be necessary to rely on engineering estimates, but the time is approaching when data with respect to past experiences as to realized depreciation will be complete for many classes of property. In many cases data are available for a

sufficient length of time to give a very good idea of the proper amount to allow as an annual charge for depreciation or retirements.

In all recent cases the Kansas Commission's accounting department has endeavored to ascertain the realized depreciation and maintenance over as long a period as possible and their relation to the book value of the property. In the Leavenworth electric case it was possible to get these data for a period of over twenty years. In other cases it has not been possible to get the data for so long a period. In those cases where studies have been made the results have indicated that the usual amounts allowed have been amply sufficient.

Under the authority of the Interstate Commerce Commission many investigations of depreciation have been made. They are especially interested in depreciation as it concerns the undervaluation of common carriers, and, under their definition of common carriers, they see fit to include telephone companies.

Delegates, including a representative from Kansas, presented to the National Association of Railroads and Utilities Commissions a brief with respect to telephone depreciation. In order to carry out their plans properly, the committee accepted information from the accounting, statistical and engineering departments of the various commissions which they represented. In their brief they contended that a very small per cent of the telephone business is really interstate except in towns that are located near the borders of states; therefore, they decided that the state commissions should have jurisdiction in all such cases. Reports show that in interior places the portion of interstate business often drops to the point
where it is only two per cent of the total amount, and for exchanges
near state borders the larger per cent of telephone exchange business
is local. The committee determined, should it be decided that the In-
terstate Commerce Commission take jurisdiction in the matter of de-
preciation of telephone property, the system of basing the deprecia-
tion on the past experience of the companies should be followed with
due regard to the actual realized depreciation of each company.

In Kansas the large telephone companies gather their realized
depreciation data for their company as a unit, presented as engin-
eering estimates, in which the larger portion of such expense is
attributed to inadequacy, obsolescence and public requirements.
Many such estimates are found to be excessive when tested against
actual experience. For example, claims have been made that the
depreciation of switchboards should be based on a twelve-year life
with sixteen per cent salvage allowance, or that a charge of seven
per cent should be made each year to cover this expense. Reports
from one company indicated that the average age of their Kansas
switchboards was fourteen years, while some had been installed
twenty-two years ago. The report of the Kansas Commission advises
that provision be made for a sufficient number of men to make a
thorough study of the matter of realized depreciation and obtain the
desired information with respect to the Kansas communities where the
companies are in operation.

It was necessary to make audits or investigations of records
whenever applications were received asking for either an increase
or a decrease in rates for service. These investigations were made
to determine the normal annual return on the investment at the rate
in effect and at the rate requested. This necessitated trips to the towns desiring a change of rates and an inspection of books. The work of such investigations was largely determined by the size of the utility and the efficiency and accuracy of their accounting methods. The time necessary to be spent in such investigations has been found to vary from one day to over six weeks.

The data secured from such investigations are secured at the hearings of cases that come before the Commission while the exhibits obtained present the Commission with whatever pertinent facts it is possible to obtain.

Conferences are frequently held with city attorneys, representatives of chambers of commerce, city councilmen and others interested in valuation of property for rate making.

When the rates at exchange which are units of multi-exchange telephone companies are affected, the Kansas Commission accountants make apportionments of the operating expenses of the exchanges in question between the local exchange expense and the originating, terminating and accounting expense. They believe that the revenue derived from local exchange service should cover the expenses of furnishing such local service and revenues from toll should cover toll expenses. Multi-exchange telephone companies usually contend that in exchange rate cases a certain per cent of the toll revenue originating in the exchange should be included with the local exchange revenue for the purpose of covering the accounting expense of handling the toll business at the exchange.

It frequently happens therefore that in telephone rate cases the experts from the companies present income statements with what
they claim to be toll revenues and expenses eliminated; oftentimes
these constitute the only income statements that the experts for the
companies present.

An example of this is found in the Salina case of the United
Telephone Company, in which the company objected to the introduction
by the accountant of the Commission of an exhibit showing an income
statement which did not so eliminate toll revenues and toll expenses,
although the accountant for the Commission informed them that such
income statement was not considered conclusive, but was introduced
to give further light in the case under consideration.

The greater number of cases that come before the Kansas Service
Commission are in connection with rates for telephone exchange ser-
vice, because the number of telephone companies operating in Kansas
is greater than that of all other companies under the jurisdiction of
the Public Service Commission.

Some considerations in telephone cases are as follows: (1) The
establishment of toll rates between specified points. (2) Settlement
of disputes as to boundaries between exchange areas for the purpose
of avoiding duplication of service. (3) Discontinuation or reestab-
lishment of free service between exchanges. (4) Settlement of dis-
putes as to the allowance of percentages of originating tolls. (5)
Prevention of overcharges between companies due to overtiming toll
calls and to other causes. (6) Issues of capital stock and funded
debt.

