

**PUBLIC UTILITY RATE MAKING
AND THE PRICE LEVEL**

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By

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PREFACE

THE GREAT DIFFICULTIES that have been experienced by public utilities commissions in regulating utility rates have to a considerable extent been due to the large fluctuations in prices throughout the greater part of the period in which the policy of administrative rate making by commissions has been in effect. In the decade prior to the World War the rise in prices was moderate and it was possible, although not without some difficulty, to make the necessary revision in utility rates. The tremendous rise in prices during and immediately after the war necessitated large and frequent revision of rates which could not be made satisfactorily in view of the general opposition of consumers. The short period of relatively stable prices in the 1920's relieved utilities commissions to some extent of the burden of frequent rate revision. However, with the sharp decline in prices during the recent great depression, difficulties were once more encountered. Consumers pressed for large reductions in rates, and utility companies faced with a decline in revenue from decreased sales resisted rate revision that would have reduced their net incomes even more.

Even the instability of prices would not have prevented effective regulation of utility rates if a satisfactory rate making method had been available. Unfortunately, the rate making rule established by the courts was too complex in its required procedure to permit the prompt and complete adjustment of utility rates in the period of rapidly changing prices. The ultimate purpose of the rule that utility rates must provide a fair rate of return on the fair value of utility property was to duplicate in the field of regulated rates the process of normal price determination in competitive society. Although it would have been desirable to regulate utility rates in a manner that would generally maintain equality of the prices of utility services with their costs of production, this was not in fact achieved under the rate making rule. With the complex, dilatory, and expensive rate making procedure

required under the rate making rule it was impossible to bring about prompt adjustment of rates with changing costs of production. Utility rates thus acquired an undesirable rigidity entirely out of harmony with the purpose of the rate making rule. The experience of the past twenty years shows conclusively the futility of attempting to regulate utility rates on the precise pattern of the price making process of competitive society.

Throughout the war and again in the great depression, commissions found it was impossible to use the rate making method and procedure required by the rate making rule. Instead, it was necessary to develop new methods of rate making that permitted the use of a simpler procedure under which rates could be adjusted more promptly to changing operating costs. The rate making methods developed during the period of unstable prices were designed to introduce greater flexibility in the rate making process, and for this reason they deserve consideration with other proposals for increasing the effectiveness of rate regulation.

It is the purpose of this study to show how the rate making rule and its procedure were developed, to consider the difficulties that were experienced under this rule, to discuss the new methods of rate making that commissions used during the period of rapid fluctuation in prices, and to offer a reasonable solution for the rate making problem.

This study of *Public Utility Rate Making and the Price Level* was undertaken at the suggestion of Professor F. W. Taussig. In his *Principles of Economics* (II, 118), Professor Taussig has commented briefly on the effect of the abrupt price advance during the war on the public utility industries. I have tried to carry the analysis into various aspects of the rate making problem during the war and postwar years and during the recent depression. The aid and advice of Professor Taussig have been invaluable in completing the study.

I should like to record my obligation to the Harvard Club of Chicago for the scholarship I held in 1927, and to the authorities of Harvard University for the Ricardo Prize Scholarship and the University Fellowship in Economics that I held in 1928.

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E. M. B.

