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Public Utilities -- Valuation of Leased Property and Jointly Owned Property

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Public Utilities—Valuation of Leased Property and Jointly Owned Property.

Mandamus[1] to compel the Interstate Commerce Commission to ascribe a definite value under section 19a of the Commerce Act to complainant's interest in: (a) the joint use, with the owner, of twelve miles of track, under a perpetual lease, rental being adjusted every five years by agreement, and in case of failure to agree, by arbitration; (b) the Grand Central Terminal under perpetual lease up to 50 per cent of the terminal's capacity, used by complainant with the owner, rental being complainant's share of the operating expenses and that proportion of 4½ per cent interest on the cost of construction which the use made by complainant bears to the total use; (c) the Boston terminal arising from ownership of 80 per cent of the stock in the Terminal Company, and the use of 75 per cent of the terminal's total use, rental being proportioned to use and the aggregate rental paid by all the carriers to equal, in addition to each user's share of the operating expenses, the interest on outstanding bonds and 4 per cent on the capital stock. *Held:* The duty to ascribe a definite value was not so clearly and definitely imposed by statute[2] as to be enforceable by mandamus.[3]

The present case leaves open the important question of how regulatory bodies shall value for rate making purposes the property not owned by the utility, but used by it in the public service. The Interstate Commerce Commission uses the following methods of valuation where there is a division of interest between ownership and use: (1) jointly owned and jointly used property is ascribed to the respective carriers in conformity with their agreement as to ownership, and in the absence of agreement as to ownership, in proportion to use;[4] (2) property owned by a common carrier, but used jointly

[1] Interstate Commerce Commission v. New York, N. H. & H. Ry. Co., 287 U. S. 178, 53 Sup. Ct. 106, 77 L. ed. 132 (1932).

[2] Valuation Act of 1913, 37 STAT. 701, 49 U. S. C. A. §19a. §19a requires the commission to determine the value of all the property owned or used by the carrier for its purposes as a common carrier. §15a (2) provides for the establishment of rates that will earn an aggregate annual net railway operating income equal to a fair return upon the aggregate value of the railway property of such carrier held for and used in the service of transportation. §15a (1) provides that "net operating income" means railway operating income including in the computation debits and credits arising from equipment rents and joint facility rents.

[3] Three judges dissented but reserved their reasons until the question of correct valuation is raised in a rate controversy.

[4] Lessees Buffalo Creek Ry., 141 I. C. C. 1, 5 (1927); Central Ry. of New Jersey, 149 I. C. C. 659, 682 (1929).

with others for common carrier purposes is valued as property of the owning carrier only;[5] (3) property exclusively used by a carrier and owned by some other party, is valued as the property of the user.[6]

Where property owned by some other party is partly used by a carrier the use is not valued; where such property is wholly used by a carrier the use is valued, indeed, the full value of the property is ascribed to the user. This seems inconsistent;[7] if the whole use of the property carries with it the whole valuation of the property for rate purposes, why does not part of the use carry part of the value?

The basic theory in determining what property of a public utility should be valued for the purpose of allowing the utility to charge rates which will earn a fair return on that value, is that property used or useful in furnishing utility service will be included in the valuation. If this theory were consistently followed, property leased in whole or in part would be valued during the period of the lease and to the extent of the lease as the property of the lessee utility. The rental should not be considered as an operating expense of the lessee utility, neither should it be considered as income of the lessor utility, for rate purposes. The lessee's stockholders would thus profit if the rent were less than a fair return on the fair value of the property, for the rates of the lessee, so far as possible, would be so fixed as to allow a fair return on that fair value, and the rent being less, lessee's stockholders would have the difference. Lessor's stockholders would be paying this difference. That is, if the lease had not been made, lessor would have been entitled to a fair return on the fair value of the leased property; instead lessor now receives the rent, which is less. Accordingly, lessee's stockholders profit by a lease advantageous to lessee, and lessors stockholders lose. Conversely, if the lease were disadvantageous to lessee, in the sense that the rent were more than a fair return on the fair value of the leased property, lessee's stockholders would lose and lessor's would gain. The rate paying public would not be affected at all by the question of which utility made the better bargain. They would pay precisely

[5] *Ex parte* No. 42, 84 I. C. C. 1 (1923); Texas Midland Ry., 75 I. C. C. 1, 21, 23 (1918).