A large number of electric cases brought before the Commission
in the last few years have also necessitated valuations on large
properties. In these cases consumers were asking for a rate reduc-
tion. Examples of this nature are the Kansas Electric Power Company at Leavenworth, the Garden City Irrigation Power Company of Garden City, the Riverside Light and Power Company, Florence, and the Caney Electric Company.
CHAPTER IV
DETERMINATION OF RATES

I. THE PROBLEM OF RATE MAKING

Years ago, it would have been an absurdity to suggest that a third party should claim and exercise a right to fix the returns on any business enterprise. Yet in the course of a few decades this notion has lost its apparent harshness and is now generally recognized as if it had been an ancient custom. The origin and the growth of this right of regulation is found in our judicial history, for the courts were the first to recognize the principle of rate making and to give it judicial sanction. In other words, the courts held that rate making was a purely legislative matter, and, while the courts did not claim this extraordinary authority, they invariably said that it was a function of the legislature and beyond their control unless the rates so established resulted in confiscation. Hence, it is evident that the origin of the power is judicial, while its source is necessarily legislative.

There is often, however, a misunderstanding as to just where the functions of the legislature end and those of the courts begin. Many claim that valuation is entirely within the province of the courts, but in the last analysis valuation and rate making are both legislative in character.

It is the function of the commissioners through their delegated authority to determine the basis of valuation and what rate of return is to be allowed. Rates cannot be determined unless these two factors are greed upon, and in the exercise of this power there is the con-
stitutional limitation that property must not be confiscated. Therefore unreasonable rates cannot be enforced provided the court acts in compliance with the Constitution. In view of this, all these matters pertaining to valuation and rate making by the commissions must have judicial sanction in case the acts of the commissioners are unsatisfactory.

According to the authorities, the entire process of rate making devolves in the first instance upon the legislature or its delegated authority. The only check upon this legislative authority as expressed in rate making is the power of the court to declare the rates confiscatory. In other words, if the rates are not confiscatory, the court has no jurisdiction in the matter. This constitutes the only ground for the court's interference.

In view of this it is evident that the legislatures alone have the power to decide what shall be done or to fix the policies for the public interest. For, as has been seen, the courts are concerned only with the question, when it arises, whether the legislative action has not injured private rights by confiscating private property. Therefore, the power of the courts being restrictive and not constructive, it follows that whatever improvement or efficiency is made in respect to rate regulation, its forthcoming will result from legislative action. This principle is applicable to all phases of regulation and the fixing of rates. Economists are agreed that the formulation of definite principles of valuation and a uniform method of continuous rate control are the primary duties of the legislature in respect to public utilities.

It is further suggested by economists that, in order to meet
the difficulties in formulating fixed principles of valuation, a
distinction should be made between existing properties and future
investments. In regard to future investments there could be no
possible grounds for judicial interference with such definite ar-
rangements for the future.

But, as already explained, the elements of value as to existing
properties are of uncertain and indefinite determination, and the
principles on which a rate base should be determined have never been
satisfactorily formulated. These uncertainties have caused much con-
fusion in rate making, which can be gotten rid of only when the un-
certainties are relegated to the past. These uncertainties arise on
account of the difficulty of making a just appraisement of the proper-
ty, of determining a fair allowance for current expenses, and of mak-
ing a fair reduction for depreciation.

In order to clear up and simplify this ambiguity, it is neces-
sary that certain principles of valuation must be adopted and that
such principles must be construed in every case as actual appraisals
of the properties; hence the establishment of a rate base that will
not be affected as to the amount of past investments and will remain
unaltered. This cannot, however, be accomplished except through legis-
lative action. Economists say that it is a matter of affirmative
policy which cannot be established by the courts. Therefore, it is
necessary to determine by legislative rule the principle of valuation
and to instruct the commissions to make appraisals of all the proper-
ties in which the commissioners are required to take action, so that
the appraisals of the commissions will constitute once for all in
every case, the amount of past investment on which the public must
pay a return. This method has been adopted by the Interstate Commerce Commission, and the outlook indicates that it will prove advantageous.

To this original valuation of existing properties should be added from time to time all future investments, so that for the future the total rate base would be ascertainable at any moment from the accounts. Hence, there would be no further doubt as to facts, and causes for disputes and litigations would be removed. Accordingly, rates could be adjusted to correspond to the change in total cost of operation. In this way, the investors would know exactly what they are entitled to receive and also the amount the public is obliged to pay; in other words, rate making would become an automatic procedure based on facts under the control of the Commissioners and beyond the possibility of dispute between the public and the company. Hence, this would put an end to judicial rate making.

Robinson, in discussing the principles of rate making, says:
"In fixing the initial rate base for existing properties, it must be admitted that there are very grave difficulties both in determining the proper principles of valuation and in applying the principles to the appraisals. Our belief is that for the most part, with certain adjustments, the actual reasonable investment should be adopted as the fundamental principle applied to the existing properties as well as to all future additions." But there are serious objections to the adoption of this standard for existing properties, and difficulties in its application. Reasonable elasticity should be provided in the statute; it may be undesirable to prescribe rigid principles. The wide variations between different properties doubtless would

1) Robinson's Public Utilities, p. 234.
require various special adjustments so that in any event only very
general principles could be laid down to guide the appraisals. There
would have to be sufficient flexibility to meet special conditions.
But, whatever individual adjustments may be necessary or what varia-
tion in principles may appear desirable, definite appraisals should
be made in each case to fix the initial rate base for existing prop-
erties. The valuation should then remain fixed for the future, to
be increased only with actual additional investment.

