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GOING VALUE AS VALUE FOR PURPOSES OF RATE REGULATION

By THOMAS PORTER HARDMAN*

The recent widespread demand on the part of many public utilities to be allowed to increase their rates has made of compelling importance the much disputed question, when or to what extent the "going value" of a public utility is value for purposes of rate regulation. Perhaps no problem of importance in the whole field of law is the subject of more confusion or contrariety of opinion. The question arises, or may be raised, in practically every case of rate regulation. The "going value" of the enterprise usually amounts to a very considerable sum, often to hundreds of thousands of dollars. Yet the courts and commissions have so far failed to settle upon any definite rule as to when or to what extent, if any, this value constitutes a part of the value upon which the utility is entitled to earn a fair return.

Some courts and commissions, while admitting that a utility has an added element of value vaguely called "going value," refuse to make any allowance for such value in rate-making cases. Other authorities expressly allow a definite sum for this element of

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1 Consolidated Gas Co. v. City of New York, 157 Fed. 849; Cedar Rapids Water Co. v. City of Cedar Rapids, 118 Ia. 234, 91 N. W. 1081, sed cf. Cedar Rapids Gas Co. v. Cedar Rapids, 144 Ia. 426, 120 N. W. 986; Contra Costa Water Co. v. City of Oakland, 159 Cal. 323, 113 Pac. 668. For an extended citation of authorities pro and con, and for a fuller citation of authorities on notes 2, 3 and 4, infra, see 1 WHITTEN, VALUATION OF PUBLIC SERVICE CORPORATIONS, §§ 550-644, 2 ibid., §§ 1350-1386.
value. Others allow "something" for "going value"—at least they say they do—but refuse to allow any definite or separate sum. And, to add chaos to confusion, some authorities allow something sometimes, and sometimes not, but (and this applies to many authorities) when and to what extent are left largely matters of mystery.

In the latest ruling on the question by the United States Supreme Court it was held that "going 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." This holding, it might reasonably be supposed, had practically settled the whole conflict; for, inasmuch as the United States Supreme Court is, under the Constitution, the court of last resort upon the question of valuation for purposes of rate regulation, i.e., regulation by statute or commission, it would be supposed that other tribunals would follow the Supreme Court upon this question. On the contrary, however, there has been a tendency on the part of many authorities either to disregard, or to construe away, the apparent effect of the Supreme Court's decision.

A typical illustration of this tendency is the rather recent decision of the West Virginia Public Service Commission in the case of In re Clarksburg Light and Heat Company. In that case the "going value" of the plant, estimated at $360,000, was excluded by the commission on the ground that the "history of the company clearly shows that it suffered no losses." The theory of the

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6 Public Service Gas Co. v. Board of Commissioners, supra. See BEALE & WYMAN, RAILROAD RATE REGULATION, 2 ed., §§ 273, 274.

commission seems to be that of a New York case upon which the commission places much reliance, \textit{viz.}, that "going value" is made up only of uncompensated losses of the earlier years; and that if such losses have been offset by subsequent profits in excess of a fair return, then there is no "going value." Similar rulings have been recently made by the Supreme Court of California in the case of \textit{San Joaquin Light & Power Corporation v. Railroad Commission},\footnote{supra.} by the Maine Public Utilities Commission in the case of \textit{Rich v. Biddeford & Saco Water Company},\footnote{People v. Wilcox, \textit{supra.} See further, as to the New York view, Herman \textit{v. Newton Gas Co.,} (N. Y. P. S. C. 1st Dist.) \textit{P. U. R.} 1916D, 825.} and by several other commissions.\footnote{165 Pac. 16, \textit{P. U. R.} 1917E, 37. For a complete understanding of this troublesome decision, see the case before the commission, \textit{East Bakersfield, etc. Association v. San Joaquin, etc. Corporation}, (Cal. R. C.) \textit{P. U. R.} 1916C, 380.} As these recent cases are subsequent to the above-mentioned United States Supreme Court decision, which is apparently contra, and as some of these cases expressly rely upon that decision as a justification for their conclusions, the important question thus raised is whether "going value" under the Supreme Court doctrine depends in whole or in part upon the continued existence of past deficits.

In order to answer this question adequately it will first be necessary to determine definitely just what "going value" is, for it seems that the whole conflict and confusion on the subject is due fundamentally to a failure to analyze the "elusive, intangible and troublesome thing" in question. What then is "going value," and when or to what extent, if at all, should it be included as a proper part of the value upon which a public utility should be allowed to earn a reasonable return?