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CONTENTS

PREFACE.....	v
I. THE RATE MAKING PROBLEM..... The regulation of rates—The unsettled questions of rate making.	3
II. THE RATE MAKING RULE..... A statement of the rule—The fair rate making value—The fair rate of return—The Supreme Court on value and return.	8 ✓
III. THE PRICE LEVEL, VALUATION, AND RETURN..... Fluctuations in prices and interest rates—Valuation at current reproduction cost—Valuation at prudent investment—Capital cost and rate of return.	20 ✓
IV. WARTIME REGULATION AND RATE MAKING..... The objects of wartime rate making—The doctrine of corporate needs—Utility rates and the burdens of war—Wartime methods of valuation.	33
V. VALUATION: REPRODUCTION COST AT AVERAGE UNIT PRICES..... The prewar use of average prices—Five-year average prices—Ten-year average prices—The attitude of the courts—Some objections considered.	44
VI. VALUATION: THE USE OF CORRECTIVE INDICES..... Reasonable and normal appreciation—Corrective index valuation in Missouri—Corrective index valuation by federal courts—Disapproval of indices by the federal courts—An appraisal of corrective index valuation.	59
VII. VALUATION: THE SPLIT INVENTORY..... The split inventory method of valuation—The split inventory in New York—The split inventory in Wisconsin—The valuation of the railroads—The Supreme Court on the split inventory—An appraisal of the split inventory.	75
VIII. THE FAIR RATE OF RETURN..... The problem of rising interest rates—A temporary deficiency of return—A normal rate of return—Interest, dividends, and the rate of return—The Supreme Court on fair rate of return—Summary and conclusions.	91

IX. RATE MAKING IN PROSPERITY AND DEPRESSION.....	105
The valuation question in prosperity—Fair rate of return in prosperity—The doctrine of reasonable worth—Corrective index valuation in depression—The rate of return in depression—Summary and conclusions.	
X. A PROPOSED SOLUTION.....	120
Necessary changes in rate making—Prudent investment and capital cost—The New York rate making proposals—A solution to the problem—The prospect for the new plan.	
INDEX.....	135



INDEX

- ABILITY** to pay, 110
Accounting, 20, 26, 83, 127, 131
Additional percentage, 59, 84. *See also*
Appreciation, Corrective indices
Administrative problems, 26
Administrative rate making, 5
Alabama Public Service Commission,
67
Allison, J. E., 17
American Electric Railway Associa-
tion, 58
American Society of Civil Engineers,
10, 44
American Telephone & Telegraph Co.,
132
Appreciation, 18, 38, 59-61. *See also*
Corrective indices
Approximate valuations, 42
Arizona Corporation Commission, 40
Arkansas Department of Public Utili-
ties, 49
Ashland Water Co. (Wisc.), 82
Association of Railway Executives, 133
Atwill, H. C., 132
Average unit prices, advantages of, 56;
attitude of courts toward, 55; attitude
of utilities toward, 46, 57, 113; dis-
advantages of, 57, 88; fifteen-year,
53; five-year, 44, 46-49, 77; four-
year, 47; prewar use of, 44-46; re-
placed by corrective indices, 69; ten-
year, 44, 49-53; three-year, 47;
twenty-year, 53; two-year, 47; used
in railroad valuation, 84; used with
split inventory, 76; war construction
and, 58
- BALTIMORE** street railway case, 108
Bauer, J., 24, 127
Bauer plan, 93, 127-128, 130
Bay State Street Railway Co. (Mass.),
98
Bickley, J. H., 91
Bluefield Water Works & Improvement
Co. (W. Va.), 87, 102
Bonbright, J. C., 87, 127
Bonds. *See* Securities.
Book cost. *See* Prudent investment
Brandis, Justice, 20, 43, 86-87, 93,
101, 102, 109
Brewer, Justice, 5
Brooklyn Borough Gas Co. (N. Y.),
39, 47, 54, 77, 79
Brown, H. G., 122
Brundige, H. W., 40
Buck, S. J., 4
Built up value, 75, 77, 81, 88. *See also*
Split inventory
Burdens of depression, 115
Burdens of war, 94, 95, 99
Bureau of Labor Statistics index num-
bers, 60, 67, 70, 71, 113, 118
Butler, Justice, 55, 87, 102
- CALIFORNIA** Railroad Commission
on average prices, 47; prudent in-
vestment, 105; return, 107, 110; split
inventory, 77; wartime return, 40
Cambridge Electric Light Co. (Mass.),
108
Capital cost and fair return, 28-30, 38,
91-93, 99, 102, 103, 121, 125, 128,
130, 131. *See also* Corporate needs
Capital structure and fair return, 30-31
Capitalization. *See* Prudent investment
Cardozo, Justice, 116
Cedar Rapids Gas Co. (Ia.), 18
Chesapeake & Potomac Telephone Co.
(Md.), 66, 69, 71, 114
Coal Prices, 33, 36
Coast Gas Co. (N. J.), 60, 70
Columbus Gas Light Co. (Ind.), 97
Commissions, bound by constitution, 4;
bound by rate making rule, 8-9;
emergency powers of, 33; estab-
lished, 5; facilities for work of, 6.
See also Alabama Public Service
Commission, Arizona Corporation
Commission, etc.
Committee on Interstate and Foreign
Commerce, 133
Common law, 3
Common stock basis for return, 31,
38, 92, 93, 99, 103, 116, 121, 125,
130, 132, 134
Compensatory return. *See* Rate of re-
turn
Competitive rate making, 3, 4
Conference of Governors and Mayors,
34