In view of the foregoing theory it is obvious that the uncertain-
ty of past investments should be settled once for all as the burden
of the argument is that certainty is the prerequisite of scientific
and effective rate regulation. It follows, therefore, that certain-
ty is not based on any one rule of valuation but that the existing
investment must be reduced to definite sums in order to make rate
regulation reasonable and equitable. To disregard this is to render
rate making futile. Therefore, the basis of valuation adopted, whether
actual investment, reproduction cost of the properties or a combina-
tion of factors, should be definitely determined by statute. But
regardless of which of the three principles is adopted, it is evident
that a fixed valuation should be made of the property, and a definite
rate base provided for the future.

Among the first cases in which the court said that it had no
right to abolish the rate fixed by the legislature were the Granger
Cases decided on the ground that the property was affected with a
public interest and the regulation of the rate of charge was solely
a legislative power and the courts were powerless to prevent the
abuse of such power by the legislatures. This doctrine was soon modi-
II. INTERNATIONAL SCOPE OF RATE MAKING

The opinions of the Supreme Court of the United States in the following cases are given here in support of the principle that both valuation and rate making are within the province of the legislature and are not subject to judicial review except on account of the rates being so low as to become confiscatory.

The first case in which it was explicitly announced that under certain conditions the court had a right to interfere, when, in their opinion, the rates were confiscatory, was that of the Spring Valley Water Works vs. Schottler, decided in 1884; likewise in 1866, in the Railroad Commission cases, Chief Justice Waite held: "It is not inferred that this power of limitation or regulation is itself without limit. This power to regulate is not a power to destroy, and limitation is not the equivalent of confiscation." In 1888, however, in Dow vs. Beidelman, Chief Justice Gray says in substance that the court has no means, if it would have the power, of determining that the rate of three cents per mile fixed by the legislature is unreasonable. Later the same court in 1889, in Chicago, Milwaukee and St. Paul Railway vs. Minnesota, promulgated the rule that it is necessarily within the power of the courts to declare illegal and unreasonable a rate fixed by a legislature or commission. Nine years later the right was clearly recognized and established that the court had power to set aside the rulings of the Commission in certain instances, as, for example, in the case of Smythe vs. Ames, where it was clearly decided that a fair return on the fair value of the prop-

1) 206 U. S. 142.  2) 131 U. S. 541.  3) 134 U. S. 418.
erty used for the convenience of the public was the chief basis for the determination of the reasonableness and the constitutionality of a rate.

In Reagan vs. Farmers' Loan and Trust Company, decided May 26, 1894, Justice Brewer further enlarged upon this principle by saying in substance: It is not necessary to decide, and we are not laying down an absolute rule, that in every case a failure to produce some profit to those who have invested their money in the building of a road, is conclusive that the tariff is unjust and unreasonable. And yet justice demands that every one should receive some compensation for the use of his money or property, if it be possible without prejudice to the rights of others. There may be conditions which would justify such a tariff; there may have been extravagance; there may be waste in the management in the road; enormous salaries, unjust discrimination as between individual shippers resulting in loss. Material and labor may have been at the highest price during construction, so that the actual cost was far in excess of the present value; the road may have been unwisely built, in localities where there is not sufficient business to sustain the road. Doubtless, too, there are many other matters affecting the rights of the community in which the road is built as well as the rights of those who have built the road.

In the case of Stanislaus County vs. San Joaquin and King's River Canal and Irrigation Company, decided January 18, 1904, the court held, in respect to the rates, that it is not confiscation nor a taking of property without due process of law, to fix water rates so as to give an income of six per cent upon the then value.

1) 164 U. S. 362
of the property used, for the purpose of supplying water as provided by law, even though the company had previously been allowed to fix rates that would secure to it one and a half per cent a month income upon the capital actually invested in the undertaking. If not hindered by a contract, providing that a certain compensation should always be received, it appears that a law which reduces the former compensation to six per cent upon the present value of the property used for the public is not unconstitutional. There is nothing in the nature of confiscation about it.

A far more logical case is that of Wilcox vs. Consolidated Gas Company. In this case the court discredited the notion of a uniform rate by saying: "There is no particular rate of compensation which must, in all parts of the country, be regarded as sufficient for capital invested in business enterprises. Such compensation must depend greatly upon circumstances and locality; among other things, the amount of risk in the business is a most important factor, as well as the locality where the business is conducted and the rate expected and usually realized there upon investments of a somewhat similar nature with regard to the risk attending them." There may be other matters which in some cases might also be properly taken into account in determining the rate which an investor might properly expect or hope to receive and which he should be entitled to without legislative interference. The rule holds here, that the less risk, the less right to any unusual return upon the investments.

In the case of Knoxville vs. Water Company, decided January 4, 1909, the court, in deciding the question whether or not a specific rate amounted to confiscation, said: "Upon any aspect of the evidence 1) 192 U. S. 201. 2) 212 U. S. 19.
the company is certain to obtain a substantial net revenue under the operation of the ordinance. The net income, in any event, would be substantially six per cent, or four per cent after an allowance of two per cent for depreciation. We cannot know clearly that the revenue would not much exceed that return." The court did not decide whether a reduction of income to that point would or would not amount to confiscation. However, it is generally conceded that there is an abundant supply of capital seeking such a return, provided the risk is reduced to a minimum. For this reason it would seem that the amount allowed is a sufficient return upon the capital invested.