First, what is "going value"? As was pointed out in one of the latest cases,\footnote{E. g., Moritz \textit{v. Edison Electric Illuminating Co.,} (N. Y. P. S. C., 1st Dist.) \textit{Case No. 1540, P. U. R.} 1917A, 364; \textit{City of Sparta v. Monroe Telephone Co.,} (Wis. R. C.) \textit{P. U. R.} 1917C, 507; \textit{Roundup v. Roundup, etc. Co.,} (Mont. P. S. C.) \textit{P. U. R.} 1916D, 398.} "experts, courts and commissions" do not agree as to what this "troublesome" thing is. "Some define it as one thing, some another." Now, so long as courts and commissions do not agree even as to what they are arguing about, it is, of course, impossible for them to arrive consistently at harmonious or sound conclusions. Hence, it is necessary at the outset to settle upon some definite meaning as the proper meaning of "going

\footnote{Re Indianapolis Water Co., (Ind. P. S. C.) \textit{P. U. R.} 1917E, 553.}
value'' for purposes of rate regulation; and fortunately the United States Supreme Court, in the above-mentioned case, has supplied a definition which sufficiently expresses the general principle involved. "Going value'' that court defines as "the value which inheres in a plant where its business is established as distinguished from one which has yet to establish its business.''

To express the idea more fully, "going value'' may be defined as the difference between the value of a plant valued as a whole in its present condition and the sum of the values of the various component parts of the plant, considered and valued as a "non-going'' or static plant with its business and operating system yet to establish. It is indisputable that this difference—this "going-concern'' element—is a thing of value; but is it, in all cases and to its full extent, value upon which a public utility is entitled to base its rates? To begin with, just what does this intangible element of value really represent? It is the present representative of the money or money's worth spent in transforming the static "bare bones'' of the plant into the present "going'' concern with its established business. Perhaps the best judicial exposition of the nature of this item of value is the following excerpt from the opinion of Miller, J., in the leading case of People v. Willcox.:

"What then, is 'going value' and how is it to be appraised?

"It takes time to put a new enterprise of any magnitude on its feet, after the construction work has been finished. Mistakes of construction have to be corrected. Substitutions have to be made. Economies have to be studied. Experiments have to be made, which sometimes turn out to be useless. An organization has to be perfected. Business has to be solicited and advertised for. In the case of a gas company, gratuitous work has to be done, such as selling appliances at less than a fair profit and demonstrating new devices to induce consumption of gas and to educate the public up to the maximum point of consumption. None of those things is reflected in the value of the physical property, unless, of course, exchange value be taken, which is not admissible in a rate case. The company starts out with the 'bare bones' of the plant, to borrow Mr. Justice Lurton's phrase in Omaha Waterworks case, supra. By the expenditure of time, labor and money it co-ordinates those bones into an efficient work-

13 Des Moines Gas Co. v. City of Des Moines, supra, 165. For other definitions of "going value'' see Wyer, REGULATION, VALUATION AND DEPRECIATION OF PUBLIC UTILITIES, §§ 536, 555; 1 Whitten, op cit., §§ 636, 580 et seq.
14 210 N. Y. 479, 486, 104 N. E. 911.
ing organism and acquires a paying business. The proper and reasonable cost of doing that, whether included in operating expenses or not, is as much a part of the investment of the company as the cost of the physical property."

It is clear, then, that this "going-concern" element has cost money or money's equivalent. Hence, it is clear that the utility must in some manner be compensated for this expenditure. But how? Is the whole value of this "going-concern" element value upon which the utility may perpetually charge rates? First, it has been argued that those portions of wages of employes which have gone toward creating this item of value must not, if they have already been charged to operating expenses, be also represented in value for purposes of rate regulation; for those wages, having been charged to operating expenses, cannot, of course, be charged also to capital account. This argument, however, as will subsequently appear, cannot be supported. Besides, it is largely brain work (knowledge derived from experience, which is proverbially expensive) that created this item of value; and the value of much of this work is frequently not the result of wages charged to operating expenses. Furthermore, as will appear later, things of value other than work have gone toward creating this "going-concern" element. Second, it must be observed, that under the prevailing doctrine, which for the time being is assumed to be the correct doctrine, the value of a plant for rate-making purposes is not the actual cost of constructing the plant but the properly determined "present value" of the plant. Hence, if any part of "going value" is ever value for rate purposes, it is not the actual cost, but the present value, of that part of the "going-concern" element thus created, that constitutes value for purposes of rate regulation. Third, "good-will" value, though a part of "going value" as above defined, is not a proper element of value in rate-making cases. That point is settled law for the very good reason that, since a public utility is monopolistic in nature, it would obviously be improper to allow the utility to capitalize the value of its monopoly and base its rates upon such capitalization. "Going value," then, for purposes of rate regulation does not include "good-will" value. The ultimate question in all cases, therefore,

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35 See a discussion of this point in 27 Harv. L. Rev. 744, 745.
16 San Diego Land & Town Co. v. Jasper, 189 U. S. 439; Public Service Gas Co. v. Board of Commissioners, supra; see Beale & Wyman, op. cit., §§ 273, 274, 275.
17 Wilcox v. Consolidated Gas Co., 212 U. S. 19; see Beale & Wyman, op. cit., § 276.
is, when or to what extent, if any, this remaining part of "going value" is value for purposes of rate regulation.