- Confiscation. *See* Rate of return
Congress, 4
Connecticut Public Utilities Commission, 40
Consolidated Gas Co. (N. Y.), 17, 18, 19, 38, 48, 54, 71
Constitutional rights, 4, 5, 7, 9, 12, 17, 18, 22, 35, 52, 82, 114, 134
Construction costs, 38, 50, 72, 73, 123
Consumers, 31, 39, 110, 129
Consumers' income, 22, 111
Contract plan, 127, 128
Cooke, M. L., 36, 49
Cooley, Professor, 44
Corporate needs, 35, 37, 97, 98, 103
Corrective indices, advantages of, 69, 113; additional percentage and, 59; attitude of courts toward, 65, 67-68; during depression, 113-15; future use of, 126; misuse of, 68; objections to, 72; used by federal courts, 63
Cost of producing utility services, 3, 4, 23-24, 122, 129
Courts. *See* Federal courts, State courts, Supreme Court
- DAYTON**-Goose Creek Railway Co., 102
Dayton Power & Light Co. (Ohio), 116
Deficiency in return, 131
Deflation. *See* Depression, Interest rates, Prices, Profits
Depreciation, 10, 13, 18, 26, 131
Depression, 4, 5, 6, 13, 21, 29, 45, 109-11
Des Moines Gas Co. (Ia.), 17
Discrimination, 3
District of Columbia Public Utilities Commission, 44, 77
Dividends, 30, 97, 98, 118. *See also* Common stock basis for return
Donovan, W. J., 127, 128, 130
Dozier, H. D., 92
Due process of law. *See* Constitutional rights
Duluth Street Railway Co. (Minn.), 66
- ECONOMIC** emergency. *See* Depression, War
Efficiency of management, 14, 15, 16, 97
Electric light and power industry, 20, 34, 50, 73
Elements of fair value. *See* Prudent investment, Reproduction cost
Elizabethtown Gas Light Co. (N. J.), 54, 100
Elizabethtown Water Co. (N. J.), 109
Emergency powers, 33, 36, 37
Emergency rate making, 37, 41, 111
Engineering News-Record index number, 63, 71, 72, 73, 113, 114
Equal protection of the law. *See* Constitutional rights
Equalization reserve, 128
Equipment, 10, 75
Equivalent service, 24
Expansion, 13, 16, 27
- FAIR** return. *See* Rate of return
Fair value, affects return, 13; cases in Supreme Court, 17; cost of determining, 35; factors to be considered in, 9-10; normal value, 38; proposed methods of determining, 126-31; required for rate making, 5; translator for, 114; unit prices and, 12; wartime methods of determining, 32. *See also* Average prices, Corrective indices, Prudent investment, Reproduction cost, Split inventory, Valuation
Farrington, Judge, 65
Federal courts on average prices, 54; burdens of war, 41, 95; corrective indices, 63-64, 67-68, 114; current prices, 62; deficient return, 94; prudent investment, 105; reproduction cost, 106; return, 13, 100, 108, 109, 116, 117; split inventory, 79, 80, 82, 85; temporary rates, 112
Federal courts, cases in, Ashland Water Co. (Wisc.), 82; Cambridge Electric Light Co. (Mass.), 108; Consolidated Gas Co. (N. Y.), 54; Duluth Street Railway Co. (Minn.), 66; Elizabethtown Water Co. (N. J.), 109; Fort Worth Gas Co. (Tex.), 108; Galveston Electric Co. (Tex.), 64, 86, 101; Georgia Railway & Power Co. (Ga.), 66, 87; Greencastle Water Works Co. (Ind.), 108; Houston Electric Co. (Tex.), 63; Indianapolis Water Co. (Ind.), 55, 102; Joplin Gas Co. (Mo.), 63; Kings County Lighting Co. (N. Y.), 94; Maryland telephone company, 66, 114; Minneapolis Gas Light Co.



