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Reproduction Cost and Original Prudent Investment

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Begin now by joining the national organization. It would be a very fine compliment to the State of North Dakota, the first 100% state bar organization, if it could be said at this meeting that it had also the largest percentage of its lawyers as members of the national association.—*A. M. Kvello,* President.

REPRODUCTION COST AND ORIGINAL PRUDENT INVESTMENT

With the permission of the editors of the Iowa Law Review, we reprint the editorial on the above subject in the February issue of that journal, to-wit:

The cost of reproduction theory and the original prudent investment theory have furnished for many years the two leading plans upon which evidence is collected and introduced bearing upon the valuation of public utility property. The proponents of each urge that the element stressed by their theory should be given controlling influence in public utility valuation. During the many years of controversy on this point the respective sides have passed through several changes in attitude. The cost of reproduction theory was early advocated by attorneys representing the public, at a time when the cost of reproduction appeared to be far below the supposed original expenditure. On the other side, the utilities were urging that the amount of the original investment should be accepted as the test determining fair value. (*72 N. W.* 713; 50 *Pac.* 633; 15 *Mich. L. Rev.* 205; 18 *Mich. L. Rev.* 774.)

Later, as costs of construction and equipment began to advance, the utility attorneys, in turn, urged that the cost of reproduction be considered. (*P. U. R.* 1919*A* 448, 464.)

It is not strange, therefore, that courts and commissions gradually came to give this method of ascertaining value much emphasis in arriving at conclusions as to the proper rate base.

The United States Supreme Court gave an early, detailed consideration to the question in the leading case of *Smyth vs. Ames,* 169 *U. S.* 466. There, in listing the elements to be considered in the determination of fair value, the court said, " . . . in order to ascertain that 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 the 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 is just and right in each case." This statement did not make it altogether clear, which theory the court had adopted or whether it had accepted any particular theory at all. Subsequent cases, however, indicate that the Supreme Court looked upon cost of reproduction as one of the controlling factors to be considered in determining the rate base, (174 *U. S.* 739; 212 *U. S.* 19; 212 *U. S.* 1), but that it would not use that evidence as the sole test when it would lead to an unfair result. (230 *U. S.* 352.)

But as is illustrated by the concurring individual opinion of Mr. Justice Brandeis, (262 *U. S.* 276), favoring the original prudent investment theory, the decisions which emphasized cost of reproduction were not invariably the unanimous opinion of the court. Though the argu-

ments thus pressed in that opinion were very able and very persuasive, the majority of the court concurred in the restatement of its former position and later decisions show that cost of reproduction is still regarded as a primary element in valuation cases. (*262 U. S.* 679; *272 U. S.* 400.)

During the period of these decisions by the Supreme Court the World War occurred and with it came great fluctuation of prices. The experience of that period brought out, with extreme clarity, the uncertainties and difficulties that arose in the application of the reproduction theory. The result was that many legal writers advocated the use of the original prudent investment theory on the ground that it would offer a more fixed and certain standard than did cost of reproduction, and the Supreme Court decisions emphasizing the cost of reproduction were highly criticized. (15 *Mich L. Rev.* 205; 92 *Cent. L. J.* 153; 31 *Yale L. J.* 263; 9 *A. B. A. J.* 392; 30 *W. Va. L. Quart.* 70.)

The state courts and the commissions then began to manifest a tendency to minimize the importance of reproduction cost and to give greater weight to original cost, (125 *N. E.* 891; 177 *N. W.* 306; 20 *A. L. R.* 555; 75 *I. C. C.* 463), for when the amount of the original prudent investment was once found, it would give a rate base that was stable and one that could be used repeatedly in every case regarding the same property, without the necessity of going through another complete process of valuation.