In the case of Cedar Rapids Gaslight Company vs. Cedar Rapids, decided May 4, 1909, which decision was later affirmed by the United States Supreme Court, the court, in attempting to indicate what a fair return would be under the existing circumstances, in substance said: When government bonds bearing two per cent annual interest are selling at a premium, and those issued by states or municipalities at little if any more than double such rate are in demand, and when the current rate of interest on gilt edge securities on real estate or public service corporations rarely exceeds five per cent, it will not do for the courts to say that the income, above all expenses, including taxes, on property devoted to the public service, must necessarily exceed the last-mentioned rate to avoid the charge of being confiscatory. The usual earnings of such plants, unless they are based on reasonable charges, cannot be accepted as a criterion, for usually the rates fixed are all the traffic will bear. Possibly the plant should earn a return equal to the interest

1] 212 U. S. 129.
paid in the community on investments equally reliable and permanent
in character. The function of fixing compensation for public ser-
vice should be exercised with a keen sense of justice on the part
of the regulating body. The company should aid therein by a frank
and full disclosure of its affairs. It would seem that rates might
be selected which, on the one hand, would not dampen the zeal to
furnish the best service and extend the plant as the needs of an
advancing municipality shall require, nor, on the other hand, exact
from the people more than fair compensation for the service received.

In view of the foregoing decisions it is clear that the courts
have not formulated any general rule in respect to the sufficiency
of rates, but the merits of each case had to be specifically con-
sidered, because it is manifest that no two cases are exactly alike
in factors that constitute valuation, depreciation, together with
other material data that are relevant, or, in the language of Moody,
"The attitude of the Supreme Court of the United States in relation
to what constitutes a fair return has been a slow evolution." The
Supreme Court held in 1876 that it had no power to declare void an act
of a legislature fixing rates, but this position of the court was
later gradually reversed. Up to the present time statutes or regula-
tions fixing rates have been annulled by the Supreme Court only when
the confiscatory nature of the rates fixed was so apparent that it
was unnecessary to determine or discuss what constituted a fair rate
of return.

III. THE ATTITUDE OF COURTS AND STATE COMMISSIONS WITH
REGARD TO RATE MAKING

In respect to the attitude of the state courts and the federal
courts below the Supreme Court, it seems that there are many cases
1) 144 la. 426.
in which specific rates of return have been declared to be either confiscatory or non-confiscatory, or have been held to be the fair rates of return. Up to the organization of the Kansas Public Utilities Commission there was scarcely any judicial authority for a rate of return higher than five per cent or six per cent, the legal rate of interest; usually six per cent has apparently met the approval of the courts in the determination of the fair rate of return. The idea seems to be that so long as the company is permitted to earn the legal rate of interest, there can be no question of confiscation.

The decisions since 1911 indicate that the federal courts are now inclined to allow higher rates of return than formerly, instead of six per cent the prevailing rates in the decisions since 1911 are seven per cent and even eight per cent. The higher rates may be partially attributed to the influence and example of the state regulatory commissions.

If we compare the attitude of the courts and state commissions in their attempt to evaluate and determine a fair rate, it is evident that the general tendency of the commissions has been exceedingly conservative in fixing the valuation for rate purposes, but quite liberal in determining a rate of return upon such valuation, while, on the contrary, the courts have in general been liberal in fixing fair value, but have been conservative as regards the rate of return. It is said this difference in method arises doubtless from two sources, namely, first, the courts are always ready to defend property rights and the valuation seems to be in their opinion more directly connected with the prevention of confiscation
than does the rate of return; second, the courts have not been clear as to just how far the commission should go in regard to the rate of return as some of the earlier decisions merely indicate that the company should be allowed some return.

It was not until 1898 in Smyth vs. Ames that the Supreme Court for the first time laid down the rule that what the company was justified in earning was a fair return on the fair value of its property. Yet after this decision there still existed considerable uncertainty and perplexity as to whether a fair return required by the Constitution was to be measured by the same standards as that fair return which would satisfy the best standard of public policy in the encouragement of public service enterprises. It is claimed that the state commissions have been influenced in most instances to accept this latter viewpoint, while the courts at least for the most part have not considered it relevant to take into consideration the effect of a given rate of return on the future development of public utility enterprises, but merely to protect in a manner investments already in existence.

It is also apparent from the history of the state commissions that some have adopted a uniform rate of return for all utilities at all times irrespective of circumstances, while other commissions vary the rate to meet conditions affecting the individual company. It is said the latter method is approved by a majority of the courts and consequently is more equitable and should become the rule of all commissions.

In studying the rulings of the commissions and the courts, 1) 109 U. S. 486.
whether state or federal, it is apparent that there exists great diversity of opinion, yet, notwithstanding this, it is evident that there is considerable harmony in their decisions, because both commissions and courts, have now recognized the two main factors in determining the value of a public utility property for the purpose of rate making. The first of these two factors may be called legal, the second, economic; each of these must be taken into consideration in every case that comes up for adjudication. The legal fact is that the United States utilities are entitled to earn a reasonable return on the fair value of the property used in the public service. The economic factor is that the cost of a commodity, service, or property is not the measure or test of its value. As the Supreme Court has declared repeatedly, the utility is entitled to a fair return not on the cost as such, but on the value of the property.