- (Minn.), 65; Mobile Gas Co. (Ala.), 67; Monroe Gas Light & Fuel Co. (Mich.), 68; New York & Queens Gas Co. (N. Y.), 94; New York Telephone Co. (N. Y.), 80; Pacific Gas & Electric Co. (Calif.), 105; Potomac Electric Power Co. (D. C.), 79; St. Joseph Railway, Light, Heat & Power Co. (Mo.), 79; St. Louis & O'Fallon Railway Co., 85; Southern California Telephone Co. (Calif.), 105; Springfield Gas & Electric Co. (Mo.), 63; Toledo Railways & Light Co. (Ohio), 41; West Palm Beach Water Co. (Fla.), 116; Wisconsin-Minnesota Light & Power Co. (Minn.), 64; Worcester Electric Light Co. (Mass.), 106
 Federal operation, 33, 62
 Financial stability, 110, 112, 133
 Fixed return, 93, 121, 128, 130
 Formula for rate making, 12, 13, 16, 17, 120. *See also* Uniform methods of rate making
 Fort Worth Gas Co. (Tex.), 108
 Franchise plan, 130, 131, 133
 Franchise value, 10
- GALVESTON** Electric Co. (Tex.), 64, 86, 101
 Gas industry, 20, 34, 72, 73
 Georgia Public Service Commission, 42, 87
 Georgia Railway & Power Co. (Ga.), 42, 66, 87, 102
 Gifford, W. S., 132, 133
 Goddard, E. C., 20, 87
 Going concern value, 10
 Gold, N., 24
 Good will value, 10
 Granger movement, 4
 Green Bay Water Co. (Wisc.), 80
 Greencastle Water Works Co. (Ind.), 108
 Grunsky, C. E., 123
- HADLEY, A. T.**, 4
 Hand, Judge L., 20, 54, 55, 71
 Harlan, Justice, 17
 Hartford street railway case, 40
 Hayes, H. V., 17
 Historical cost. *See* Prudent investment
 Holmes, Justice, 18, 86, 93, 101
 Home Telephone Co. (Ind.), 49
 Houston Electric Co. (Tex.), 63
 Hughes, Chief Justice, 18, 39, 47, 54, 77, 79
 Hutcheson, Judge, 63, 64
- IDAHO** Public Utilities Commission, 14
 Illinois Bell Telephone Co. (Ill.), 118
 Illinois Commerce Commission on average prices, 47, 49; corporate needs, 99; normal return, 95-96; rate of return, 107; split inventory, 77; valuation conferences, 49
 Improvident investment, 18
 Income of consumers, 22, 111
 Index numbers, Bureau of Labor Statistics, 60, 67; construction costs, 72, 73; cost of living, 71; during depression, 113, 118; retail prices, 71, 72; special indices, 70; wholesale prices, 71, 72. *See also* Corrective indices
 Indiana Bell Telephone Co. (Ind.), 97
 Indiana Public Service Commission on average prices, 48, 52, 53, 58; normal return, 96-97; prudent investment, 48; reproduction cost, 105; return, 103; return during depression, 115; split inventory, 77
 Indianapolis Water Co. (Ind.), 52, 55, 102
 Inflation, 5, 29, 49. *See also* Interest rates, Prices, Prosperity, War
 Intangibles, 10, 11, 75
 Interest rates, during depression, 29, 110, 115; fluctuations of, 5, 6, 13, 20-21, 29, 94, 107, 115; investors and, 30; and rate of return, 14, 29, 97; during prosperity, 94, 107; table of, 94, 107, 115; during war, 29, 38, 94
 Interstate Commerce Commission, 4, 45, 51, 83-85, 102
 Inventory for valuation, 10, 11, 26, 83
 Investment. *See* Expansion, Prudent investment
 Investors, 28, 29, 129, 133
 Iroquois Natural Gas Co. (N. Y.), 79
- JOPLIN** Gas Co. (Mo.), 63
 Judicial review, 5. *See also* Federal courts, State courts, Supreme Court
 Just compensation. *See* Constitutional rights