[6] Texas Midland Ry., *supra* note 5, 20, 122; Georgia Ry., 125 I. C. C. 551, 561 (1927); Minneapolis, St. Paul & S. Ste. M. Ry. Co., 143 I. C. C. 547, 592 (1928).

[7] Esch, *Valuation of Leased Railroad Property* (1924) 33 YALE L. J. 272, 279.

what they ought to pay, a fair return on the fair value of the property, and they would pay that return to the utility using the property in their service.

On the other hand if any method is followed whereby the value of the leased property is included in the rate base of the lessor, it follows that the rent must be included as operating income of the lessor, otherwise its customers would be paying a full return on property already earning a return. By corollary, the rent must be deducted as an operating expense of the lessee. The result is that where the rent is more than a fair return on the fair value of the leased property, the customers of the lessee pay too much, that is, more than a fair return on the fair value of the property used in utility service, and the customers of the lessor pay too little. Conversely, when the rent is less than a fair return on the fair value of the rented property, the customers of the lessor pay too much; they pay the difference between a fair return on the property and the rent.

The decisions of state regulatory bodies on the right of lessee utilities to have the leased property valued in the rate base are not in harmony. In the *Chicago Elevated Railways* case the Illinois Commission refused to allow the lessee the value of the leased property and said, "In the absence of improper payments as rentals the public is not concerned with the acts of the companies between themselves, and the public has discharged its full duty when it reimburses the carrier for all proper expenses paid out as rentals."[8] On the other hand, the New York Commission has said that, "the trend of decision indicates that property leased by a public utility, used exclusively in its business, proved to be used or useful, should be valued on the same basis as the other property, the rental for such property under the lease being excluded from operating expenses."[9]

[8] *Re* Metropolitan West Side Elevated Ry. Co., P. U. R. 1921B, 229; Bay State Rate Cases, P. U. R. 1916F, 221 (Mass.). For cases refusing to allow value to favorable contracts generally see: Pub. Serv. Com. v. Flathead Valley El. Co., P. U. R. 1926C, 822 (Mont.); Fuhrmann v. Cataract Power and Conduit Co., 3 P. S. C. 2d D. (N. Y.) 656, cited in WHITTEN, VALUATION OF PUBLIC SERVICE CORPORATIONS (2d. ed. 1928) 77.

[9] *Re* United Traction Co., P. U. R. 1927D, 637; Landon v. P. U. Com., P. U. R. 1918A, 31 (S. C.); Moore v. Valley Ry. Co., P. U. R. 1919F, 493 (Pa.); *Re* Cinn. Gas & El. Co., P. U. R. 1916F, 416 (Ohio); Milwaukee El. Ry. & Lt. Co. v. City, P. U. R. 1919D, 504 (Wis.). For cases allowing value to favorable contracts see, Valparaiso Lighting Co. v. P. S. Com., 190 Ind. 253, 129 N. E. 13, P. U. R. 1921B, 325 (Ind.); Duluth Street Ry. Co. v. Minn. Com., 4 F. (2d) 543, P. U. R. 1925D, 226 (Minn.); San Joaquina Co. v. Stanislaus County, 233 U. S. 454, 34 Sup. Ct. 652, 58 L. ed. 1041 (1914).

The writer has been unable to find any case where a state regulatory body has been sustained in refusing to consider in the rate base any leasehold shown to be of substantially greater value than the rental paid.

Proceeding upon the theory that an advantageous lease has value, rather than upon the theory, above advocated, that leased property should be valued as property of the lessee, it would seem that the complainant in the instant case would have little reason to object to the Commission's refusal to value the twelve miles of track under (a), *supra,* since the rental is adjusted every five years, by arbitration if necessary. Such a lease could hardly have any value in excess of the rental paid, and the value assigned to the total of complainant's property as a going concern. It would seem, however, that complainant's interest in the Grand Central Terminal under (b), *supra,* might be of substantial value, since complainant pays as rental a rate of interest on the original cost somewhat less than the rate of return allowed under the recapture provision of the Commerce Act,[10] and under *Smyth v. Ames*[11] and the *O'Fallon*[12] case, is entitled to a return upon the present value rather than original cost. The same is true of the interest in the Boston Terminal, (c) *supra,* where only 4 per cent is paid upon a proportionate share of the capital stock used for the construction of the terminal.

