

June 1925

## Rate Regulation--The Rate Base--Amortization

C. L. W.

*West Virginia University College of Law*

Follow this and additional works at: <https://researchrepository.wvu.edu/wvlr>



Part of the [Energy and Utilities Law Commons](#)

---

### Recommended Citation

C. L. W., *Rate Regulation--The Rate Base--Amortization*, 31 W. Va. L. Rev. (1925).

Available at: <https://researchrepository.wvu.edu/wvlr/vol31/iss4/8>

This Student Notes and Recent Cases is brought to you for free and open access by the WVU College of Law at The Research Repository @ WVU. It has been accepted for inclusion in West Virginia Law Review by an authorized editor of The Research Repository @ WVU. For more information, please contact [researchrepository@mail.wvu.edu](mailto:researchrepository@mail.wvu.edu).

**RATE REGULATION—THE RATE BASE—AMORTIZATION.**—The subject of regulation of the rates of public utilities, with its many collateral problems, is perhaps the most important and the most uncertain of modern judicial questions. While the courts generally accept the “present fair value” rate base, there is manifest a dissatisfaction with this theory, and a trend of judicial opinion, if not of actual judicial decisions, toward the “prudent investment” theory.<sup>1</sup>

In the West Virginia Public Service Commission case just cited, the present fair value theory is adopted. In the opinion of Stathers, Chairman, the argument is advanced that, to be consistent, if the present fair value is adopted as the rate base, it must also be adopted as to amortization. Divine, Commissioner, argues that only the amount actually invested should be amortized. Two questions at once arise in deciding this point:

1. Is present fair value the proper rate base, and if so,
2. Should amortization of this present fair value be allowed?

Present fair value as a rate base has been severely criticized but generally adopted. Through a long series of cases this theory has been developed until it is now the orthodox theory.<sup>2</sup> In brief, the present fair value rate base permits the utility to earn a fair return based on a consideration of “all relevant facts” which go to make up the present value of the utility as a utility.<sup>3</sup> The “relevant facts” include present replacement cost, less depreciation, original cost, and other items, from which the present fair value is computed or estimated.

The opponents of the present fair value theory contend that it is unfair to the public, in that it permits the utility to earn a return on “unearned increment,” the increased value of the plant not due to any exertion or expenditure by the utility. It is also contended that it is mathematically impossible to determine the present fair value of the utility, and that even if it is once determined, it is such a variable and fluctuating thing that the fair value today will probably not be the fair value tomorrow. As the solution, the suggestion has frequently been made that a return be allowed based on the “prudent investment.” The argument ad-

<sup>1</sup> *Missouri ex rel S. W. Bell Telephone Co. v. Public Service Commission of Missouri*, 262 U. S. 276 (1923), concurring—dissenting opinion of Brandies and Holmes; *Long Branch Commission v. Tintern Manor Water Co.*, 70 N. J. Eq. 71 (1905); *W. Va. Pub. Ser. Com. Case 1516*, in *re United Fuel Gas Co.*, Bulletin No. 91, P. S. C., 38, Mar. 24, 1925.

<sup>2</sup> *Smyth v. Ames*, 169 U. S. 466 (1898); *Wilcox v. Consolidated Gas Co.*, 212 U. S. 19 (1909); *City of Charleston v. Public Service Commission*, 95 W. Va. 91, 120 S. E. 398 (1923).

<sup>3</sup> *Georgia Railway & Power Company v. Railroad Commission*, 262 U. S. 625 (1923); *Natural Gas Co. of W. Va. v. Public Service Commission*, 95 W. Va. 557, 121 S. E. 716 (1924).

vanced in favor of this theory is that it makes possible a rate based on something that is determinable as a fact, and eliminates the uncertainties based on mere opinion or estimate, that are considered the great evil of the present fair value theory.

Undoubtedly present value is difficult to determine, but is that sufficient reason for discarding the theory in favor of the prudent investment theory, if the former theory is otherwise just and reasonable? The "prudent investment" which is hailed as the panacea for rate evils is really, called by another name, practically the same as the historical cost, or actual investment. The exponents of the prudent-investment theory contend that because it eliminates the element of unearned increment from the rate base, it is a more advanced theory than present value. The argument presupposes the desirability of the conclusion. What is the evil in allowing a return on unearned increment?

It is the opinion of the writer that when money is invested in a public utility it should be subject to the same chance for natural increase, or decrease, as is money invested in a strictly private enterprise, and that income, or return, should include a return on this increase, or should make allowance for the decrease, as it does in private business. An investment in a public utility should be neither a sacrifice for the public good nor a guaranteed investment. It is a fact that it is not naturally regarded as such, for public service companies are like private companies in that both are organized with hope of profit, with hope of increase in the value of property, and with hope of a return on such increase. There is of course a tendency of the various commissions to allow a return based on present value or actual investment, whichever is the higher.<sup>4</sup> This tendency is not sufficient excuse for discarding the present value theory. Commissions should be consistent, and, if present value is the accepted rate base, should base the return on that basis in all cases. In that way, and in that way only, can the present value theory be logically applied.

If consistently applied, it is therefore the opinion of the writer that the present value theory, *because* it allows a return on unearned increment, is better than the prudent investment theory.

As to the second question, the amount to be amortized, Chairman Stathers' opinion in the case cited above, was that, present fair value being the rate base, it must also be accepted as the base for amortization purposes. Divine, Commissioner, dissented, on the ground that the theory of amortization was that the utility should

---

<sup>4</sup> Brandies, in *Mo. ex rel S. W. Bell Telephone Co., v. Public Service Commission of Missouri*, *supra*.

have returned to it, in addition to a fair return, the amount actually invested. To adopt the theory of Mr. Divine would be to allow a return on the rate base, present value, including as it does the unearned increment as an element, but to refuse to return to the owners, in allowance for amortization, this unearned increment. This seems to present an inconsistency. If present value is proper as a rate base, why is it not proper when amortization is to be computed? Present value as a rate base is, theoretically and in effect, actually, money "devoted to the use of the public by the utility." In a certain sense this is true, although this money was not all actually *invested* by the owners of the utility. True, the owners have returned to them money they never actually expended, but if amortization of anything is proper, that seems to be the only logical amount to be allowed. To hold with Mr. Divine would be to allow a *return* based on unearned increment, but to refuse to the owners of the utility the *principal* of the same unearned increment.

The instant case, as a problem of rate regulation, presents many other questions of as great importance as those discussed herein, but of such magnitude as to negative the possibility of discussing them in a note of the scope of this. The problem of ascertaining the present value of gas leaseholds, the question as to the various elements proper to be considered in determining present values and a fair return, are elaborately discussed in the opinion of Chairman Stathers. On the whole, the case seems right both in argument and conclusion.

—C. L. W.