- KINGS** County Lighting Co. (N. Y.),
94
- LAND** valuation, 10, 11, 75, 83
Legal questions, 22, 23, 127, 128, 134
Legislative rate making, 4, 5
Legislatures and rate making, 5, 8, 125,
127, 134
Lincoln Gas & Electric Light Co.
(Neb.), 95, 101
Litigation, 5, 12, 21, 26, 42, 119, 120
Location of industry, 122
Lockport Light, Heat & Power Co.
(N. Y.), 78
Lynchburg Traction & Light Co. (Va.),
61
- McADOO**, W. G., 34, 37, 97
McReynolds, Justice, 101
Maine Public Utilities Commission, 50,
107, 110
Maintenance of service, 34, 35
Maryland Public Service Commission
on corporate needs, 37, 98; rate of
return, 108; split inventory, 77
Maryland telephone case, 66, 69, 71,
114
Massachusetts Commissioners of the
Department of Public Utilities on
common stock basis for return, 92,
117; corporate needs, 98; rate mak-
ing policy, 132; rate of return, 99
Massachusetts plan, 130
Maximum original cost, 83
Michigan Board of Tax Commissioners,
44
Michigan Public Utilities Commission,
68, 70, 110
Milwaukee Electric Railway & Light
Co. (Wisc.), 80
Minimum valuations, 42
Minneapolis Gas Light Co. (Minn.),
65
Minnesota Railroad and Warehouse
Commission, 40
Minnesota rate cases, 11, 18
Missouri Public Service Commission on
average prices, 61; corrective indices,
62, 63; high prices, 39; prudent in-
vestment, 61; rate of return, 14,
107; split inventory, 77, 86; tem-
porary rates, 112; wartime valua-
tion, 36
- Mobile Gas Light Co. (Ala.), 67
Monroe Gas Light & Fuel Co. (Mich.),
68, 70
Montpelier & Barre Light & Power Co.
(Vt.), 51
Mt. Vernon water case, 78
Munger, Judge, 65
Munn v. Illinois, 4
- NASH**, L. R., 73
National Electric Railway Commission,
34
Natural gas industry, 15
Nebraska State Railway Commission,
39
Nevada Public Service Commission, 15
New Hampshire Public Service Com-
mission, 77
New Jersey Board of Public Utility
Commissioners on appreciation, 60;
average prices, 60; corrective indices,
70; split inventory, 77; valuation
conferences, 49
New York Commission on Revision of
the Public Service Commissions Law,
6, 93, 126-29
New York Department of Public Serv-
ice, Public Service Commission on
burden of war, 99; common stock
basis for return, 116; corporate
needs, 98; emergency rate making,
111; index numbers, 113; rate of
return, 99, 107; split inventory, 77-
80
New York Department of Public Serv-
ice, Transit Commission, 78
New York Interurban Water Co. (N.
Y.), 78
New York Public Service Commission:
first district, 78; second district, 78.
See also New York Department of
Public Service
New York State Railways (N. Y.), 80
New York Telephone Co. (N. Y.), 80
New York Transit Commission, 78
Normal appreciation, 60, 70
Normal rate of return, 38, 39, 94, 95-
97, 99, 103
Normal value, 38, 39, 46, 50
North Carolina rate making law, 8
North Carolina Utilities Commission,
113
North Dakota Board of Railroad Com-
missioners, 45