It might seem, at first thought, that for rate-making purposes there should also be deducted that cost of production which has been charged to operating expense, and paid for from current revenues, so that there would ordinarily be nothing left in this so-called "going value." But such a result does not follow, for two reasons. First, suppose for the sake of argument that in the particular case the whole of the prima facie expense of developing the business (building up the operating system) has been properly charged to operating expense and paid for from current revenues, there is still an important difference between the value of the static plant with its business yet to establish and the value of the present plant with its business and operating system already established, that is to say, a difference in value which is neither "goodwill" value nor the present representative of expenditures paid for from current revenues. Thus, during the development period, i.e., before a paying business is established, the rates charged by a utility are not sufficient to pay operating expenses and also a fair return upon the capital value of the plant. In other words the investors must wait until a paying business is established before they begin to earn a fair return upon the value of the plant. Now, after this unproductive period it is clear that the utility must be allowed to charge rates which will compensate it for the use of its capital during the unproductive period. Hence, the value of the property with the business established is, as a general rule, enhanced to the extent of a sum equivalent to the sum which the unproductive capital invested would have earned at a fair profit during the unproductive development period. Thus, suppose that the proper capital value of a static plant is $1,000,000 and that during the first year the plant pays only operating expenses. This capital value, invested elsewhere, would have earned a fair return of, say, six or eight per cent., viz., $60,000 or $80,000. This fair return upon that capital, however, has in effect been invested in creating the "going-concern" part of the plant, that is to say, it is now "going value." The second reason why such a result does not follow is that the actual cost of constructing a plant, and therefore the actual cost of constructing a part thereof, is not, by the prevailing doctrine, the proper value thereof for purposes of rate regulation.

This remaining part of going value, then, is an important part
of the value of a plant. But, is it value for rate-making purposes, or, as the question is presented by these recent cases, does it, for rate-making purposes, depend for its existence upon the existence of past deficits? For the sake of convenience this part of going value will, unless otherwise indicated, be hereafter referred to simply as going value.

In the first place, from the foregoing definition and analysis of going value, it seems clear that this "going-concern" element—this operating system—when once it is created, is a continuous instrument of production, that is to say, it is not, like an operating expense, a mere temporary instrument of immediate return, but, like capital expenditure, a permanent instrument of production, which without further outlay, continues year after year to bring in its annual return. Hence, going value possessing, as it does, this, the distinguishing characteristic of capital expenditure, constitutes, upon principle, a part of the capital value of the plant. In the second place, it will be seen that the doctrine of these recent cases allows this capital value to be wiped out by subsequent earnings, for under that doctrine, if there are past deficits there is a corresponding going value, i.e., capital value, but if there are no past deficits, that is to say, if the earnings are sufficient to offset the development cost, then there is no going value; in other words, the going value which, as seen, is capital value, is then wiped out by subsequent earnings. But if this capital value may be wiped out by later earnings, then by the same reasoning all capital value may be wiped out pro tanto by later earnings, and, therefore, if a utility is allowed to charge sufficient excessive rates, the plant's total capital value would be wiped out and the utility, having no value for rate-making purposes, would have to serve the public gratuitously—an absurd conclusion which would seem to establish the fallacy of the doctrine.

Upon this point the following observation of the Interstate Commerce Commission would seem to be entitled to great weight:

"These assets [prior earnings] cannot, however, be considered in the fixing of a reasonable express rate. Even were it true that these companies had accumulated a surplus by the imposition of charges which were, when made, unjust and unreasonable, this commission cannot undertake to distribute that surplus to the public by putting into effect to-day rates which are not fairly compensatory for the present service."

So, Rider, C., in the recent case of Bluefield v. Bluefield Waterworks & Improvement Company:19

"It could not be said in fairness to a utility, that it should be deprived of a fair return on a proper valuation of its property used in the public service at the present time because of excessive earnings it may have realized in the past."

This argument as respects the capital value of physical property would seem to be irrefutable. But certainly all capital value must stand in this respect upon the same footing. It would seem, therefore, that the above-mentioned part of going value is always value for purposes of rate regulation, and that cases which make going value depend in whole or in part upon the continued existence of past deficits, or allow going value to be offset pro tanto by subsequent earnings, proceed upon an erroneous theory as to the fundamental nature of this item of value.

