

MUNICIPAL OWNERSHIP OF PUBLIC UTILITIES

Continued from the March Issue.

STATUS OF MUNICIPAL ENTERPRISES.

Gas and electric plants, tramway and telephones held and operated by a city are business enterprises;⁴² and when a public corporation goes into business it is peculiarly amenable to the general rule stated by the Supreme Court: "The same principles of right and justice which prevail between individuals, should control in the construction and carrying out of contracts between the government and individuals."⁴³

These enterprises are in a sense private property as distinguished from municipal buildings and other accessories of government.

Without discussing how far the governmental property of a city is exempted from the pursuit of creditors,⁴⁴ it appears that these undertakings are not immune. They can be mortgaged and so foreclosed on default. They can be taken in execution of judgment.

It is not necessary to consider here questions regarding the continuance of service in such eventualities, though I note a recent decision to the effect that an undertaking deemed to be of public necessity—waterworks in this case—should not be sold for taxes, but should be placed in a receiver's hands.⁴⁵

DISCONTINUANCE OF MUNICIPAL OWNERSHIP.

A public service when once installed is likely to be maintained. Discontinuance of municipal ownership will usually mean the transfer of an undertaking to another body, and not its abandonment.

Of voluntary discontinuance it is only necessary to say that when a city has embarked on an undertaking by permission of

⁴² See *Baily v. Philadelphia*, 184 Pa., 594; *Illinois Trust Co. v. Kansas City*, 76 Fed. Rep., 232.

⁴³ *United States v. Utah & Nevada Stage Co.*, 199 U. S., 423. See also *Little Falls, etc. Co. v. Little Falls*, 102 Fed. Rep., 663.

⁴⁴ See *Meriwether v. Garrett*, 108 U. S., 472.

⁴⁵ *Covington v. District of Highlands*, 113 Ky., 612.

the State, it cannot abolish or sell it without the State's consent.⁴⁶

Involuntary discontinuance may conceivably result from private action—foreclosure and sale under a mortgage, for example—or it may be caused by the State.

Remarking that the State may oust a city from the management of an undertaking by reason of maladministration, the municipality saving of course whatever property rights may have become vested in it, we pass to what may become a question of interest.

In case the State brings several undertakings—tramways, for example—under a single public authority, and one of them is owned by a city, is there a mere shifting of control from one political corporation to another, or is there a taking of communal property calling for compensation?

As the undertaking is in a sense the private property of the community, and so is not subject to the State's pleasure, it would seem that substantial compensation is due whenever the change of owners involves a pecuniary detriment to the community.

When an undertaking is returning a profit the city should not be forced to part with it without indemnity for loss of revenue.

Furthermore, an undertaking which the community have paid for for their own use may, in the merger, contribute to the larger district a very substantial benefit—for example, when a municipal power plant is capable of serving outlying territory lying within the new district. In such case the legislature should provide for compensating the community for their excessive contribution; for, as they would not have taxed themselves originally for a plant for outlying service, they should not be compelled to donate a going concern to this service.

ENTERPRISES TOO EXTENSIVE FOR MUNICIPAL CAPACITY

The municipal ownership programme assumes that the city is competent to administer all the services proposed. The assumption is correct in respect of gas, electric, telephone and tramway enterprises performing service only within a town, but when these serve a larger territory we have to consider whether, if public ownership be planned, the owner should not be a political corporation of broader jurisdiction.

⁴⁶ See *Huron Water Works Co. v. Huron*, 7 S. Dak., 9; *Indianapolis v. Gas Co.*, 144 Fed. Rep., 640.

The service area of a private company is within the discretion of the legislature. The company can be readily authorized to maintain a single undertaking in any number of political divisions—cities, villages, townships, even in two or more States. However extensive its range it will nowhere conflict with any political corporation, but will be subject in each division to whatever local governance may be requisite and lawful.

How is it with a city? Each of our communal subdivisions has its peculiar place in a system of government. Therefore, in turning from the company to the city we turn from an elastic to a rigid body, from a voluntary organization of commercial purpose to an institution vested with the dominant duty of governing a community and subject to the law of political jurisdiction.

A city, like every other governmental organization, acts within a defined area, and is generally incompetent to exercise jurisdiction beyond it. Commonly jurisdiction and territory are coterminous.

Does this rule forbid a town to perform utility services beyond its limits? Or is this permissible on the theory that it pertains to business and not to politics? Applying the theory of business capacity, there seems to be no constitutional objection to one town acting as a mere purveyor to another. When A contracts to supply so many gallons of water to B it acts simply as a vendor of commodities. It exercises no jurisdiction in B's territory but simply delivers water to a system which B owns and administers. So the municipal proprietor of a lighting plant might deliver gas or electricity to its neighbors' distributing plant.

Furthermore, a city might, without causing embarrassment, operate certain utilities in a suburban district having no municipal government of its own.⁴⁷

Is not a different question presented in case a city seeks to operate an undertaking in and for another town?—when one political corporation proposes to exercise in another functions for which the latter is equipped? Can there be properly attributed to Metropolis, whose political jurisdiction is rigidly delimited by metes and bounds, a jurisdiction of indefinite extent which, though of a business nature, involves a certain use and control of streets by metropolitan boards and their employees and a corresponding supersession of local authority?

⁴⁷ See *Henderson v. Young*, 83 S. W., 583, Ky., 1904.

The question has not been sufficiently adjudicated to enable us to say positively how far one city can be empowered to exercise such jurisdiction in another, at all events against the latter's wish. But, constitutional questions apart, I think a brief survey of the utilities under consideration—especially great tramway and telephone systems—will show how unlikely is their public ownership to be vested in single cities.

We need not anticipate many serious attempts at city ownership of telephones in this country.

Few communities would be satisfied without the long distance service; and this a city could not administer effectively. Yet a company would find an exclusively long distance service unprofitable; and, if it operated in local competition with a municipal service, both would probably suffer.

If the service is to be performed by the public it is likely to be managed by States, perhaps even by the United States.

The embarrassments involved in municipal operation of widely ramifying undertakings are notably illustrated in the case of tramways.

Originally designed, as a rule, for urban passenger service, these now usually serve suburban districts, frequently link groups of towns, and are reaching out for freight and mail. Originally laid along highways exclusively, many of them now occupy long lengths of their own right of way, often competing with the short, and occasionally with the long service of great railway systems. In some cases they have been acquired by these systems, and the electrification of railways will bring the two services still closer.