O'FALLON case, 85
 Ohio Public Utilities Commission, 77, 110
 Operating expenses, 8, 22, 27, 33, 34
 Oregon Public Utilities Commissioner, 77, 115
 Original conditions of construction, 17, 24
 Original cost. *See* Prudent investment
 Overheads. *See* Intangibles

PACIFIC Gas & Electric Co. (Calif.), 105

Past earnings, 16, 128, 131
 Pennsylvania Public Utility Commission on average prices, 45, 48, 50, 52; rate of return, 107, 115; reproduction cost, 52; valuation conferences, 48

Potomac Electric Power Co. (D. C.), 79

Prendergast, W. A., 6, 126
 Prendergast plan, 126

Present cost. *See* Reproduction cost
 Present value rule, 18, 82

Price level. *See* Index numbers, Prices
 Prices, abnormal, 39; coal, 33, 36; current, 53; fluctuations in, 5, 6, 13, 20-21, 28, 29, 56; future, 51, 62, 64; postwar, 51, 57; rates and, 110; trend of, 60, 70; reproduction cost and, 112; wartime, 33, 38. *See also* Wage rates

Prima facie valuation, 36, 42

Private operation, 7, 134

Procedure for rate making, and average prices, 56; complex and expensive, 29; dilatory, 35; corrective indices and, 69; during depression, 118; objections to present, 27; and split inventory, 75, 81, 88; unsatisfactory, 120; in wartime, 43, 59

Productive resources, 23-24, 122

Profiteering, 39

Profits in competitive industry, 101, 105, 107, 115, 116, 119

Property used and useful, 9, 10, 11

Prosperity, 29, 45, 105-9

Prudent investment, advantages of, 26-28, 129; attitude of Supreme Court toward, 134; basis for proposed uniform method of rate making, 121, 127; capital cost and, 28; changing costs of production and, 123; com-

missions prefer, 48, 120; consideration required, 8, 12, 83; and constitutional rights, 22, 23; and corporate needs, 38; current prices and, 124; during depression, 111; disadvantages of, 122; economic aspects of, 26-28; investors and, 27; legal theory of, 23; method of determining, 26; price fluctuations and, 21, 22; security issues and, 38; and stability of return, 28; and split inventory, 75, 89, 90; and wartime valuation, 42

Public interest, 3

Public ownership, 7, 131, 132

Public purchase, 131

Purchasing power, 25, 55, 71, 110

QUEENS gas case, 94

RACINE Water Co. (Wisc.), 80

Railroads, 20, 33, 44, 83-85, 133

Rate base. *See* Fair value

Rate making, administrative, 6; competitive, 3, 4; legislative, 4, 5; problems, 5-7; rule, 5, 6, 8, 16, 18; uniform methods of, 16; unit prices and, 12; unsettled questions of, 9; wartime methods of, 6, 7, 33-34, 37, 41. *See also* Average prices, Corrective indices, Fair value, Procedure for rate making, Prudent investment, Rate of return, Reproduction cost, Split inventory

Rate of return, base to which applied, 91; capital cost and, 28-29, 31; capital structure and, 30-31; compensatory, 19; in competitive industry, 31; controversies on, 29; in depression, 114-15, 117; dividends and, 97; and emergency rates, 111; excessive, 30-31; factors affecting, 14; interest rates and, 21, 91; past earnings and, 16; profits and, 115; proposed methods of determining, 128; in prosperity, 107-8, 119; variability of, 29; wartime methods of determining, 32. *See also* Capital cost, Common stock basis for return, Corporate needs, Normal return, Stable return, Standard rate of return

Rates, comparative, 15; consumers' income and, 22, 111; emergency, 111;