Upon principle, then, it would seem that these cases cannot be supported. But how about the authorities? On this point, since these cases often purport to follow the above-mentioned decision of the United States Supreme Court,20 and since that court is under the Constitution, the court of last resort on the question of valuation for purposes of rate regulation, i.e., regulation by statute or commission,21 it would seem unnecessary to go beyond that decision if that decision is contra to these cases and at the same time in accord with sound principle. First, is there anything in the Supreme Court's opinion to support these recent cases? The only part of the opinion upon which any of these cases seem to rely is the following (p. 165):

"Included in going value as usually reckoned is the investment necessary to organizing and establishing the business; which is not embraced in the value of its actual physical property. In this case, what may be called the inception cost of the enterprise entering into the establishing of a going concern had long since been incurred. The present company and its predecessors had long carried on business in the City of Des Moines, under other ordinances, and at higher rates than the ordinance in question established. For aught that appears in this record, these expenses ["overhead charges"] may have been already compensated in rates charged and col-

20 Des Moines Gas Co. v. City of Des Moines, supra.
21 See note 6, supra.
lected under former ordinances. As we have said, every presumption is in favor of the legitimate exercise of the rate-making power, and it is not to be presumed, without proof, that a company is under the necessity of making up losses and expenditures incidental to the experimental stage of the business.

Does this passage, then, support cases which exclude going value on the ground that there have been no losses, or that the development cost has been offset by later earnings? In the first place, these cases fail to notice that the Supreme Court, notwithstanding its language, did not exclude these expenses but by negative inference approved the allowance of these expenses. In the second place, this passage is only a dictum. In the third place, it is interesting to note, though the point is more interesting than important, that the Supreme Court in the above-quoted passage was not dealing with going value at all, viz., going value as defined by the court, but, to use the language of the court, was dealing with an item of "going value as usually reckoned," viz., "overhead charges" which are "pre-operation" expenses, and, therefore, of course, not an item of technical going value, for these expenses inhere in the plant before the plant starts business and, therefore, before the plant can possibly have a going-concern value. The Supreme Court's decision, therefore, not only does not support these recent cases, but is, so far as it goes, a decision to the contrary, for there is nothing in the Supreme Court case to show that the utility had not "received ample returns" to offset the development cost. In fact, the opinion expressly states that the plant there in question was "a long established and successful plant." In short, the plant was so successful that the gas rates had been reduced by ordinance from $1.30 per thousand to $1.00, and finally by the ordinance in question to 90 cents, and yet this final reduction was upheld by the United States Supreme Court in the case relied upon by some of these cases as justifying an exclusion of going value where the utility had so far "received ample returns." Lastly, it will be recalled that the United States Supreme Court held in that case that the "going value" of such a plant "is a property right, and should be con-

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22 Italics ours.
23 Id.
25 Des Moines Gas Co. v. City of Des Moines, supra, 171.
26 See statement of the case in the lower court, 199 Fed. 204.
sidered in determining the value of the property upon which the owner has a right to make a fair return.\textsuperscript{27} Hence, since the Supreme Court's decision is, so far as it goes, contrary to these cases and in accord with what would seem to be sound principle, it would seem that these recent cases, are wholly without tenable support, and that the aforementioned part of going value is always and to its full extent a proper element of value for rate-making purposes.

Upon principle this conclusion seems quite clear if it is once admitted that the present value of a plant is the basic value upon which the utility must be allowed to earn a fair return. It must be remembered, however, that present value is by no means the universally accepted view as to the proper basic value for purposes of rate regulation, for there are at least four widely diversified views—all sanctioned by some authority—as to what is the proper basic value upon which a public utility is entitled to realize a reasonable return;\textsuperscript{28} and it is undoubtedly to this conflict and confusion that much of the conflict and confusion as to going value must be attributed. Thus, some courts and commissions hold that the \textit{cost of reproducing the plant} in its present condition at present prices is the proper basic value for rate-making purposes;\textsuperscript{29} others insist that the \textit{original cost of the plant} must be taken as the basis;\textsuperscript{30} some say that the \textit{outstanding capitalization} is the proper valuation;\textsuperscript{31} while the prevailing view is that the \textit{present value} of the plant is the proper value, and that any regulation of rates by statute or commission that prevents the utility from realizing a reasonable return upon that value is confiscatory and unconstitutional.\textsuperscript{32}

It is not primarily within the purview of this article to discuss these various theories and for that reason it has been thus far assumed that present value is the proper value. But as many