At the present time a utility is privileged to charge a rate sufficient to meet operating expenses, including taxes and depreciation, and to yield a reasonable return on the fair value of the property used and useful in the public service. Interest charges and dividends on stock must be paid out of the reasonable return. However, there is no guaranty that the utility will be given earnings sufficiently large to meet both interest obligations and stock dividends. There are two factors that measure the adequacy of the return; first, the fair value of the property, and, second, a rate on this which, in the locality and at a given time, would attract capital, having due regard for a reasonable capitalization.

In the preceding pages I have dealt with rate making in its
national scope. This was necessary in order that my treatment of the question should at least have the appearance of method and logical sequence. For it is obvious that all these cases could be brought within the purview of the federal Constitution; hence, the actions of the commissions and the state courts were not final in deciding what is a fair or reasonable rate; so each state can boast of its own commission or a state supreme court, yet neither a state commission nor a state supreme court has anything to do with the ultimate decision of any question that may arise between the commission and the public utility company as regards a fair and reasonable rate.

IV. STATE REGULATION IN KANSAS

In Kansas, the State Commission has the delegated authority to establish rates for services, rendered by public utility companies. The law provides that every common carrier and public utility governed by the provisions of this act is required to furnish reasonably efficient and sufficient service, joint service and facilities for the use of any and all products or services rendered, furnished, supplied, or produced by such public utility or common carrier, and to establish just and reasonable rates, joint rates, fares, tolls, charges and exactions, and to make just and reasonable rules, classifications and regulations; and every unjust or unreasonable, discriminatory or unduly preferential rule or regulation, classification, rate, joint rate, fare, toll or charge demanded, exacted or received is prohibited and declared to be unlawful and void, and the Public Utilities Commission has the power, after notice and hearing of the interested parties, to require any common carrier and all public utilities governed by the provisions of the act to
establish and maintain just and reasonable joint rates wherever the same are reasonably necessary to be put into effect, in order to obtain sufficient service from the public utilities and common carriers.

The Kansas Supreme Court in construing the foregoing statute holds that where a telephone rate fixed by a statute or utility commission is found to be insufficient to pay cost of service and is changed by an order of the court, such action is illegal, as the court has no jurisdiction to fix rates; but where a court having jurisdiction finds that a rate fixed by the Kansas statute and approved by the Kansas Commission is confiscatory, the utility is free to operate under such a rate as it may establish until a different rate has been fixed by the Commission.

A case under this division of the law is that of the State vs. The Emporia Telegraph Company. In this case the telegraph company changed rates without permission of the Commission. The court held the provision of the statute requiring a public utility to obtain the consent of the Commission before changing any rate, rule, regulation, or practice to be a valid exercise of legislative power.

In carrying into effect the provisions of the law empowering the Commission to fix or regulate rates, there is a provision in the Kansas law in respect to filing schedules of rates by the public utility companies, which is as follows: Every public utility and every common carrier doing business in Kansas, over which the Public Utilities Commission has control, is required to publish and file with the Public Service Commission copies of all schedules of rates, 1) 97 K. 136. 2) 96 K. 298.
joint rates, tolls, fares, charges, classifications and divisions of rates affecting Kansas traffic, either state or interstate, and is further required to furnish the Commission with copies of all rules, regulations and contracts between common carriers or public utilities pertaining to any and all services to be rendered by the public utility or common carrier. The Public Service Commission has power to prescribe reasonable rules and regulations regarding the printing and filing of all schedules, tariffs, and classifications of all rates, joint rates, tolls, fares, charges and all rules and regulations of such utilities and common carriers.

The principles that underlie the public utilities act of this State are the same as those which underlie the Interstate Commerce Act of the United States. Rules that are applicable under the latter act are applicable under the former one.

The General Statutes of 1915, passed by the legislature of Kansas, prohibit the charging in excess of published rates as follows: No common carrier or public utility governed by the provisions of this act may knowingly charge or receive a greater or less compensation for the same class of service performed by it within the State, or for any related service, than is provided in the printed schedule or classification. There are exceptions to this rule in which it is lawful that rates different from those specified in the printed schedule may be charged by any street railway in case of charity, emergency, festivity, public entertainment, and further that any utility may grant free rates or services to its officers and employees.
According to a decision in the case The State ex rel. vs. The Telephone Company, the gratuitous permission by one telephone company of the use by another company of a line owned by the former constitutes a discriminating practice, forbidden by the statute. Therefore, such permission being illegal, the Utility Commission is powerless to order the continuance of such a discriminating practice.

In construing the foregoing statute, the court held that the furnishing of free gas to cities in consideration of the use of the streets is discrimination against those consumers who are required to pay schedule prices; therefore, it was ordered discontinued.

In the case of Leavenworth City vs. The Light and Water Company the charge of discrimination was that the water company furnished free service to the city and its schools. The water company was ordered to discontinue such services on the ground that such practice is both unreasonable and discriminatory, and that the amount of all water hereafter used by the city and schools must be determined according to the meter and must be paid for according to the usual rates which are imposed upon other users.

Free service according to these decisions is opposed to the general policy of all regulatory legislation, and is expressly prohibited by the public service law of Kansas.

The interstate commerce act provides that the rate of the carrier which is filed, is the only lawful charge. Deviation from it is not permitted upon any consideration. Shippers and travelers as well as the carrier must observe it, unless it is found by the com-

1) 102 K. 319. 2) 92 K. 227.
mission to be unreasonable. Ignorance or misquotation of rates is not a valid excuse for not abiding by the rates that are filed. This policy has been adopted by Congress in the regulation of interstate commerce in order to prevent unjust discrimination.