- inadequate, 5; prices and, 21-23; schedules of, 13
 Raver, P. J., 73
 Reasonable appreciation, 71
 Reasonable worth, 8, 39, 109-11
 Recapture of excess earnings, 102
 Regulation, 3, 7, 134
 Reproduction cost, attitude of courts, 121; advantages of, 23-25; and average prices, 44, 56; consideration required, 8, 63, 83; constitutional rights and, 17; during depression, 112; disadvantages of, 23-25; dominant consideration given to, 105, 106; economic aspects of, 22-25; and fair value, 64; investors and, 25; legal theory of, 23; method of determining, 25; normal, 40, 50; prices and, 21, 22; and wartime valuation, 41
 Richberg, D. R., 92
 Rigidity of rates, 27
 Risk, 14, 15, 28, 30
 Rockford City Traction Co. (Ill.), 96
 Roosevelt, Franklin D., 125, 127
 Rosenberry, Judge, 82
 Ruggles, C. O., 91
- ST. JOSEPH** Railway, Light, Heat & Power Co. (Mo.), 79
 St. Louis & O'Fallon Railway Co., 85
 San Diego Land & Town Co. (Calif.), 17, 18
 San Joaquin & Kings River Canal & Irrigation Co. (Calif.), 17
 Securities, 25, 28, 38, 91
 Single sum value, 84
 Sliding scale, 36
Smyth v. Ames, and corporate needs, 37; elements of value prescribed in, 12; modification in rule proposed, 127; procedure conforms to rule of, 16; and reasonable worth, 109; rule of, 8; and split inventory, 89; uniform methods of rate making and, 20; on valuation, 17; and wartime rate making, 41, 42
 South Carolina Public Service Commission, 114
 Southern Bell Telephone & Telegraph Co. (N. C.), 113
 Southern California Telephone Co. (Calif.), 105
 Southwestern Bell Telephone Co. (Mo.), 20, 43, 62, 93, 101, 113
 Speculation, 28, 82, 119
 Split inventory, abandoned, 82; attitude of courts toward, 78-80, 85; advantages of, 88; average prices and, 76; built up value, 75; classified inventory, 25; defined, 75; division date, 76; Interstate Commerce Commission uses, 85-87; land valuation and, 75; misuse of, 86, 88; New York uses, 78-80; proposed use of, 126, 129; purpose of, 75, 77, 88; Wisconsin uses, 80-82
 Spring Water Co. (Penna.), 49
 Springfield Gas & Electric Co. (Ill.), 96
 Springfield Gas & Electric Co. (Mo.), 63
 Stable return, 25, 71. *See also* Fixed return
 Standard rate of return, 19, 91, 95-96, 104, 108, 117, 131
 State courts on average prices, 54, 60; burdens of war, 94; corrective indices, 61; emergency rate making, 100, 111; normal return, 96, 97; rate of return, 100; return during depression, 116, 117; split inventory, 78-79, 82, 85
 State courts, cases in, Bluefield Water Works & Improvement Co. (W. Va.), 87; Brooklyn Borough Gas Co. (N. Y.), 39, 47; Columbus Gas Light Co. (Ind.), 97; Elizabethtown Gas Light Co. (N. J.), 54, 100; Iroquois Natural Gas Co. (N. Y.), New York Interurban Water Co. (N. Y.), 78; New York State Railways (N. Y.), 80; Southwestern Bell Telephone Co. (Mo.), 86; Springfield Gas & Electric Co. (Ill.), 96; United Railways & Electric Co. of Baltimore (Md.), 108; Waukesha Gas & Electric Co. (Wisc.), 82
 Stocks and bonds. *See* Securities
 Stone, Justice, 88, 102, 114
 Street railways, 20, 34, 72, 73
 Supreme Court on capital cost and return, 134; constitutional guaranties, 4; contract rates, 134; corrective indices, 114; current prices, 53; fair value, 16-17; fixed return, 93; formulas for rate making, 120; juris-