The capacity of a municipal corporation to own a great steam railway was considered by the courts nearly forty years ago, when the city of Cincinnati took advantage of a statute authorizing it to finance the construction of a line from that city to Chattanooga, Tennessee, called the Cincinnati Southern Railway, and to administer its interests by a board of trustees.

Judge Dillon justly says that the decision of the Supreme Court of Ohio sustaining the act,⁴⁸ subverted "all previous notions of the appropriate powers, functions and duties of municipalities."⁴⁹

⁴⁸ *Walker v. Cincinnati*, 21 Ohio St., 14.

⁴⁹ *Municipal Corporations*, p. 229, note.

The decision has not found favor elsewhere,⁵⁰ and it seems to be discredited even in Ohio.⁵¹

But if, for some reason or other, a city might be invested with capacity merely to own a great railroad, it would be difficult to devise a lawful and effective scheme for municipal operation.

The considerations of public convenience and economical management which long since welded short railways into trunk lines are quite as influential in the case of tramways, and I assume that, as a rule, a public ownership scheme will not find favor unless it preserves this unity of service. How, then, shall unity be maintained? Shall a single city manage a system serving its neighbors? Shall two or more cities exercise joint control? Or shall some larger political corporation specially created for the purpose override all the municipalities interested and assume entire control?

In Great Britain we find examples of single management of a sort.

Manchester, for instance, operates an extensive system in this way: It leases from certain suburban district councils the lines within their limits, paying "an annual rental sufficient to pay off in the twenty-one years' term of the lease the capital outlay of the local authority in connection with the purchase and reconstruction of the tramway." Manchester assumes "the entire financial obligation in connection with the tramways" in question, and is to "maintain the tramways during the period of the lease, and to hand over the track in good condition to the local authorities at the end of twenty-one years." It also operates lines in Salford and Ashton under running power agreements with these corporations, retaining out of the receipts the operating expenses only.⁵²

The Manchester plan might serve in this country for a system comprising a town and its suburbs, but it would be inadequate for our great systems.

Joint management by two or more towns might, perhaps, be worked out on paper.

But either single or joint municipal administration would tend to arouse jealousies and conflicts as to the apportionment of receipts and expenses, and would increase that tendency to confused

⁵⁰ See *Sun Publishing Co. v. New York*, 152 N. Y., 259; *Attorney General v. Pingree*, 120 Mich., 550.

⁵¹ See *State v. Pugh*, 43 Ohio St., 120.

⁵² Royal Comm. on London Traffic, III, pp. 849, 850.

accounting which is observed even when a town is managing an enterprise of purely local interest.

The truth is the tramway in this country has outgrown or is rapidly outgrowing municipal capacity for its administration.

If the private companies now owning the great systems are to be supplanted, these are not likely to be split up among the towns they serve.

Their unity will be maintained, if not extended. Each system will be managed by a public corporation specially created, or else they will be consolidated and operated by the State.

In the former case the State would probably delimit districts conterminous with the given undertaking, which would be administered by a board of control, following in a general way the precedents suggested by the districts and boards created for levee, drainage, and irrigation works.

MUNICIPAL OWNERSHIP FROM THE STANDPOINT OF PRIVATE INTERESTS

Having considered the capacity of municipalities in respect of public utility works, we come to the effect of municipal ownership schemes upon the persons whose property or business will be affected by their execution.

TRADERS

When a political corporation engages in a business within the normal field of private enterprise, private traders may complain that they are subjected to a competition which is unfair because their public rival draws its capital from the community and is not committed to profit-seeking.

The spread of municipal trading in Great Britain has provoked such complaints from plumbers, stone-cutters, manufacturers of electrical supplies and others whose business has been affected by the production and sale of their commodities by public authorities. English publicists of high standing voice a well-supported opinion that private enterprise has already been affected by municipal trading and would be seriously compromised by its enlargement—a welcome result, be it noted, from the socialist's standpoint.

Like conditions in this country will bring like complaints.

There seems to be no redress at common law for damage thus done by private business by an authorized public competitor; in-

deed, it remains to be determined whether a private trader would have sufficient standing in court to prove a lack of authority.

It would seem, however, that in case a public corporation should compete in a manner which the law condemns as unfair between private parties it could be called to account.

It is interesting to note in this relation that in France merchants are not without opportunity to complain of public competition. For example, at the instance of the bakers of Poitiers, the Council of State set aside a municipal project to subsidize a coöperative bakery.⁵³

PUBLIC SERVICE COMPANIES

The enterprises chiefly affected by the municipal ownership programme are those conducted by public service companies, but we need not consider in detail the bulky and complex body of law relating to these companies. The present purpose will be served by indicating their relation to the programme in a very general way.

As their undertakings are distinguished from ordinary business enterprises in being open to private activity only by the State's permission, the companies are correspondingly differentiated from the ordinary business corporation, and it is material to define their distinguishing characteristics and their leading types.

The Operating Company

All public service companies occupying streets are in a sense lessees in respect of the premises, inasmuch as the streets belong to the community, and when occupation is granted for a term they are somewhat like lessees in the quality of their tenure.

But this general relation of lessor and lessee is quite different from the one created by the formal lease of an undertaking by a city to an operating company. Here is municipal ownership in its simplest form, and regarding the law of the matter it is only necessary to say at present that it is, broadly speaking, conventional, being embodied in the terms of the contract.

Public ownership with private operation upon terms at once fair to the community and attractive to operating companies is coming into favor as a reasonable basis for the installation of certain undertakings.

⁵³ P. Mercier: *Les Exploitations Municipales en France*, p. 226.

The Proprietary Company

The majority of the companies are, as regards the community, proprietors of the undertakings they operate, though as we develop their position we shall perceive that in some respects proprietorship of public utility works differs from ownership of ordinary property, being a peculiar interest defined by public grant—an interest always limited in quality and generally in duration.

There are certain companies with special charters, but most of them are chartered under general laws applicable to all their kind in the State, and this practice is now embodied in the generality of State Constitutions.

The general standing and capacity of a company is measured by the quality of its franchise to perform the given service, and it must be understood that whatever limitations inhere in or are attached to this franchise are largely due to the company's use of the highways.