The Interstate Commerce Commission was no doubt influenced by this original prudent investment movement, when only three months after the decision in *272 U. S.* 400 it advanced that theory in the case of 124 *I. C. C.* 3. In this case the commission rejected evidence of reproduction cost at current prices as proof of the fair value and by a six to four vote it adopted the original prudent investment theory as the means to determine the value of the railway property for the purpose of computing the excess profit to be recovered by the government under Section 15-a of the Transportation Act of 1920. This case directly involved the St. Louis & O'Fallon Railway, which was merely a nine mile coal carrying railway in Illinois. But in reality it was a test case, which concerned all of the railway interests in the United States, for the commission in its report had stated that the methods employed in that case were those to be applied to all of the railroads in the United States. The Transportation Act provided, however, that in determining the value of the property for recapture purposes, the commission should consider all the elements of value recognized by the law of the land for rate-making purposes. So, when the case went to the Supreme Court, there was presented the same question that had been passed on several times before in rate cases. The United States Supreme Court in the case of *279 U. S.* 461 reached the conclusion which might have been expected in view of the prior decisions. The Interstate Commerce Commission was reversed because it had overemphasized the importance of the amount of the original prudent investment, and Mr. Justice McReynolds, delivering the majority opinion, said, "The elements of value recognized by the law of the land for rate making purposes have been pointed out many times by this court. . . Among them is the present cost of construction or reproduction."

There are, as noted above, certain advantages offered by adherence to the original prudent investment theory but that course is hardly consistent with the 14th Amendment to the U. S. Constitution. A valuation based upon cost of reproduction does not seem to confer upon the

utilities any property which is not theirs according to accepted constitutional notions. Though such property is devoted to a public use, still the current legal theory recognizes that it is subject to non-public ownership and management and the owners of it would seem to be entitled to the increased value as are the owners of other property. It is the present value of the property, the property as it is presently, and a reasonable return thereon to which the owner seems to be entitled and in which he is protected by the guaranties of the 14th Amendment. (37 *Harv. L. Rev.* 173; 9 *A. B. A. J.* 534.)

A different view would seem to require a distinct change in constitutional theory, or a drastic denial of traditionally recognized incidents of ownership notwithstanding the Constitution.

Ed:—It is to be noted here that the U. S. Supreme Court has handed down another decision, 50 *Sup. Ct. Rep.* 123, since the editor of the Iowa Law Review wrote the foregoing. The Court again divided, Justices Brandeis, Holmes and Stone dissenting.

PROXIMATE CAUSE—CAUSAL RELATION—CONTRIBUTORY NEGLIGENCE

The rather recent case of *Mahoney vs. Beatman,* 147 *Atl.* 762, is worth the reading, if for no other reason than because of the fact that the writer of the opinion, Chief Justice Wheeler of Connecticut, is making a considerable contribution to the restatement of tort law by the American Law Institute.

The facts in the case were: Defendant, while proceeding northerly, drove his car across the center of the road and onto the left hand side, so that plaintiff, who was driving rapidly in the opposite direction, was forced off the concrete onto the shoulder of the road. Despite this giving of ground, the defendant's car struck the hub of the left front wheel of plaintiff's car. Plaintiff's chauffeur lost control of the car, and it swerved and crashed into a tree and a stone fence. The findings—defendant's car was on wrong side of road; speed of plaintiff's car was unreasonable but did not contribute to collision, which was due entirely to defendant's negligence; the speed did, however, materially hamper plaintiff in controlling car after collision; actual repair bill was nearly $6,000; since court was unable to find from evidence the amount of damage caused at time of impact, plaintiff is entitled to "nominal damages," assessed at $200.

HELD: (on appeal) Excessive speed and loss of control did not defeat plaintiff, because defendant's violation of duty (driving on wrong side of road) was a *substantial factor* in the total result.

Editorial discussion of this decision in the February Yale Law Journal is very interesting and instructive. We quote: "Under the theory of the trial court the plaintiff would have contributed to the full loss, hence he should recover only for the damage done by the first impact. Under the appellate court's theory, either the judge (or the jury) could have found substantial causal relation between the total loss and the original impact. Under the dissenting opinion the case could have gone back to the trial court for determination of the relation between the plaintiff's negligence and the total loss. Under the analysis