\textsuperscript{27} Italics ours.
\textsuperscript{28} See Beale & Wyman, op. cit., § 251; Pond, Public Utilities, § 477.
\textsuperscript{29} For a citation of authorities and general discussion of this view, see Beale & Wyman, op. cit., §§ 285-296.
\textsuperscript{30} Coal & Coke Ry. Co. v. Conley, 67 W. Va. 129, 67 S. E. 613 (the "amount of money" actually and properly "invested"). For a further citation of authorities and a general discussion of this view, see 2 Wyman, Public Service Corporations, §§ 1081-1090.
\textsuperscript{31} For a citation of authorities and discussion of this view, see 2 Wyman, op. cit., §§ 1091-1098.
\textsuperscript{32} San Diego Land, etc. Co. v. Jasper, 189 U. S. 439; Public Service Gas Co. v. Board of Commissioners, supra. See Beale & Wyman, op. cit., §§ 273, 274, 275; Wyman, op. cit., §§ 1099, 1100.
courts and commissions do not accept this view, it is, therefore, necessary in passing to dispose of this point, for it is obvious that the question, to what extent, if any, going value is a proper part of capital value, depends altogether upon what is taken to be the proper basis of capital value. Thus, if outstanding capitalization is taken as the proper capital value, clearly going value would not be a necessary part of that basic value. So if original cost is taken as the proper basic value, going value is not necessarily represented in original cost, as that cost is often calculated. Likewise cost of reproduction in present condition at present prices does not necessarily include a full measure of going value. From the very nature of going value it is, as a rule, fully represented only in present value, though, of course, it is, or may be, very extensively represented in reproduction cost, and to some extent perhaps in other basic values. It follows, therefore, that if any basic value other than present value is adopted, e.g., a combination of present value and any other value or values, then going value is or is not an element or to some extent an element of capital value, depending upon the basic value chosen as the proper basis of capitalization. All this may seem somewhat beside the point. Its significance, however, will clearly appear upon an examination of the way in which the question is often dealt with by courts and commissions; and perhaps there is no better case for illustrative purposes than the very recent decision of the West Virginia Public Service Commission in the case of In re The West Virginia Traction & Electric Company. The language there used by the commission in arriving at its conclusion is as follows:

"In arriving at the value of the different items constituting applicant's plant, we have, among other evidences or elements of value, considered the original cost, reproduction cost, and present value, and under the great weight of authorities it is, proper to allow in a case of this character something for going value, organization expenses, etc. In fixing the value of many of the items constituting said plant, the fact that same was a going concern was taken into consideration and due allowance made therefor. In this particular case, the Commission feels that it would not be improper to allow 7 1/4 per cent. on the value of said property thus found by it,
or about $59,700.00, to cover omissions, emergencies, superintendence, etc., usually termed 'overhead expenses,' making the total value of said property on which to pay a return about $853,000.00.\textsuperscript{36}

This holding suggests several interesting and important questions: First, to what extent is such a decision inconsistent with the conclusions reached in the other recent cases under consideration, for there is nothing in the case to show that the utility has not in the past received ample returns? The answer to this question will sufficiently appear in answering the next two questions. Second, the commission states that "in fixing the value of many of the items constituting said plant the fact that the same was a going concern was taken into consideration and due allowance made therefor."\textsuperscript{37} But what is "due allowance?" The case does not purport to overrule the principal case, In re Clarksburg Light & Heat Company, supra, and by the doctrine of the principal case it would seem that "due allowance" would be nothing if the utility had "suffered no losses" or its losses had been recouped from later earnings. At any rate there was no separate allowance made for "going value" and it does not appear whether the "due allowance" was one hundred dollars or one hundred thousand dollars. Hence, the second question raised by such a decision is this: Should there be a separate allowance for going value so that, among other reasons, an appellate court may readily determine whether there was a proper allowance for this "property right." This question for purposes of convenience will be answered after the next. Third—and this is the question with which we are immediately concerned—can the basic value here chosen be justified? As to the latter question, it will be seen that the basic value adopted is a composite value arrived at by expressly adopting several distinct theories as to the proper basic value, \textit{viz.,} [1] "original cost, [2] reproduction cost and [3] present value," and also, to use the language of the commission, "other evidences or elements of value."\textsuperscript{38} Now, to what extent is going value, as above defined, a part of this composite basic value? It would seem to be impossible to answer the question categorically, for it does not appear in what proportions these various theories of valuation are represented in this composite basic value, and, as already pointed

\footnotesize{\textsuperscript{36} Italics ours.\textsuperscript{37} Id.\textsuperscript{38} Id.}
out, whether or to what extent going value is capital value depends altogether upon the basic value adopted as the proper capital value for rate-making purposes. Nor is the West Virginia Commission alone in taking such a position. It has the distinguished company of the Supreme Court of the United States in the leading case of *Smyth v. Ames*. In that case Mr. Justice Harlan, speaking for the court, used the following much-quoted and much-misapplied language:

"We hold, however, that the basis of all calculations as to the reasonableness of rate to be charged must be the fair value of the property being used for the convenience of the public. And to ascertain this value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience."