Monopoly franchises are now rarely granted. Indeed most States forbid them.

Perpetual franchises are also exceptional in these days. In some States they are forbidden by the constitution. In others they are discouraged by public opinion.

A franchise is usually granted for a fixed term, often with provision for one or more renewals. This is a favored form of concession to tramway companies. But in Massachusetts the concession "is perpetual in theory, though in point of fact revocable at any time."⁵⁴

In some States the Constitution makes all franchises subject to amendment and revocation. In others, charters and general laws frequently contain a like provision.

Note here that while the forfeiture of a franchise through legal proceedings, or its repeal in virtue of a reserved power, may give the city an opportunity to continue the undertaking on its own account, it does not necessarily transfer the company's plant to the public.

Repeal of a franchise simply means the cutting off of a corporate privilege, and even its forfeiture does not necessarily involve the confiscation of the property acquired under it.⁵⁵

⁵⁴ Report of Massachusetts Committee on Street Railways, 1898.

⁵⁵ See *People v. O'Brien*, 111 N. Y., 1.

How far the processes of repeal or forfeiture can be effectively employed by the State to depreciate the franchise value of a coveted undertaking, may become a question of practical concern.

Public service companies differ from the ordinary run of private corporations in being subject to a peculiar State regulation covering such matters as the charges, method and quality of service, etc. The degree of regulating power is measured by the terms of the charter and by general rules consistent with constitutional principles, and with such charter privileges or exemptions as amount to valid contracts between the State and the company.

This brief survey of public service companies shows that they perform services which the community might undertake on its own account and are subject to responsibilities to the public in consideration of the privileges they receive, and that they are corporations of limited scope, and often of brief, occasionally of precarious tenure.

Because of these things it is perhaps not surprising that the propaganda for municipal ownership is more or less disfigured by a notion that these companies are really public corporations, and that private interests therein are comparatively negligible.

The company is not a public corporation, nor will calling it "quasi-public" affect the measure of its substantial rights. It represents a group of individuals organized for profit; and this pecuniary motive should be emphasized in view of the disposition to exaggerate public, at the expense of private interests. Now it is true that a public service company "exercises a sort of public office," and its undertaking "is established primarily for the convenience of the people;"⁵⁶ yet such phrases merely emphasize the public duties of a private corporation.

Much of the company's property is of a peculiar kind, but its interests are of substantial and often enormous value. Hence, whenever a city in executing a municipal ownership scheme has to reckon with a company it is confronted by private interests entitled to full protection.

With this preliminary sketch of the public service company let us consider its relation to municipal ownership projects.

Whenever a municipal ownership scheme touches private interests we may expect a controversy.

Now, in every controversy it is of prime importance to determine the parties immediately interested, and intercorporate rela-

⁵⁶ See *Donovan v. Penn. Co.*, 199 U. S., 279.

tions are so common and often so complicated that in some cases it will require great care and, perhaps, adjudication to determine the precise company with whom the city has to deal.

It has been decided that a holding company—that is to say, a company formed to acquire stock of other companies—has no direct interest in any proceeding for transferring the undertaking of one of the controlled companies to a public authority.⁵⁷

When one company has acquired control of another by purchase of stock the latter is a party interested. And a company leasing its works would seem to be in like case, though both purchaser and lessor may have claims to recognition. When one company has been so merged into another as to lose its identity of course it has no interest.

A company is affected by a municipal ownership scheme when its income is reduced by municipal competition, or when its undertaking is actually acquired by a city, either in pursuance of provisions incorporated in its charter or by way of expropriation or ordinary purchase.

A public service company can check municipal competition only by producing a contract excluding it.

Occasionally we find a service contract with a city of this kind.⁵⁸

More often, however, a company will endeavor to avert competition by alleging a charter contract of monopoly.

In this case it is not enough for a company to show that its franchise bars out private competitors. In order to check a municipal competitor it must present a charter distinctly allowing it to hold the field against the city.⁵⁹

Rarely is a modern service company so strongly entrenched. Occasionally, however, a company has proved a monopoly excluding a public competitor,⁶⁰ and a widespread development of the municipal ownership programme would doubtless encounter here and there monopolies of like breadth.

Furthermore, monopoly of a sort may be shown and yet fail to support the allegation: While a grant of monopoly may be so phrased as to comprehend all means of performing a certain

⁵⁷ *Kennebec Water District v. Waterville*, 97 Me., 185.

⁵⁸ *Potter County Water Co. v. Borough of Austin*, 206 Pa., 297. See also *Vicksburg Waterworks Co. v. Vicksburg*, 185 U. S., 65.

⁵⁹ *Electric Co. v. Newton*, 42 Fed. R., 723; *Joplin v. Electric Light Co.*, 191 U. S., 150; *Knoxville Water Co. v. Knoxville*, 200 U. S., 22.

⁶⁰ *Walla Walla v. Water Co.*, 172 U. S., 1.

service—such sweeping grants are rare. Thus a gas monopoly is not equivalent to a general lighting monopoly which would be impaired in point of law by an electric light service, though in fact this might greatly depreciate its value.⁶¹

Proof of monopoly will not in point of law check municipal competition when the city has the power to condemn whatever property is needed. For the legislature in granting a monopoly, however broad and permanent its terms, does not and cannot release it from subjection to the eminent domain. But as such a monopoly has a peculiar, and usually a very high value, its establishment in a particular case will increase the cost of a municipal enterprise—perhaps beyond the city's intention, possibly beyond its borrowing powers.

ACQUISITION OF PRIVATE ENTERPRISES

An immediate development of the municipal ownership programme suggests a greater initial activity in acquiring the works of private companies than in constructing new ones.

The services in question are at present largely performed by companies, and we should not anticipate a general installation of competing public works, for it is commonly agreed that as a rule the best service is more or less monopolistic, and in many cases municipal competition would mean a contest wherein the city could disable its rival only by prodigal expenditure.

In these circumstances companies are more concerned with the possible acquisition of their properties than with municipal competition.

ACQUISITION BY PURCHASE

When a city negotiates with a public service company under a mere authority to purchase its works the latter is a free agent in fact as well as in law.

This authority, however, will frequently be coupled with a power to expropriate, or, more accurately, the power will be reserved for use in case negotiation fails. Hence the legal freedom of the company to stand out for its own price may be somewhat qualified in fact by the threat of expropriation.