In order to prevent all such difficulties arising from a disparity between rent and a fair return on fair value, it would seem both practicable and desirable to have the Interstate Commerce Commission police the rentals paid for leased property, as is now done in a few of the states in the case of leases by local utilities.[13] If such supervision were exercised and the rental fixed at a fair return upon the fair value of the leased property,[14] it would make little difference

[10] 41 STAT. 488-491, 49 U. S. C. A. §15a (6) (1920).

[11] Smyth v. Ames, 169 U. S. 466, 18 Sup. Ct. 418, 42 L. ed. 819 (1898).

[12] St. Louis & O'Fallon Ry. Co. v. U. S., 279 U. S. 461, 49 Sup. Ct. 384, 73 L. ed. 798 (1929).

[13] West Jersey and Seashore Ry. Co. v. Board of P. U. Com., 87 N. J. L. 170, 94 Atl. 57 (1915). The New Jersey statute provides, "No public utility . . . shall without the approval of the Board [of Public Utility Commissioners] sell, *lease,* [author's italics] mortgage or otherwise dispose of or incumber its property, franchises, privileges, or rights, or any part thereof; nor merge or consolidate its property, franchises, privileges, or rights, or any part thereof, with any other utility . . . ." N. J. COMP. STAT. (Supp. 1924) p. 2887, §167-24 (H).

[14] Where the lessee is unable to earn a fair return on the fair value of its property, the rent might be fixed at a figure which would pay the rate of return on the value of the leased property which the utility is able to earn on its other property.

whether such property was included in the rate base inventory of the owner or in that of the lessee, since the ultimate result upon both the utilities and the public would be the same. An Act of Congress giving the Commission similar authority over all leases of lines and equipment as it now possesses over extensions and withdrawals[15] and over security issues[16] would perhaps produce the end desired.

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Quasi-Contracts—Filling Stations—Recovery by Lessee for Defects in Equipment.

Plaintiff orally contracted to purchase gasoline and oil daily from defendant at one cent per gallon above tank wagon prices, the one cent being paid as rent for the premises and tanks and gasoline pumps. Within sixty days plaintiff found he was losing money and a series of complaints to the defendant suggesting that there was a leak in the tanks elicited as many assurances from the defendant that there could be no leaks. Finally defendant dug up the tanks and found a leak therein. Plaintiff alleged defendant was under a duty to inspect the tanks and to keep them in repair, and sued for loss sustained by the leakage. Defendant's demurrer to the complaint was overruled and this was sustained on appeal.[1]

The possibility that suit upon the facts above might be successfully based on landlord and tenant law does not present itself. It is settled law that in the absence of a covenant to the contrary, there is no duty on the lessor to keep the premises in repair.[2] And it is generally held that the lessor does not impliedly covenant that the premises are suitable for the use which the lessee intends to put them to.[3]

The North Carolina court based its decision on the implied contract growing out of the assurances by the defendant and the reliance thereon by the plaintiff. The opinion emphasized the generality with which a cause of action for money received may be

[15] 41 STAT. 477, 49 U. S. C. A. §1 (18) (1920).
[16] 41 STAT. 494, 49 U. S. C. A. §20a (1920).
[1] Andrews v. National Oil Co, 204 N. C. 268, 168 S. E. 228 (1933).
[2] I TIFFANY, LANDLORD AND TENANT 87; Richmond v. Standard Elkhorn Coal Co., 222 Ky. 150, 300 S. W. 359 (1927), 58 A. L. R. 1423 (1929); Smithfield Improvement Co. v. Coley-Bardin, 156 N. C. 255, 72 S. E. 312 (1911), 36 L. R. A. (N. S.) 907.
[3] Duffy v. Hartsfield, 180 N. C. 151, 104 S. E. 139 (1920); Federal Metal Bed Co. v. Alpha Sign Co., 289 Pa. 175, 137 Atl. 189 (1927); Plaza Amusement Co. v. Rothenberg, 159 Miss. 800, 131 So. 350 (1930); Smithfield Improvement Co. v. Coley-Bardin, *supra* note 2.