The inconsistencies in the tests of *Smyth v. Ames*, however, have several times been pointed out, and the view now adopted by the United States Supreme Court, while originating in the inconsistencies of *Smyth v. Ames*, is that the present value of the plant is the value upon which the utility must be allowed to earn a fair return. That is to say, "original cost, reproduction cost," etc., when considered, are to be considered only as a means of arriving at the present value, the proper basic value for purposes of rate regulation. Thus, as stated by Mr. Justice Hughes in the recent *Minnesota Rate Cases*:

"The cost-of-reproduction method is of service in ascertaining the present value of the plant, when it is reasonably applied and when the cost of reproducing the property may be ascertained with a proper degree of certainty."
Hence, since the prevailing view is that present value alone is the value upon which the utility is entitled to base its rates; also, since that is the view of the United States Supreme Court, and since all cases of rate regulation (i.e., regulation by statute or commission) may ultimately come before the United States Supreme Court on the ground that the regulation is confiscatory and therefore violative of the Federal Constitution, present value alone is the value herein adopted (without discussion as to merit) as the proper basic value for purposes of rate regulation. Upon this point Mr. Justice Swayze in one of the leading cases on this question makes the following important observation:

"We are met with difficulties and valid objections whether we adopt the standard of actual investment, of cost of reproduction, or present value. It would be a waste of time for us to go over this discussion. We think it enough to say that the great weight of authority is in favor of the standard of present value. That standard has the sanction of the United States Supreme Court in cases involving the constitutional rights of the companies, and is said by that court to be no longer open to dispute under the Constitution. San Diego Land & Town Co. v. Jasper, 189 U.S. 439, 442, 23 Sup. Ct. 571, 47 L. Ed. 892. Since all cases of the kind may come before that tribunal for final adjudication, and its decisions upon the constitutional question would be binding upon us, we ought to adopt the same rule."

It is not proper, therefore, considering the purpose and scope of this article, to go further into the question as to what is the proper basic value. but the point, which it is both proper and important to emphasize, is that in determining whether, when or to what extent going value is an element of capital value it would seem to be an absolutely indispensible prerequisite to settle upon some definite basic value as the proper value for rate-making purposes; for whether, when or to what extent going value is value for rate-making purposes depends entirely upon the basic value adopted. Hence, unless otherwise indicated, all that is said in this article is said upon the assumption that the basic value is the actual present value of the plant.

The second question raised in the case of In re West Virginia Traction & Electric Company, supra, is whether there should be

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44 See authorities cited in note 32, supra.
45 Public Service Gas Co. v. Board of Commissioners, 84 N. J. L. 463, 87 Atl. 651.

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GOING VALUE FOR RATE PURPOSES

a separate sum allowed for going value or whether it is sufficient simply to allow an indefinite "something." The commission there states that it is allowing "something for going value," and that "in fixing the value of many of the items constituting said plant the fact that the same was a going concern was taken into consideration and due allowance made therefor." But there is nothing in the case to show whether the "due allowance" was one dollar or one hundred thousand dollars. This method of making an allowance for going value is sanctioned by many authorities; but, with great deference, it is submitted that the method above adopted is subject to two valid objections. First, since going value is a property right upon which a public utility "has a right to make a fair return," it is unconstitutional to prevent the utility by rate regulation from earning a fair return upon the present value of its property, including the value of that "property right" called "going value." But, if only an indefinite something is allowed, how can an appellate court, in passing upon the constitutionality of the rate regulation, determine with a proper degree of certainty whether a sufficient amount has been allowed for going value to prevent the rate from being confiscatory? Thus, since it constitutional by rate regulation to reduce rates to a point where the utility may still realize a reasonable return upon the present value of the plant, but unconstitutional to reduce rates below that point, it may well be that a given rate regulation would be unconstitutional if the amount allowed for going value was $100, but constitutional if the amount allowed was $100,000. But where only an indefinite something is allowed it would be practically impossible in many cases for an appellate court to determine whether the amount allowed was $100 or $100,000, and hence, to say the least, very difficult in many cases to determine whether the rate regulation was constitutional, and impossible in practically all cases to determine whether this "property right" was given a proper value.