In respect to complaints and investigations, it is the duty of the Commission, either upon complaint or upon its own initiative, to investigate all rates, joint rates, fares, tolls, charges, schedules of rates, and rules and regulations. Should the Commission find any irregularities or exactions, it may fix an order substituting such rates as it may deem just and reasonable.

The issue in the case of Elliot vs. The Empire Natural Gas Company was whether there was sufficient evidence before the Commission on which to base the finding of the Commission as to the reasonableness of the then existing rate. The court held that the Commission had the authority and power to fix a temporary rate. In discussing the case, the court showed that the appeal involved the validity of an order of the Public Service Commission and the right of a public utility to discontinue service on account of an over-due and disputed bill. The Commission, according to this opinion, has authority to fix the rate to consumers in the City of Wichita and other towns on defendant's pipe lines, even though in doing so it abrogated contracts between the municipality and the distributing company. As, in the Winfield case, it was pointed out that the city is a creature of the state whose destiny as to its public utilities has been entrusted to an agency of the state, i.e. the Public Service Commission. Therefore, as far as the City of Wichita was concerned.

1) 123 K. 558.
the jurisdiction of the Commission was complete, and in the same way it had complete jurisdiction over the distributing company except as it might be protected by its own contractual rights.

The question of jurisdiction of the Commission was raised in the case of The City of Winfield vs. The Court of Industrial Relations, and, in discussing the case, the court called attention to the rule that, where a court of general jurisdiction has exercised its powers, the facts necessary to give it jurisdiction are presumed to exist although not recited in the record. In the same case it was held that, where a utility commission, after a hearing, changes an existing rate for a higher rate, the implication that it had concluded that the old rate was too low, for some of the reasons assigned by the statute, seems so clear as to do away entirely with the occasion for a formal declaration to that effect in the record.

The extent of jurisdiction was also discussed in the case of The City of Emporia vs. The Telephone Company. The latter, the defendant, was located in the City of Emporia, operating exchanges and toll lines in Lyon's county and in four adjacent counties and in six other towns using many miles of line besides numerous toll lines. There were two thousand four hundred stations in the City of Emporia and six hundred elsewhere; hence, about one-fifth of its property was located outside of the city; but, notwithstanding this, the court held that its property was subject to the control of the Public Utilities Commission.

It was further held in this case that the changing of rates allowed by the Utility Commission cannot be enjoined by a district

1) 111 K. 580.  2) 90 K. 118.
judge during the pendency of litigation between the city and the telephone company.

The Public Service Commission has power to order the installation of devices for regulating pressure and for obtaining measurements, and the fact that the order is experimental and the use of the devices required for only a short time does not affect the validity of such installation.

The Commission is vested with the power to regulate and limit the extent of territory in which a utility may operate and thus prevent wasteful competition and duplication of service, which would tend to increase the cost to consumers and cause inconvenience to the public. The Commission with its power over rates and efficiency of service, can suppress any evil consequences of monopoly, and public policy favors a single system. This regulation constitutes an exercise of the police power which the state retains for the protection of the public safety and welfare; however, before a contract can be interfered with through the police power, it must appear that the contract does in some measure affect adversely the welfare of the public.

If, upon investigation, the Commission finds that any regulation, measurement, practice, or service, is unjust or discriminatory, the Commission has power to substitute therefor such other regulation or service and to make such order respecting any such change as may be just and reasonable.

It has been determined that reasonable changes and improvements in the affairs of public utilities may be ordered at the expense of the public utility company.
In the case of The City of Persons vs. The Water Supply and Power Company, the court held that, where a city complains that a public utility has failed to furnish efficient and sufficient service and has failed to make improvements and provide facilities necessary for the performance of the duties and contract obligations of the utility to the city and its inhabitants, such city should first invoke the relief provided by the public utility act before resorting to the courts for relief. Whether plaintiff should have first invoked the action of the municipal commission or of the Public Utility Commission depends upon whether or not the defendant is a one-city utility. The statute provides that, if the utility is situated and operating wholly within a city, the authority is vested in the municipal commission, otherwise it is in the Public Utility Commission. Hence, under the provision of the law, if the jurisdiction is in the municipal commission, a review of its decision may be had by the Public Utility Commission. From this it appears that state courts have no jurisdiction through receivers to regulate rates of public service corporations; and neither the courts nor the receivers of such corporations can change legal rates without the consent of the Public Utility Commission.

Upon a complaint in writing made against any common carrier or public utility governed by the provisions of this act by any person or corporation, setting forth any violation of the schedule of rates or rules and regulations or any other charge disregarding any provision of the utility law, the commissioners shall proceed with or without notice to make such investigation as they may deem necessary.

The commissioners may, however, upon their own motion and with-
out any complaint being made, proceed to make such investigation, but no order affecting the rights of any common carrier or public utility may be made without a formal public hearing of which notice shall be given by the Commission to the common carrier or public utility.

Any public investigation or hearing which the Commission has power to make or to hold may be made or held before any one or more commissioners, and all investigations, hearings, decisions, and orders made by a commissioner are deemed and held to be the investigations, hearings, decisions and orders of the Public Utility Commission, when approved and filed by such Commission in their office.