Authority to purchase should be carefully safeguarded in the public interest, for a sentimental zeal for public ownership is

⁶¹ *Gas Co. v. Parkersburg*, 30 W. Va., 435.

quite likely to open a way for owners of unprofitable works, and there are many such to unload them on the community.

ACQUISITION UNDER CHARTER STIPULATION

Certain companies have constructed works under a stipulation that these can be acquired at a future date by the public, which may be represented by the State itself in the case of such extensive works as steam railways, and by a city in the cases of present interest.

When the stipulation involves simply a power to purchase works at any time, without specifying terms, there is no particular relation between the company and the city. The latter is merely invested at the outset with a power that could be conferred in the future.

A contract is proffered whenever the statute under which a company acts authorizes a city to acquire the undertaking at a fixed or contingent date, and deals with the terms of acquisition, either defining them or providing a method for their ascertainment, as by arbitration.

While the legislature is wholly incompetent to dictate the measure of compensation in cases of expropriation, it is, in the matter of statutory purchase, free to fix the terms in advance, for here it merely offers a contract. A company accepting this agrees to its provisions, and I cite several cases illustrating these provisions and their interpretation.

The English Tramways Act⁶² enables a public authority to buy out a tramway company "upon terms of paying the then value (exclusive of allowance for past or future profits of the undertaking, or any compensation for compulsory sale or other consideration whatever) of the tramway and all lands, buildings, works, materials and plants of the promoters suitable and used by them for the purpose of the undertaking." The House of Lords has decided that the "tramway" is not synonymous with the "undertaking," but means simply the structure, and the "then value" is what it would cost to construct the work at the date of sale with deduction for depreciation, and does not include rental value.⁶³

⁶² 33-34 Vict., Ch. 78, S. 43.

⁶³ *Edinburgh Tramway Co. v. The Lord Provost*, 1899 (A. C.), 456; *London Street Tram. Co. v. London County Council*, 1894 (A. C.), 489. See also *London Tram. Co. v. London County Council*, 1905, 1 K. B., 316.

When the price paid on a statutory purchase is to be determined "without enhancement on account of future earning capacity or good will or on account of the franchise," evidence of past profits is not admissible.⁶⁴

In *National Waterworks Co. v. Kansas City*⁶⁵ the company enforced a contract of purchase under a statute which ordered the city to buy the works at the end of twenty years if no renewal were effected. Mr. Justice Brewer held that the city did not take title to the works by operation of the law, leaving the company to sue for compensation, but must first pay their "fair and equitable" value—not the mere cost of reproduction, but the worth of the undertaking as a going concern. "It should pay, therefore, not merely the value of a system which might be made to earn, but that of a system which does earn."⁶⁶ He held that if the city had become disabled from holding all the property originally contemplated by the statute, the company was nevertheless entitled to be paid for its entire property, leaving the city to settle its own responsibilities later.

Usually acquisition of an undertaking at the end of a term calls for a payment of money to the company, but a contract may be so framed as to oblige it to seek its reward during the term, leaving the public authority free to take possession without payment.

Before leaving the subject of purchase under charter contract I call attention to a question of general importance.

When the original scope of an undertaking has been subsequently enlarged by statutory authority—as when a company chartered to serve a city, thereafter, under additional powers, extends its service to outlying territory—has the city a right under the original statute to dismember the undertaking and acquire only the urban section, or can it acquire the whole?

In any event, when the undertaking cannot be split up without loss, the company is entitled to have it treated as a unit to the extent of insisting upon payment for at least whatever injury the taking of a part would inflict upon the remainder.

Returning to the question of municipal power, there is reason to argue that, by enlarging the scope of the work, the legislature has impliedly repealed the city's original right of purchase.

⁶⁴ *Newburyport Water Co. v. Newburyport*, 168 Mass., 541.

⁶⁵ 62 Fed. R., 853.

⁶⁶ See also *Norwich Gas & El. Co. v. Norwich*, 76 Conn., 565.

When the legislature authorized the extension of the work it should be presumed to have intended the single undertaking to serve a larger territory. This greater undertaking the city cannot dismember by setting up an earlier statute permitting it to acquire a smaller one. Nor, under the original contract, can the city acquire the enlarged work, for, even if it be constitutionally competent to perform the service beyond its limits, it cannot do this without express authority. Its powers will not expand automatically with the expansion of the company's service. Nor can the legislature compel the company to sell its additions upon the terms of the original contract, for they were not made under those terms.

In these circumstances it appears that the city can be empowered to acquire the whole undertaking only by new legislation authorizing purchase or expropriation.

ACQUISITION BY EXPROPRIATION

The legislature can authorize the expropriation of any public utility work, whatever the charter provisions respecting the term and conditions of the company's life, for its property is always subject to the eminent domain.

Invariably a public authority must find its warrant for an expropriation in some act of the legislature. Invariably it must follow the statutory directions in respect of condemnation proceedings.

These elementary propositions require no discussion here. We are concerned with the application of the constitutional rule that private property shall not be taken for public use without just compensation.

The legislature cannot prescribe the amount of compensation,⁶⁷ nor indicate the principles of assessment, nor can it withdraw this or that claim of property from consideration.⁶⁸

The assessment of compensation is primarily a matter for impartial appraisers who, in ordinary cases, are usually a jury, but, unless a jury is required by the Constitution, the legislature may authorize the appointment of commissioners.⁶⁹

Commissioners are generally preferable for determining the complex questions involved in the expropriation of public service

⁶⁷ *Pa. R. v. B. & O. R.*, 60 Md., 263.

⁶⁸ *Monongahela Nav. Co. v. United States*, 148 U. S., 312.

⁶⁹ *Norwich Gas Co. v. Norwich*, 76 Conn., 565.

companies, and in a case involving both individual and company property a jury has been designated for one and a commission for the other.⁷⁰

The expropriation of a public service company by a public authority differs in some respects from an ordinary exercise of the eminent domain.

This usually means a taking of property in order to put it to a new use—as when farm land is taken for a railway. In the present case there is no change of use, but simply a change of owners.

In ordinary cases the property taken is real estate only, but, as a rule, the real estate interests of a public service company consist largely of easements in public streets and highways—easements of varying quality and of no value except in connection with the company's franchise.

