

April 1929

Public Utilities--Valuation of Leaseholds

R. P. Holland

West Virginia University College of Law

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Recommended Citation

R. P. Holland, *Public Utilities--Valuation of Leaseholds*, 35 W. Va. L. Rev. (1929).

Available at: <https://researchrepository.wvu.edu/wvlr/vol35/iss4/7>

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STUDENT NOTES AND RECENT CASES

PUBLIC UTILITIES—VALUATION OF LEASEHOLDS.—Appellant gas company, a public utility, has a total of 814,910 acres of gas territory under effective control, principally by lease. Of this amount 136,384 acres are proven territory. 126,208 acres are probable territory, the rest being designated as improbable or unfavorable. Not all the proven territory is now in use. On the “present value” rate base theory the appellant claims that its leaseholds should be valued at \$36,449,176.00 instead of the amount fixed by the commission, \$6,732,920.00, the “book value.” *Held*, “expert” testimony, based upon assumed quantities of gas under lease, but not yet in possession, estimated life of the fields, estimated profits in an estimated and yet to be established “unregulated” market, is not sufficiently clear and positive evidence of “present value” to justify interference with the findings of the commission. *United Fuel Gas Company v. Railroad Commission of Kentucky*, 49 Sup. Ct. Rep. 150 (1929), and *United Fuel Gas Company v. Public Service Commission of West Virginia*, 49 Sup. Ct. Rep. 157 (1929),

These decisions apparently terminate the long controversy begun by the gas company in 1917 with the intention of doubling its rate base by an ingenious appreciation of its leaseholds. 1 W. Va. P. S. C. 504, P. U. R. 1918-C, p. 193; 1 W. Va. P. S. C. 561, P. U. R. 1920-C, p. 583. The present decisions do not question the “present value” theory of the rate base. The Supreme Court assumed the soundness of the proposition that present reproduction value of the property used and useful in the business is to be taken as the primary factor in determining the present value. Thus the latest pronouncements of our highest tribunal still state the theory which has given rise to such immense difficulties. See also, *Mobile Gas Company v. Patterson*, 271 U. S. 131, 46 Sup. Ct. Rep. 445 (1926). No attempt will be made herein to point out those difficulties. That has been done by many writers. See Richberg, “A Permanent Basis for Rate Regulation,” 31 *YALE L. J.* 263; Hale, “The ‘Physical Value’ Fallacy,” 32 *YALE L. J.* 710; Hale, “Pseudo-Protection of Property in Rate Cases,” 24 *MICH. L. REV.* 166. The accepted doctrine of valuation for rate purposes flows from *Smyth v. Ames*, 169 U. S. 466, 42 L. ed. 819 (1898). Increasingly muddled by every new decision, the turbulent flood becomes larger year by year. Justice Brandeis made an examination of 363 cases taken from Public Utility Reports between the years 1920-1923 and found therein eleven distinguishable methods of

arriving at the elusive "present value." Thirty-six of these cases could not be classified, due to an apparent lack of any formula. *Missouri, ex rel. Telephone Company v. Public Service Commission of Missouri*, 262 U. S. 276, 43 S. Ct. Rep. 544 (1923). However, Goddard suggests that the commissions are more willing to accept an improved theory than the courts. "Public Utility Valuations and Rates," 19 MICH. L. REV. 849. Because we have no certainty in this matter every possibility is tried by the utility to the end that rates may be advanced. The public fights back manfully. The result is a compromise, usually without more than a mere approximation to that which *ought* to be the base. *Smyth v. Ames, supra*, allows almost everything "to be taken into consideration" and in the end the result is in the sound (?) judgment of commissions and courts.

Writers almost unanimously denounce the present value theory as a logical fallacy, depending upon artificial and metaphysical reasoning for its support. Every man of affairs knows that there is no value except that based upon the return for service. To hide the "bogey" behind the so-called rule of *Smyth v. Ames* is only temporarily possible. The courts have refused to place the rule squarely upon exchange value. Under such a theory the utility makes its large earnings the excuse for a higher capitalized value, that justifies an increase in rates, which in turn justifies another, and so on, *ad infinitum*. The converse would also be true. If the utility earned nothing on one valuation, then the fault is in the valuation, and to earn a return all that one need do is to make up one's mind that the property is less valuable. The exposure is too rapid—everyone perceives the "vicious circle." What avenue of escape is there?