Whenever notice is required to be given any common carrier or public utility, thirty days written or printed notice of when and where such investigation or hearing will be held, must be given. Such notice may be served by mailing a copy to the public utility or common carrier. The object of the notice is to advise the common carrier or public utility of the nature of the charge that has been preferred. The Commission may require the production of any books, papers, contracts, or other documents in possession of or under the control of the utility.

In the case of The State ex rel. P. U. C. vs. Atchison Topeka and Santa Fe R. R., when the Kansas Commission was collecting evidence in preparation for a trial of a grain rate case before the I. C. C., it deemed it expedient to examine the books and records of the various railroads involved. The first books and records sought to be examined were those of the Santa Fe. Upon refusal of the Santa Fe to allow the accountants of the Commission to examine its books and records, the
Commission filed a suit in mandamus in the Kansas Supreme Court asking for a writ to compel the Santa Fe to produce its books and records. An alternative writ was issued and the defendant filed a motion to annul the writ, and set up the following facts: that the defendant is engaged in interstate commerce; that as an interstate commerce carrier it is subject to the control of the Interstate Commerce Commission, and keeps its books and accounts as required by that commission; that there is nothing pending before the Public Utility Commission requiring an examination of the books used by the defendant. The court overruled defendant's motion to annul and gave it ten days in which to answer. On the hearing of the case, plaintiff's motion was sustained, the court holding that a writ of mandamus will issue to compel the railroad companies organized under the laws of this State to submit their books to the examination of the Public Utilities Commission, its agents or accountants for the purpose of obtaining information to be used as evidence in a proceeding before the Interstate Commerce Commission, where the public Utilities Commission of the State of Kansas is petitioner and the Santa Fe railroad is respondent.

To hold that the state cannot inspect and examine the books, accounts, and records of domestic corporations would be to say that the state which creates corporations and endows them with power, has not reserved the power to control them.

If, upon such hearing, the charges are sustained against the common carrier or public utility, the Commission has power to order substituted such rates, regulations, or schedules, as it may find to be reasonable.

1) 108 K. 847.
In construing the statute, the court held in the case of The Flour Mill Company vs. The Gas and Electric Light Company that the public utility commission act provides that, if the Commission finds an existing rate charged by a public utility to be unreasonable, it may fix and order substituted therefor such rates as may be reasonable, and that this does not impose a jurisdictional requirement that the order or other part of the record should contain a recital to the effect that the board had found the existing rate unreasonable. The validity of such an order cannot be attacked collaterally, because it is a fair inference that the Commission found the existing rate to be unlawful.

The court ruled in the case of Kaul vs. The Telephone Company that a contract for rates with a public utility cannot be abrogated except after a finding by the Commission that the rates are unreasonable. The question involved, however, is not whether it is necessary for the Utility Commission to find that an existing rate is too high or too low before it can change the rate, but whether in order to give validity to such an order, there must be inserted a statement or recital that the Commission has so found. In my judgment, a finding by the Commission that an existing rate requires change for some statutory reasons may be and in this case should be presumed from the fact that a change is made without any express declaration to that effect being incorporated in the order.

All orders and decisions of the Commission changing rates or regulations, are to be written and a certified copy sent to the public utility or common carrier by registered mail; and such orders 1) 119 K. 47. 2) 95 K. 147.
and decisions are to become operative and effective within thirty days after such notice.

No person is to be excused from testifying or producing any books, accounts, maps, papers, or documents in a proceeding growing out of any violation of any of the provisions of the utility law on the ground that the testimony might tend to incriminate him.

All orders and regulations fixed by the Commission are to be in force and effect within thirty days after they are made.

Whenever any common carrier or public utility desires to make a change in rates, rules or regulations, such common carrier or public utility is required to file with the Public Service Commission a schedule showing the changes desired to be made. But no change may be made in any rate regulation or schedule without the consent of the Commission and not before such change has been authorized by the Commission.

The court holds in the case of The City of Scammon vs. The Gas Company that a public utility cannot change any rule or regulation or practice pertaining to rates or services without the consent of the Commission. A gas company supplying several cities had for years under a franchise with the City of Scammon supplied gas to a street lighting company, the latter paying for all the service pipes leading from the gas companies mains to the lighting companies posts in excess of fifty feet from such mains. The service pipes having become leaky and dangerous, the gas company turned off the supply from thirteen of the sixty-five posts. The city by ordinance directed the gas company to repair and maintain such service pipes and to restore the supply of gas. The gas company refused. The city sought 1) 90 K. 118.
by mandamus to compel obedience. The court held that such a controversy should be submitted to the Public Utility Commission, as it is not a proper one to be controlled by mandamus in the first instance, and, further, that a public utility cannot change any rule or regulation or practice pertaining to rates or services without the consent of the Commission.

Any common carrier or public utility governed by the provisions of the act who is aggrieved at the finding of the Commission may within thirty days from the making of such order commence an action in a court of competent jurisdiction against the Public Utility Commission to vacate and set aside such order. During the pendency of any action all orders made by the Public Utilities Commission prescribing rates, joint rates, tolls, fares, charges, rules, regulations, classifications or findings, unless temporarily enjoined, remain in full force and effect until final judgment is rendered. During the pendency of such appeal the judgment of the lower court remains in effect, unless stayed by order of the supreme court. Service of summons to any member of the board is sufficient service on the board.