Usually, when a strip of land is condemned for a railway or a street, part of a tract only is acquired, and the question of consequential injury or benefit to the remainder will be considered in assessing compensation. Here there is rarely a remainder; an entire property—a complete business—is acquired.

Usually the eminent domain is exercised by a political corporation or a public service company against the property of a private owner. In these circumstances property is frequently somewhat overvalued by appraisers. But when a community expropriates a company the Courts may be called upon to correct under-valuations due to prejudice.

The Measure of Compensation.

It must be understood at the outset that there is no comprehensive practical test for compensation. The market value of the property is to be ascertained, and this is composed of various elements. Elements of enhancement, elements of depreciation; none, as a rule, of singular predominance but each more or less influential.

The elements considered in valuing a strip of farm land taken for a highway are comparatively simple. In valuing a public utility work they are very complex. One case involves property of the commonest sort; the other a business enterprise, distinguished from the ordinary in being an undertaking within public competency which, actually, is confided to private hands.

⁷⁰ *Kennebec Water Dist. v. Waterville*, 96 Me., 234.

Expropriations of gas and electric works and tramways have been so infrequent in this country that we have no substantial body of precise precedents in the matter of compensation.

However, the general principles of assessment are well established, and very pertinent applications have been made when a public authority has acquired waterworks, or has thrown open toll bridges and turnpikes, or freed navigation from tolls imposed by chartered companies.

For convenience of consideration let us divide the property of a public service company into two parts, the plant and the franchise, though in the last analysis these are generally valued together as inseparable elements of the whole enterprise.

The plant includes all the tangible property connected with the work. This is to be valued generally in the light of its use, though if any part has a greater value for another use this must be allowed; for example land occupied by a gas-holder may have a greater value for general business purposes.

In valuing a plant the cost of construction, less depreciation, and the cost of duplication, may be considered as elements, but not as measures of value.⁷¹

It is well settled that a franchise is property for which a company is entitled to full compensation in the event of expropriation.⁷²

I have remarked that the municipal ownership programme seems to be more inspired by discontent with company management than by confidence in public management, and this animus is expressed in the contention that corporate franchises should be lightly estimated in assessing compensation.

Now the franchises of a public service company are commonly a most valuable part of its enterprise; indeed, dissociated from the franchise to perform the particular service, its tangible belongings are frequently of comparatively little value. If, then, franchises were lightly esteemed investors would suffer a heavy and unexpected loss.

Fortunately for investors, valid franchises cannot thus be disparaged, but whenever a company claims a franchise it must show

⁷¹ *Kennebec Water District v. Waterville*, 97 Me., 185; *Montgomery County v. Bridge Co.*, 110 Pa. St., 54.

⁷² See *West River Bridge Co. v. Dix*, 6 How., 507; *Water Comm. of White Plains*, 176 N. Y., 239; *Monongahela Nav. Co. v. United States*, 148 U. S., 312.

a precise and valid statutory warrant. The State can allege, and the Court determine a discrepancy between claim and proof.

The burden of proof is on the claimant; and doubtful claims are to be resolved in favor of the State, in virtue of the familiar rule.⁷³

In appraising the franchise of a particular company the precise terms of the charter are of the first importance, but these are too variant to be considered here in detail. Suffice it to say that the value of a particular franchise increases with its duration, with its liberality in the matter of rates and operating conditions and with its tendency to promote a monopoly, whether legal or actual.

The campaign for municipal ownership owes much of its strength and all its virulence to animosity against public service companies. These are charged with overreaching the community in getting franchises, with greed and negligence in management. This is not the place to weigh these charges, but it is worth while to consider whether in the event of expropriation they can be lawfully preferred in a condemnation proceeding for the purpose of depressing the value of franchises.

In this relation the opinion of Judge Lacombe in *Consolidated Gas Co. v. Mayer, Atty. Gen.*,⁷⁴ is of interest. The New York State Commission of Gas had, in valuing the property of the gas company for the purpose of fixing its rates, excluded the value of certain franchises because "they were granted by the people without compensation." "That is so," said Judge Lacombe. "The franchises were granted very many years ago, at a time when there seems to have been no intelligent appreciation of the fact that they might become enormously valuable; when reckless improvidence was the rule and all sorts of franchises were given away without any provisions for securing to the State its fair share of unearned increment thereon. Nevertheless, when the State offers a franchise to whomever will take it, without requiring any money return thereon and for the sole consideration that the taker shall promptly, continuously and fully develop it by the expenditure of his own money, and such offer is accepted and the terms of the agreement carried out by the taker, there results a contract, which, with due consideration of all proper conditions and limitations inherent in the nature of the particular contract, is as much within the protection of the Constitution as

⁷³ *Blair v. Chicago*, 201 U. S., 473.

⁷⁴ N. Y. L. J., June 11, 1906.

are all other contracts. If the State twenty-five or fifty years thereafter should say to the taker: 'We were very improvident in not providing that you should pay us something each year for this franchise; therefore, hereafter you shall pay us eight per cent annually on \$10,000,000 or \$20,000,000, or we will evict you from the franchise,' it might find itself embarrassed by the provisions of the Constitution in thus undertaking to avoid the results of its own improvidence.

"A franchise, whatever its value may be, which has not expired, nor lapsed, nor been in some way forfeited, is property in the hands of its holder. There is force in the argument that when the State says: 'We will value this property at several millions of dollars when we tax you on it, but at nothing at all when we fix the rate you may charge for your product in order to receive an eight per cent return on your property,' it is seeking to accomplish by indirect methods what it might not be able to accomplish directly."

The Supreme Court of Maine has lately held that when a public authority expropriates the property of a water company the actual charges for service may be scrutinized in estimating the value of its franchise, but it refused to allow evidence tending to show past overcharges, either for the purpose of suggesting the liability of the franchise to forfeiture for abuse, or for the purpose of deducting aggregate overcharges from the present value of the property.⁷⁵

This means that the State cannot take advantage of condemnation proceedings to discipline its companies by giving evidence of their shortcomings in depreciation of property values. When discipline is deserved it is to be applied in direct proceedings.

There are public service companies whose valuations of their property may, in the event of expropriation, be called inflated because they are based upon an alleged "overcapitalization."