When one of the series of cases culminating in the decisions here under discussion was before the West Virginia Supreme Court, Judge Meredith expressed the regret of the court that it was unable to follow the famous concurring dissent of Holmes and Brandeis in *Missouri, ex rel. Southwestern Bell Telephone Company v. Public Service Commission of Missouri, supra*, where prudent investment theory was so ably championed for the rate base. Judge Meredith said, "We think the adoption of this as a general rule is to the ultimate interest of the utility, and particularly so to all those utilities that have made heavy outlays during the past few years when prices were extraordinarily high; and that as soon as new low price levels shall have been reached, such utilities will themselves be clamoring for the adoption of the very rule they now so vigorously assail." *Charleston v. Public Service Commission*, 95 W. Va. 91, 107, 120 S. E. 398 (1923). It is not to be seriously contended that the adoption of the prudent

investment base for rates would be a panacea for all valuation ills. No theory will be that. Its adoption becomes more necessary with each passing day, in spite of its disadvantages. See, Goddard in 15 MICH. L. REV. 205, and also, *Stanislaus Company v. San Joaquin C. & I. Company*, 192 U. S. 201, 24 Sup. Ct. Rep. 241 (1904), which case Goddard regards as being the final rejection by the court of this case. It has these positive advantages: It is certain and ascertainable; it is largely free from opinion and speculation; and, it is comparatively constant in the face of price fluctuations. It involves the new concept—that one who has invested for the public interest is entitled to a fair return upon the value prudently invested, when invested, and to a return of that value when the service is finished. It abandons the concept that the property of the utility plus the increment, at the particular moment, is the property upon which a return is to be made. What more could one ask, in the first instance, than the fair return upon the money invested? What, under the present theory, will protect the *utility* when prices go down, as they may at any time?

The difficulties of the present theory are well illustrated in the two cases now before us. If it were not for the appellant's failure of proof of the "present value" of gas under lease the people of West Virginia would be paying nearly double the price which they are now paying for their gas supply. Yet the District Court found that the appellant was earning a fair return on about \$17,000,000.00 more property than the commission said they were entitled to earn upon. Our own court has said that when the gas company can establish the actual present value of the gas in the ground by evidence independent of the rate of return or earnings, and definite enough to be reliable, that it may include that value in its rate base. *Natural Gas Company of West Virginia v. Public Service Commission*, 95 W. Va. at p. 567, 121 S. E. 716 (1924). In spite of the fact that the Supreme Court did not specifically decide the point in the present cases, it is submitted that there are two objections to allowing this supposed value to become a part of the rate base: (1) Gas merely under lease is not "property" in the rate-making sense. Hickenlooper, J. said, "Not only are percolating waters and oil and unrecovered gas in the ground not the subject of ownership until recovered, but, if the subject of ownership, such gas is the property of the owner of the fee until recovered. Not only has such gas no value unrecovered in the ground, but such value as it might have would seem to be the property of the lessor." *United Fuel Gas Company v. Railroad Commission of Kentucky*, 13 Fed. (2d) 510 (1925), citing therein *Headley v. Hoopengartner*, 60 W. Va. 626, 55 S. E. 744 (1906).

It is very clear that there is a substantial difference between gas in untested fields and the tangible equipment of this company. It would be decidedly unfair to the public to allow the utility to hold immense tracts of acreage under lease at a value of some \$200.00 per acre, at a cost of not more than \$5.00 per acre (delay rentals being charged to operating expenses and paid annually by the public) for by this means the utility could earn approximately \$28.00 per annum (\$200.00 multiplied by the 14% return on the base which was allowed). Further injustice could result if the utility should abandon the leases after several years, when the public would have paid in more than even their inflated value. (2) Aside from the question of property, it is submitted that this is a mere capitalization of earning power, which the court has refused to sanction under any circumstances. The true limit of the "present value" theory, even here, would seem to be the present value of leaseholds in the market. Uncontradicted evidence in these cases proved that the gas company had acquired leasehold rights during 1921 to 1923 at an average price of 83 cents per acre, and that in 1923, 15,184 acres were taken at a cost of 66 cents per acre. As before stated, delay rentals were paid by the utility and charged to operating cost. The whole investment amounted only to a few dollars per acre—and the public was asked to double or treble that amount annually in the form of rates on supposititious values, payable into the company coffers.

—R. P. HOLLAND.

CONTRACTS—ALTERNATIVE PERFORMANCES—DAMAGES.—An interesting subject, about which there is an apparent conflict among the authorities, is that of alternative contracts, i.e., such as by their nature may be executed by doing either of several acts, at the election of the party from whom performance is due. Completion of one of the modes, at the option of the promisor, is a performance of the entire contract. Where one of the modes of performance is to pay a sum of money however, considerable difficulty arises in determining whether it is still a true alternative contract, or merely a contract providing for liquidated damages. If the former, then by one rule the measure of damage for breach of the contract is the value of the least onerous alternative, on the supposition that had the promisor performed, he would have taken upon himself the discharge of the alternative the most beneficial to himself.¹ Thus the promisee has only been damaged to that

¹ WILLISTON, *CONTRACTS* (1920) §1407.