The court, in construing the statute, in the case of The City of Emporia vs. The Telephone Company, distinguishes between a restraining order and a temporary injunction. The difference between a restraining order and a temporary injunction is mainly in the effect produced. An order which in effect ties the hands of a going concern operating a public utility until a final hearing, should be termed a temporary injunction from which an appeal will lie. It 1) 98 K. 812.
was also held in this case that rates allowed by the Utility Commission cannot be enjoined by a district judge pending a continued litigation between such city and telephone company to prevent the latter from increasing its rates under an ordinance passed, but not yet enforced. The trial judge, therefore, temporarily enjoined the company from charging such increased rates. The injunction was dissolved by the supreme court as the trial court had exceeded its authority.

This case of The Emporia Telephone Company vs. The Public Utility Commission appealed to the supreme court of the State, was begun by the utility company, the appellant, before the Kansas Public Utility Commission, when appellant filed its application with the Commission for an increased rate. The application was dismissed by the Commission. The appellant appealed to the district court and a judgment was rendered, setting aside the order of the Commission in which an increase was denied, and also enjoined any interference with the company in charging and collecting the advanced rate. The injunction was to remain in force until the Commission should establish a reasonable rate. From this judgment of the district court the Public Utility Commission appealed to the supreme court of Kansas. The opinion of the court holds: (1) that a court has no power to fix rates; (2) that a court having no power to fix a rate to be charged by a public utility for service to be rendered in the future cannot accomplish that result indirectly by enjoining interference with a rate which it finds to have been unreasonable in the past; (3) that in case rates are insufficient to pay cost of service, although such rates cannot be increased except with the consent of the Public Service Commission of Kansas, the court has no power to order the company to cease charging the advanced rate. The court held that the district court had exceeded its authority, and the case was remanded to the district court for further proceedings.

1) 97 K. 136.
Commission, and when an application has been made to the Commission for an increase of rates and the application was dismissed by the Commission, the court could, if the existing rate was found to be confiscatory, adjudge that part of the statute fixing such rate to be inoperative and enjoin enforcement of the penalties provided for its violation; (4) that where a court having jurisdiction determines that a rate fixed by the statute and approved by the Utility Commission is confiscatory, the utility is left free to operate under such rate as it may establish until a new one has been fixed by the Commission; (5) that, while a court is powerless to fix a rate for the future, it is authorized to prevent the enforcement of any order of a board or of any statute attempting to establish a noncompensatory rate.

In the case of The Union Pacific Railroad Company vs. The Public Utility Commission of the State of Kansas, an appeal was made by the Public Utility Commission from a decision of the district court of Shawnee county, in which the Commission was enjoined from enforcing its order directing the Union Pacific Railroad Company to reduce its freight rates on coal mined at Pittsburg and delivered at Concordia, from one dollar and fifty-four cents per ton to one dollar and twenty cents per ton. The court distinguishes between the words unreasonable, unjust, oppressive, and unlawful as not being synonymous with confiscatory, and a rate may not be confiscatory, that is, it may not be as low as to amount to taking property without due process of law and yet be inequitable in that it does not yield a fair compensation.

1) 95 K. 604.
The decision of the district court was reversed and the case remanded with instructions to dissolve the injunction. It is the opinion of the court and the contention of the appellant that it is not necessary that this particular traffic be compensatory if the carrier’s entire state business shows a fair profit, and that, before the carrier can complain that the one dollar and twenty cent rate ordered by the Commission is unlawful, it must first be shown that it has depreciated his net earnings on all his Kansas business. Although like doctrines formerly have been held by the highest courts, yet several late decisions have come from the Supreme Court of the United States disavowing that doctrine by saying that the earlier decisions which are supposed to have sanctioned that view, were never so intended, and that properly read they never furnished a basis for that doctrine.

Frequently, attacks upon state rates have raised the question as to the profitableness of the entire intrastate business under the state’s requirements. But the decisions in these cases furnish no ground for saying that the state may set apart a commodity or a special class of traffic and impose upon it any rate it pleases, provided the return from the entire intrastate business is adequate. The doctrine to the effect that a state or state commission can establish a rate not in itself compensatory, provided the mass of the state business is profitable, may as well be discarded.

In the previous chapters it has been shown that the power to determine value and also to fix rates for services rendered by public utilities, is a function of the state legislature, and that
the only instance in which the courts assume jurisdiction is in case of confiscatory rates.

According to this, the relation between the Commission and the public utilities operating in Kansas is, in its legal aspects, the same as that relation which may exist between the commission and the public utilities of any other state under similar conditions.

It is apparent from what I have said in previous chapters concerning capitalization, valuation, depreciation, and rate making that all these are legislative functions exercised through the delegated power of the State Commission. Hence the situation in regard to Kansas utilities is this: The Commission has the exclusive power both of valuation and rate making, and, according to a long line of United States court decisions, this power of the Commission to value and make rates, cannot be abrogated, rescinded, or declared null and void by any court except for the reason that such valuation or rate is confiscatory.

In view of the foregoing it is obvious that, since the dissolution of the Industrial Court in 1921, the regulation of public utilities in Kansas has been in harmony with the rules and regulations which are in force in other states.