Some courts and commissions refuse to make a separate allowance, mainly on the ground of the difficulty in ascertaining the amount at which the value should be estimated. Other authorities, mainly on the same ground, refuse to make any allowance

44 Italics ours.
47 See authorities cited in note 8, supra.
48 Des Moines Gas Co. v. City of Des Moines, supra. Italics ours.
whatever. But, as was well said in one of the leading cases,\footnote{People v. Willcox, 210 N. Y. 479, 104 N. E. 911. Italics ours.} "if 'going value' is capable of ascertainment it will not do for the commission vaguely to consider it in fixing the fair rate of return. . . . . . . The difficulty of determining 'going value' will not justify the disregarding of it. Rate making is difficult. But that will not justify confiscation. The difficulty, however, will lessen, as it does in most cases, when we cease to think about the subject vaguely." The court thereupon held, and quite properly, it is submitted, that there should be a separate allowance for going value.

Another objection to allowing only an indefinite "something" as a general enhancement of the value of the separate items of physical property is that such an allowance for going value seems to proceed upon an erroneous theory as to the nature of going value. Thus, in the above mentioned case\footnote{In re The West Virginia Traction & Electric Co., supra.} where this method of valuation was adopted (which by the way is the method very commonly adopted) the various items of property were valued in the following manner: "Meters, etc., $29,000;" "machinery, $26,000;" "fields and city mains and lines, $234,000," etc., but no separate valuation of "going value," for, as we are told, "in fixing the value of many items constituting said plant the fact that same was a going concern was taken into consideration and due allowance made therefor." It will be seen that this method of allowing for going value gives a "going" value to separate "static" items of property, e. g., meters, mains, machinery, land, etc.; but how can that be, for it is of the very essence of going value that it is a value attaching because the thing is a "going" thing as distinguished from a "static" thing? Moreover, the "thing" which has a "going" value must be the "plant as a whole" and not any separate part of the plant, or separate "items constituting a part of the plant;" for, to quote the language of the United States Supreme Court in the Knoxville case,\footnote{Knoxville v. Knoxville Water Co., 212 U. S. 1, 9. Italics ours.} "going value is the "added value of the plant as a whole, over the sum of the values of its component parts, which is attached to it because it is in actual and successful operation and earning a return." Hence, since going value is the "added value of the plant as a whole over the sum of the values of its component parts," it cannot possibly be a value attaching to a component part so as to enhance the value.
of any particular component part or item as distinguished from other component parts or items. It would seem, therefore, that a separate value should be allowed for going value,52 and that cases which purport to allow for going value by simply enhancing the value of some items of property constituting the plant proceed, prima facie at least, upon an erroneous theory as to the fundamental nature of going value. In fact it is believed that almost the whole conflict and confusion on the question of going value is due fundamentally to a failure to analyze the "elusive, intangible and troublesome thing called going value" and to see just exactly what it amounts to in the particular case in question.53

Finally, a word should be said as to the method of estimating the value of this "elusive" item of property. Many courts and commissions, as already seen, estimate its value upon the basis of past losses. With such authorities going value seems to be simply a capitalization of previously accumulated deficits; hence, if no deficits, no going value. But for reasons already mentioned this method of appraisal would seem to be improper; for, to recapitulate, it proceeds, prima facie at least, upon an erroneous theory as to the fundamental nature of going value, and allows capital value to be wiped out by subsequent earnings. Several more or less workable methods of appraisal have been advocated by

52 See in accord cases cited in note 2, supra.
53 It may be argued by those opposed to the "separate-allowance" doctrine that the latest decision on the question by the United States Supreme Court does not hold that there should be a separate allowance. Des Moines Gas Co. v. City of Des Moines, supra. The answer, however, is that the case neither holds that there should be a separate allowance, nor does it hold that it is proper to make an allowance merely by way of a general enhancement. The facts seem to have been these. The case had been referred to a special Master in Chancery to report his findings of fact and conclusions of law. The Master found the "going value" to be $300,000, and was at first disposed to allow that amount as a separate sum, but subsequently decided to make no separate allowance. The Master, however, stated that the plant was valued on the basis of a plant in actual and successful operation, otherwise, as he said, its value would be much less. And on this point the Supreme Court simply held that "in view of the facts found and the method of valuation used by" the Master, the court could not say that the Master did not "sufficiently include this element [of value] in determining the value of the property of this company for rate-making purposes." That is to say, the court would not under the facts of the case reverse because of the method of valuation adopted, but the case is far from holding that a proper method was adopted. In fact a mere reading of the case would seem to show not only that it would have been more satisfactory in that case if the Master had allowed a separate sum, but also that if he had allowed the $300,000 as a separate sum, the Supreme Court would undoubtedly have upheld the separate allowance. The Supreme Court, in fact, had previously upheld a separate allowance for going value in a municipal purchase case, City of Omaha v. Omaha Water Co., 218 U. S. 180, and apparently also in one rate case, Knoxville v. Knoxville Water Co., 212 U. S. 1, 9. On the latter point see Des Moines Gas Co. v. City of Des Moines, supra, at p. 168.
different authorities, but it would seem that, on the whole, the most satisfactory method is a modified form of the method approved by the New York Court of Appeals in the leading case of People v. Willcox. There, to outline the method by using the language of the court, an expert "witness estimated the going value to be $781,916. He explained at length how he arrived at that figure. He assumed the existence of two plants situated exactly alike in the same community and with the same physical property: (1) The actual plant with its established business; (2) a suppositional plant with no business. He then estimated the length of time and expense required by the second plant to develop its business to the stage and revenue of the actual plant."