"Overcapitalization" is being widely discussed. Its meaning, its effect, even its existence in any sense prejudicial to the community are subjects of controversy. On the one hand it is denounced as a major source of corporate evils. On the other it is dismissed as unsubstantial, the argument being that whatever the face value of a stock issue the market price fixes its actual value, which is the only real matter of importance.

⁷⁵ *Kennebec Water District v. Waterville*, 97 Me., 185.

We need not now thresh out this intricate subject. The question of present interest is whether a public service undertaking may be overcapitalized to the public detriment, and, if so, whether, in condemnation proceedings, this detriment can be shown in abatement of compensation.

A claim that any excess of capital over the cost of duplicating the work, or at least over the original cost less depreciation, is inflation, denies any value to the franchise. The claim is preposterous. The franchise is property of substantial value, frequently exceeding the value of the tangible property of the company. The question turns, therefore, on the proper method of valuing the franchise.

The value depends on its earning power, which depends largely upon the service charges, and it is settled that these must be reasonable.

When the charges are within a maximum fixed by a charter contract, it would seem that their reasonableness is to be presumed—the company is taking a lawful advantage of its rights.⁷⁰ But companies subject to the general obligation to collect no more than reasonable charges are accused of collecting charges which are essentially unreasonable because they are fixed with a view to an income on watered stock—on an excessive valuation of the franchise.

When capital stock has been issued by a company in conformity with law—that is to say, by the State's permission—it is not perceived that the issue can be disparaged by the State in a condemnation proceeding on the ground that it has worked a detriment to the public. If detriment ensues this is not necessarily consequent from the issue itself, but is, as I have said, referable to making it the basis for really exorbitant rates.

Now, whatever can be done with rates in a direct suit involving their reasonableness, it does not appear that they can be attacked collaterally in a condemnation proceeding for the purpose of depreciating the franchise.

Such proceedings are not apt for the determination of collateral issues. They are statutory methods for ascertaining a particular fact, and nothing else. Nevertheless, if a company should back its claim for compensation by evidence which fairly puts in issue the reasonableness of its rates, the question would then be pertinent.

⁷⁰ See *Cleveland v. Cleveland Electric Ry.*, 201 U. S., 529.

Coming to the appraisal of a public utility work as a whole I call attention to several points of interest.

The market price of a company's stock has been received in evidence.⁷⁷

Such evidence is useful when a price has been naturally maintained for a long period, but it is of little account when the price has fluctuated widely or has been maintained by manipulation.

The profits of a business are an evidence of its value.⁷⁸

In the recent expropriation of the waterworks of the New River Company by the Metropolitan Board of London the company claimed compensation on the basis of an asserted right to pay unlimited dividends. The Arbitration Court decided that dividends were limited to ten per cent per annum,⁷⁹ and this decision was finally confirmed by the House of Lords, Lord Chancellor Halsbury dissenting.⁸⁰ In consequence the company, which claimed £13,000,000 compensation, received water stock worth about £6,000,000.

The uncertainties of business forbid the fixing of compensation by capitalizing earnings.⁸¹ This prohibition works both ways. The company will not be unduly benefited by a season of prosperity or unduly prejudiced by a season of adversity.

Dramatic justice might now and then be meted to companies by holding them down to valuations of their property in their tax returns, when the law requires a statement of full value, but true justice is not spectacular. Tax returns are occasionally pertinent,⁸² but, as a rule, they have not much evidentiary value.

It is well settled that in assessing compensation no regard is to be paid to whatever influence the anticipation of expropriation may have upon the price of the property.

This principle of our law is concisely expressed in a late English statute:⁸³ "In fixing compensation the Arbitration Court shall not make any allowance for compulsory sale and shall not take into account any enhancement or depreciation of the market value of any stock or shares of the company which, in the opinion of the

⁷⁷ *Mifflin Bridge v. Juniata County*, 144 Pa. St., 356.

⁷⁸ See *Monongahela Nav. Co. v. United States*, 148 U. S., 312.

⁷⁹ 20 T. L. R., 303.

⁸⁰ 20 T. L. R., 687.

⁸¹ See *National Waterworks Co. v. Kansas City*, 62 Fed. Rep., 865.

⁸² See *Newburyport Water Co. v. Newburyport*, 168 Mass., 541.

⁸³ *Metropolis Water Act*, 2 Edw. VII, C. 41, S. 23 (8).

Court, was caused by or resulted from the passing or the anticipation of the passing of this Act.”

This principle may be of substantial importance to our public service companies for, if the market price of company stocks should be depressed by a threat of expropriation, this will not be permitted to depress the amount of compensation.

When a State undertakes to regulate the charges of a public service company the principles for ascertaining that fair valuation of the business which must be determined in order to obtain a true basis for charges⁸⁴ may be studied with advantage in cases of expropriation.

In a Federal case growing out of the pending controversy over rates between the gas companies in New York and the State Gas Commission, Judge Lacombe said: “If, untrammelled by competition, a company charges a price far above all reasonable cost to the helpless consumer, who must pay the price or go without, while it receives an exorbitant return on such of its property as is invested in enterprise, the State may step in and reduce that price to such sum as will, taking everything into consideration, be a reasonable return upon what has been adventured in the enterprise on the faith of the State’s franchises. No one disputes this proposition.”⁸⁵

Now, strictly speaking, there is “adventured” in a public utility enterprise only the money actually expended—the cash investment with its interest charges. This alone is at risk. But the learned judge does not mean to measure the value of an undertaking by the sum actually adventured, for in a later paragraph he says: “Under the authorities, in fixing the rate to be charged for ‘public service’ by private corporations, two elements of calculation are of fundamental importance: What is the true present value of the property embarked in the enterprise? and, what, in view of the risks of the business, is a fair annual percentage of return thereon?”

“The true present value of the property embarked in the enterprise” fairly indicates the constitutional equivalent due to the owner upon expropriation. He can exact nothing more when

⁸⁴ See *Smyth v. Ames*, 169 U. S., 466; *Milwaukee Electric Ry v. Milwaukee*, 87 Fed. R., 577; *San Diego Land Co. v. National City*, 174 U. S., 739.

⁸⁵ *Consolidated Gas Co. v. Mayer*, N. Y. L. J., June 11, 1906. See also *Richman v. Gas Co.*, N. Y. L. J., Aug. 16, 1906.

this value falls below the sum invested; he need accept nothing less when the value exceeds the investment.