- diction, 9; land value, 11; prudent investment, 18, 134; rate making rule, 5; rate of return, 13, 19, 100-101, 108; reproduction cost, 18, 56; return during depression, 116, 118; split inventory, 85-86; uniform methods of rate making, 20; wartime return, 95
- Supreme Court, cases in, Bluefield Water Works & Improvement Co., 87, 102; Cedar Rapids Gas Co., 18; Chesapeake & Potomac Telephone Co., 114; Consolidated Gas Co., 17; Dayton Power & Light Co., 116; Galveston Electric Co., 64, 86, 101; Georgia Railway & Power Co., 102; Illinois Bell Telephone Co., 118; Indianapolis Water Co., 56; Lincoln Gas & Electric Co., 95, 101; Minnesota rate cases, 18; *Munn v. Illinois*, 4; St. Louis & O'Fallon Railway Co., 85; San Diego Land & Town Co., 17; San Joaquin & Kings River Canal & Irrigation Co., 17; *Smyth v. Ames*, 8; Southwestern Bell Telephone Co., 62, 86, 101; Texas railroad rate cases, 5; United Railways & Electric Co. of Baltimore, 108; West Ohio Gas Co., 118
- Sutherland, Justice, 108
 Swayze, Judge, 100
- TELEPHONE** industry, 15, 20, 33, 72, 73, 114
 Temporary deficiency of return, 94-95, 111
 Temporary rate making, 111. *See also* Emergency rate making
 Temporary valuations, 36, 41, 81
 Tennessee Railroad and Public Utilities Commission, 110
 Tentative valuations, 42, 81
 Texas railroad rate cases, 5
 Thom, A. P., 133
 Toledo Railways & Light Co. (Ohio), 41, 95
 Tompkins, Judge, 79
 Transit Commission of New York, 78
 Transportation Act of 1920, 83-84, 102
- UNIFORM** methods of rate making, 16, 20, 21, 22, 121. *See also* Formula for rate making
- Unit prices, 10, 12, 26, 44, 83, 113.
See also Average unit prices
 United Fuel Gas Co. (W. Va.), 112
 United Railways & Electric Co. of Baltimore (Md.), 108
 Utah Public Service Commission, 94, 112
 Utica Gas & Electric Co. (N. Y.), 79
 Utilities. *See* Electric light and power industry, Gas industry, etc.
- VALUATION**, conferences on, 48, 49, 131; expense of, 27; informal methods of, 42; objects of wartime, 59; reduction of, 49, 50; wartime methods of, 41-42. *See also* Average unit prices, Corrective indices, Fair value, Prudent investment, Reproduction cost, Split inventory
 Valuation Act of 1913, 44, 83
 Valuation Brief of 1915, 45, 51
 Value of money. *See* Purchasing power
 Vermont Public Service Commission, 51
 Virginia Railway & Power Co. (Va.), 60
 Virginia State Corporation Commission, 60, 61
- WAGE** rates, 33, 83, 112
 War, burdens of, 38; boards, 33; construction costs during, 38; emergency, 95; fair value in time of, 41; interest rates during, 29, 38; objects of rate making in time of, 33-34, 89; rate making rule and, 41; sacrifices of, 40; valuation methods developed in time of, 32. *See also* Average unit prices, Corrective indices, Normal return, Normal value, Split inventory
 War Finance Corporation, 97, 99
 Washington Department of Public Works, 39, 115
 Water works, 15, 20, 72, 73
 Waukesha Gas & Electric Co. (Wisc.), 82
 West Ohio Gas Co. (Ohio), 118
 West Palm Beach Water Co. (Fla.), 116
 West Virginia Public Service Commission, 58, 87, 112
 Wilson, Woodrow, 34, 37, 97, 99

- Wisconsin-Minnesota Light & Power Co. (Minn.), 64
- Wisconsin Public Service Commission on average prices, 45; common stock basis for return, 117; corporate needs, 100; emergency rates, 111; rate of return in depression, 110; split inventory, 77, 80-82
- Wisconsin railroad valuation, 44
- Worcester Electric Light Co. (Mass.), 106
- YARDSTICK, 15**
- Yield on utility bonds, 94, 104, 107, 114, 115
- York Water Co. (Penna.), 52