This method, however, cannot be accepted without some modifications. In the first place, since a plant if improperly constructed, e.g., if constructed too large to meet the reasonable, probable requirements of the community, may base rates only upon the value of the plant as it should have been constructed, so the "suppositional plant," should not, as the court there permitted, be a plant "situated exactly like" the existing plant in the same community and "with the same physical property," but the suppositional plant should be exactly like the existing plant as the existing plant should have been constructed. An estimate should then be made, based upon the length of time and expense that under the circumstances would probably and properly be required by the thus modified suppositional plant to develop its business to the stage and revenue of the present plant. This estimate, of course, would include an estimate as to the fair value of the use of the capital invested during the unproductive period of development, but would not, of course, include "goodwill" value. It would seem, then, that this estimate would represent, for rate-making purposes, the reproduction cost of this item of property called going value, and, hence, in jurisdictions where reproduction cost is regarded as the proper basis of capital value, this estimate would represent the "going value for purposes of rate regulation." It must be remembered, however, that present value, not reproduction cost, is the constitutional basic value in cases of rate regulation, i.e., regulation by statute or commission.

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84 See 1 Whitten, op. cit., §637 et seq; Wyman, op. cit., ch. 12.
85 210 N. Y. 479, 104 N. E. 911.
87 See authorities cited in note 32, supra.
and that the reproduction cost is, to repeat the language of Mr. Justice Hughes, only "of service in ascertaining the present value," that is to say, it is only "evidence of" the proper value of the property for rate-making purposes. As to this particular item of property, however, it would seem that, owing to its peculiar nature, the reproduction cost of the item is on the whole the most satisfactory evidence that can be obtained as to its proper basic value for purposes of rate regulation. Still, of course, the reproduction-cost evidence of the value of this item would not necessarily be conclusive evidence as to its present value, for there may be circumstances under which the cost of reproducing this item new would differ very materially from its present value. For example, suppose that the plant in question is a natural gas plant, that the natural gas in the community is nearly exhausted and that its use is rapidly being supplanted by the use of coal and electricity. It would seem that under such circumstances and many other conceivable circumstances the cost of developing the above-mentioned suppositional static plant to the stage and revenue of the present plant could scarcely be said to represent the present value of the going-concern part of such a plant. In other words, it would seem that the going-concern part of a plant (the operating system), like the physical part of a plant, may become in effect depreciated, in which case it would not seem to be fair to the public to allow the utility to charge rates based upon the reproduction-cost-new of this item of property. Bearing upon this point may be mentioned the following observation by the United States Supreme Court in a case in which a separate sum for going value was included in the total valuation of the plant:

"This valuation was determined by the master by ascertaining what it would cost, at the date of the ordinance, to reproduce the existing plant as a new plant. The cost of reproduction is one way of ascertaining the present value of a plant [and, it should be remembered, the Supreme Court holds that the present value of a plant includes going value] . . . . ; but that test would lead to obviously incorrect results, if the cost of reproduction is not diminished by the depreciation which has come from age and use."\textsuperscript{58,59}

Hence, it would seem that the reproduction cost of this intangible item of property, just as the reproduction cost of physical

\textsuperscript{58} In The Minnesota Rate Cases, \textit{supra}. Italics ours.
\textsuperscript{59} Knoxville v. Knoxville Water Co., 212 U. S. 1, 9. Italics ours.
property, should be translated, where circumstances so require, into the present value of the property. This may seem to be an unduly complicated and difficult process. "But," as was observed by the New York court in the passage above quoted, "the difficulty of determining the going value will not justify" confiscation. Besides, the process of determining the present value of this item of property after ascertaining the reproduction cost thereof would not differ from the ordinary process of determining the present value of physical property after first determining its reproduction-cost value. It is submitted, therefore, that the above outlined method of appraisal is not only simple enough to be practical, but, when properly applied, well adapted to effectuate complete justice both to the public and to the utility.