The several elements and evidences of value tending to enhance or depreciate compensation, all lead to a single point, the value of the property in a negotiation which each party is willing, but neither is obliged to consummate. In theory of constitutional law the just compensation, the fair price payable on the forced sale is the price supposed to be fixed in open market.

Method of Payment

Regarding the manner of paying compensation we note the familiar rule of our constitutional law that it must be made or secured in advance, and pass to the question whether the company can insist upon being paid in money.

The "compensation" prescribed by our constitutional law has been generally accepted as meaning money. Doubtless this definition has been the more readily accepted because our expropriations have not been on so vast a scale as to render cash payments embarrassing, much less impossible.

But in the event of a widespread development of the municipal ownership programme there is likely to be a demand that expropriated companies be paid in public obligations, and if public ownership of the railways be seriously urged its promoters will contemplate paying in bonds the billions required for their acquisition.

In default of domestic precedents for giving obligations in lieu of money they are likely to be sought abroad.

Apart from the cases where foreign governments have openly confiscated property, or have taken it on the more or less plausible plea of restoring it to its rightful place in the public domain, they have expropriated recognized private interests without paying cash, but making a more or less adequate compensation in other property or in obligations. In this fashion they have dealt with great agrarian problems and the suppression of serfdom.

Such expropriations are of purely political purpose. They aim to suppress or ameliorate vicious social conditions, and are not to be classed with expropriations of private enterprises in order to exploit them for the public benefit.

Coming to foreign cases akin to our subject, we note that in the recent acquisition of railways by Switzerland the stockholders received public obligations in payment. Italy is acquiring lines

on like terms; and the Railway Nationalization Law of Japan provides for purchase within a period of ten years—the “purchase money to be delivered within five years from the date of purchase, in public loan bonds bearing five per cent interest calculated at their face-value.”⁸⁶

In the Metropolitan Water Act,⁸⁷ authorizing the Metropolitan Water Board of London to acquire private waterworks, we find this specific instance of municipal expropriation without cash payment: “The sum payable to the New River Company as compensation for the transfer of their undertaking shall be discharged wholly in water stock, and the amount thereof shall, in default of agreement made in accordance with the permissions of Section 2 of this Act, be determined by arbitration under this Act.”

Had slavery in the United States been extinguished by law instead of by war, it may be conceded for the sake of argument that the huge indemnity due to the owners would have been equitably paid in bonds instead of cash, because, while the owners might not realize all the money nominally due, the taxpayers would obtain no pecuniary equivalent whatever for their contribution—making a free gift for a moral consideration.

In authorizing the taking of private property for actual public use our legislatures have rarely given the Courts opportunity to review attempts to expropriate property on any other than a cash basis.

But an early Federal case afforded an opportunity for establishing a principle. A Pennsylvania statute attempted to oust settlers from lands acquired under what was known as the Connecticut Grant, and to give them other lands as compensation. The whole Act was declared invalid, and on this point the Court said: “By the Act the equivalent is to be in land. No just compensation can be made except in money, compensation is a recompense in value, a *quid pro quo*, and must be in money. True it is that land or anything else may be a compensation, but then it must be at the election of the party; it cannot be forced upon him.”⁸⁸

⁸⁶ Financial and Economic Annual of Japan, 1906, p. 187.

⁸⁷ 2 Edw. VII, C. 41.

⁸⁸ *Van Horne's Lessee v. Dorrance*, 2 Dall, 315.

In accordance with this principle it has been held that the expropriated party cannot be compelled to accept public obligations in lieu of money.⁸⁹

If municipal ownership shall advance, whether it shall move cautiously or run a course even more swift and reckless than the earlier public adventures in railways may depend on this very question as to payment of compensation in bonds. And improvidence and injustice will be encouraged if public authorities, instead of being obliged to go into the market for compensation money on the best terms obtainable, may issue promises to pay and hand them to the expropriated owners, who must shoulder the uncertainty of their market value.

If bond payments are valid, the voting body can force promises to pay upon expropriated owners to any amount within the debt limit. If they are invalid cash must be borrowed in the market. The investor will scrutinize the terms and the security offered, and the attraction of offers will decrease with their volume. In fine, private capital will be in a position to impose some check upon public extravagance.

As the law stands whenever the State expropriates the property of a public service company compensation means cash, and nothing else.

TAXATION.

The relation of municipal ownership to taxation, which has been referred to from time to time, is sufficiently important to require special consideration, first as to levying taxes upon municipal enterprises, and then as to levying taxes in aid of them.

TAXATION OF MUNICIPAL ENTERPRISES

A city will not tax its own enterprises, though, be it noted, if it acquires an enterprise from a company which has paid taxes these will be cut off and it will be impelled to make good the loss from service charges or from new taxes.

The taxing powers of Federal and State authorities, however, are worth considering.

In *South Carolina v. the United States*,⁹⁰ the Supreme Court held that the State's liquor dispensary system is not an integral part of its government, and that consequently its liquor traffic is

⁸⁹ *Butler v. Sewer Comm.*, 39 N. J. L., 665.

⁹⁰ 199 U. S., 463.

subject to the Federal internal revenue tax, saying: "It is reasonable to hold that while the [United States] may do nothing to prevent the full discharge by [a State] of its governmental function, yet whenever a State engages in business which is of a private nature that business is not withdrawn from the taxing power."

This decision affirms a Federal right to tax whatever business enterprises may be undertaken by a State or its subordinate political corporations.

An Australian case is of interest in this relation. Section 114 of the Constitution reads: "The Commonwealth may not impose any tax on property of any kind belonging to a State." And it has been held that this precludes the collection of duties on materials imported for State railways.⁹¹

Coming to a State we find that when it levies a tax on private corporations the acquisition of their undertakings by municipalities would withdraw these from the operation of the law.

Whenever a State collects taxes from gas, electric and tramway companies, and these are acquired by cities, the State revenue will be depleted without being benefited by receipts from service charges, for these will flow into city treasuries.

Unquestionably a State can, unless restrained by some peculiar constitutional provision, tax the business enterprises of its cities; and this may be done either to recoup loss of revenue or to raise additional funds.

It has been held that property connected with a municipal undertaking and lying in another local taxing district may be there taxed—for example sources of water supply.⁹²

Reviewing the position of taxing authorities, their ability to tax municipal business undertakings and the securities issued therefor is broadly established. Policy will dictate their course, and I should say that taxes are likely to be imposed whenever revenue from private enterprises is seriously depleted by the transfer of these to cities, and, perhaps, will be levied whenever a city management yields profitable returns.

TAXATION FOR MUNICIPAL ENTERPRISES

A city will rarely undertake a public utility work without recourse to taxation; and it will call for taxes until the returns shall

⁹¹ *Attorney General v. Collector*, 1903 State Rep., N. S. W., p. 115.

⁹² *Newport v. Unity*, 68 N. H., 587. Compare *Rochester v. Rush*, 80 N. Y., 302; *People v. Hess*, 157 N. Y., 42.

have paid the original cost and meet the yearly expenditure.

In some cases this condition will be long deferred. In others it may never be reached because of mismanagement. When the management aims to cheapen service at the taxpayer's expense it will not be looked for.

In case a city acquires the works of public service companies from which it has collected an annual revenue, this will cease.

Unless it obtains a sufficient yearly surplus from receipts and applies this to make good the loss, it will be impelled to replenish the treasury by new or higher taxes.

The new burden will fall immediately upon the visible taxpayers—the property owners, but a great body who may view this complacently, thinking they pay no taxes because they receive no tax bills, will not wholly escape; in paying rent they bear a part of the burden.

Taxpayers themselves are by no means equally equipped to safeguard their interest in the municipal ownership programme. Male residents of voting age have at least their own ballots. Non-residents, minors and, as a rule, women have none.

The development of municipal ownership in Great Britain has provoked a peculiar grievance, which may be duplicated here. Railway companies complain that municipal taxation of their property is increased to finance competing public tramways, as to which their widely scattered stockholders have no opportunity to vote.

In this country manhood suffrage is the rule in municipal as in State affairs, and the occasional criticism that this imposes unjust burdens on the taxpaying class is set aside, if not answered, by saying that any economic injustice is slight in comparison with the political injustice that would follow the restriction of the suffrage to substantial taxpayers.

But if cities are to embark upon great business enterprises requiring enormous funds for their promotion and calling for thrift in their management, this opinion may not serve. We may contemplate the advisability of giving greater weight to taxpayers in such cases.

Whether a municipal ownership scheme shall deal fairly or unfairly with the body of taxpayers is largely a matter of legislative discretion, but the individual taxpayer has a legal right to enjoin the collection of tax unlawfully levied.

When the illegality consists in a departure from the provisions of a valid statute the city is simply required to alter its procedure. When the tax is unconstitutional it must be abandoned.

CONCLUSIONS

An American city is constitutionally competent to own and operate gas and electric works, telephones and tramways for common use; provided the cost be within the municipal debt limit.

But the programme for municipal operation, and, indeed, for municipal ownership as well, seems likely to be shortened, sooner or later, by cutting out the tramway and the telephone as being too extensive for effective management by a merely urban authority. This will place these great utilities in a class with steam railroad and telegraph lines, so far as the question of public operation is concerned.

None of the undertakings embraced in the programme may be forced upon the city by the State. The initiative belongs to the community which, as a rule, must express its wish by a popular vote.

A city cannot, however, proceed without the State's permission. This the legislature may grant by a general statute, but the better practice requires a community to submit its project to a central authority.

An undertaking belonging to a city is in a sense its private property and is, in some aspects, a business enterprise.

Being a business enterprise, the city, in conducting it, is largely governed by the rules of commercial law; yet, because the city is a part of the government, it can rarely manage the undertaking with true commercial freedom, for it is more or less hampered by the deliberate processes and the rigid rules which are essential to an honest and prudent handling of public moneys. The more complex the enterprise the louder the call for a free hand, and the greater the city's embarrassment.

As the undertaking is not devoted to governmental use the State cannot deal with it at pleasure, but, because it is not so devoted, creditors may pursue it and superior authorities tax it.

When an undertaking is established, its conduct is subject to State regulation and supervision; and it cannot be transferred or discontinued without the State's consent, nor yet by the State's order, unless this respects whatever municipal property rights would be impaired by its execution.

At present the propaganda for municipal operation shows signs of abatement. Here, the cost of acquiring private works has far exceeded expectations; there, a debt limit has blocked the way. But, quite apart from these local checks, the propaganda, as a business proposition, seems to have lost ground generally.

I think it has lost ground as an adjunct to municipal home rule, for, whatever the just claims of a community to self-government, it is perceived that a commonwealth cannot safely give its cities a free rein in business adventures. In truth, the State supervision being demanded for public service companies must, in matters of finance, be intensified for municipal operating authorities; for the former are spending their own money while the latter handle public funds—other people's money. By thus enlarging its sphere of activity a community would invite a deeper intervention in its affairs by the State, acting through a centralized bureaucracy.

More manifestly, municipal operation is losing ground as a business proposition. Foreign experience does not seem to be generally encouraging, and while domestic experiments are too few to furnish a decisive argument pro or con, prudent men are coming to realize the obstacles in the way of a satisfactory municipal operation of complex business enterprises.

Whatever the future course of the movement for municipal operation, the weakening of business support leaves room for the predominance of revolutionary ideas.

I am inclined to think the movement will more and more reflect political theories of a socialistic type. Not all its advocates will profess the creed of socialism, but its advocacy will increasingly display that cocksureness of the business capacity of communities this creed parades, and that intolerance of facts and figures which characterizes its presentation.

The attitude of trade unionism is of interest in this relation. Public authorities must keep an "open shop," but certificate legislation may here and there give a substantial preference to union labor; and in the matter of wages and hours public employees may have an apparent advantage over private by way of legislation and by political pressure. But far-sighted unionist leaders realize that socialism does not promise that stimulus to industrial enterprise which affords the best opportunity for the workingman.

The apparent abatement of the movement is not accompanied by abatement of that mistrust of public service companies which so greatly contributed to its inception.

Now, so far as existing companies are concerned, they cannot be bought out against their will, nor expropriated without just compensation for whatever property they possess; and in this property are included all valid franchises, even those which may have been granted improvidently.

The making of improvident grants has suffered a check, and with this wholesome reaction there is a growing inclination toward arrangements between public authorities and operating companies, wherein the former will not give away exorbitant rights in the public highways and the latter will perform the needed services upon assurances of opportunity for a reasonable reward.

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