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THE ABROGATION OF PUBLIC UTILITY RATE CONTRACTS.

BY LOUIS COX*

When operating costs began to soar to extraordinary levels following the economic disturbances caused by the World War, practically all of the public service corporations in the United States applied to the various state regulatory commissions for an increase in rates, notwithstanding the fact that they were operating under franchises, municipal ordinances or other contracts which limited the amount of their charges. The ratepayers contended that a contract was a contract, and that if corporations engaged in the ordinary lines of business had to live up to their obligations, there was no reason why a public utility company should not live up to its covenants. Thus, the ratepayers wanted the rule established that such contracts were inviolable and could not be abrogated or altered, the public service corporations maintained that such contracts did not stand in the way of a rate increase. The state commissions, in the discharge of their duty to fix reasonable rates, generally found it necessary to grant applications for temporary rate increases, and, therefore, of necessity, to disregard these rate contracts.

It is interesting to note how, and at whose instance, the rule was first enunciated that the state, by reason of the police power, had the right to vary contract rates. Curiously, the rule was established at the behest and insistence of the representatives of the public and originally was as vigorously opposed by the public utility companies as it has, in recent years, been espoused by them. The rule was established in cases prior to the "high price" era and prosecuted upon the demand of the consumers that the particular contract in controversy was exorbitant and should be reduced in protection of the inalienable rights and general welfare of the citizens. It will be remembered that in the agitation in favor of a decrease of transportation rates during the period from 1870 to 1890, one of the

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Fundamental principles of the Granger organization was that all public service corporations are subject to legislative control, and that such legislative control should be in express abrogation of the theory of the inalienable nature of charter rights. Many of the early railroad charters gave the corporations the authority to regulate rates, and the Granger organization insisted that these charter contracts did not preclude proper rate regulation by the state. It was, without doubt, just as hard for the corporations in the early days to understand why they were not protected by their rate contracts, from interference by the state as it was for the ratepayers at a later date to appreciate why such agreements were not inviolable.

Since the War many cases have been before the courts and the state regulatory commissions in which applications have been made for an increase in rates beyond the amounts fixed in franchises or contracts, and no doubt these cases now outnumber those in which applications were made on behalf of the public for a reduction of charges below the contract amount. Where these cases are taken together they show fairly conclusively that the fixing of rates by contract is a very unsatisfactory method of regulation, for the reason that conditions which cannot be foreseen at the time of the agreement may so change over a period of years as to render the contract unfair either to the public utility or to the consumer. In recent years the contracts which have been the subject of the greatest controversy are those in which rates were fixed in franchise contracts or municipal ordinances, which, upon acceptance by the utility company, became binding agreements between the municipality and the public service corporation. By the great weight of authority it has been held, for one reason or another, that state commissions may prescribe fair and reasonable rates without regard for such franchises or ordinances.

It is the purpose of this paper to discuss the various questions that have arisen relative to the abrogation of rate contracts by state regulatory bodies, and particularly what would be the situation if a utility commission was established in this Commonwealth. The various principles of law underlying a proper solution of these questions are complex in the extreme, elaborately technical and difficult to approach. They have,
however, drawn the concentrated and cooperative attention of some of the foremost attorneys in the Country.

It has been held uniformly and universally that the power to supervise and regulate rates of public service corporations is a governmental function, and occupies a large place within the police powers of the state.\(^1\) This principle of law is now so thoroughly settled that it needs no further discussion.

It may be stated as axiomatic that where no power is shown for the execution of an inviolate rate contract, the state has power, thru its public service commission or otherwise, to alter the rates fixed by contract in whatever form, franchise or otherwise, such contract has been entered into.\(^2\) While it may appear unjust for a corporation or an individual to obtain the valuable right from a municipality to use its streets and alleys to establish its lines and conduits therem, and further that rates are agreed upon, and such solemn agreement is written into the franchise, then, after the corporation has established its plant and operated under the franchise agreement for sometime, that it be allowed to repudiate its agreement. However, the courts have justified the abrogation of such agreements upon the theory that the municipality is but an arm of the state, and as public utilities are performing a public service, the state, in the exercise of its sovereign power, has the right to regulate the rates and charges therefor, and all of the late decisions, with regard to the question of rates to be charged by public service corporations, support the rule that the state, or its utilities commission, has the authority to


\(^2\)For cases sustaining this rule, see note one.
modify or annul the rates and fares of such companies.³ It is
to be remembered that a public utility company enjoys a privi-
lege that is necessarily of a monopolistic character, a privilege
granted by public authority, and from which a pecuniary
profit is derived, by accepting such a franchise or privilege
from the municipality such a company devotes its property to
a public use, and is therefore more subject to state control than
the ordinary private corporation. The authorities confirm the
doctrine that to regulate or alter rates to be charged by public
service corporations is an inherent attribute of sovereignty
which may be exercised at any time thru a state agency for
the purpose of establishing just, equitable and reasonable rates
under such circumstances as may exist at the time. It is seem-
ingly an attribute of sovereignty which cannot be contracted
away and in contemplation of which all such contracts are
made. Impliedly, from general powers, a municipality may
have the authority to contract in the matter of public service
charges as long as the legislature does not exercise its reserved
power in that particular, but a contract so made is permissive
only, and is subject to future legislative action. However, the
fact that the contract may be overruled by a sovereign power
does not destroy the binding effect between the parties when it
is left undisturbed.⁴ That such private contract rights must
yield to the public welfare, when the latter is appropriately de-
cleared and defined and the two conflict, has been often decided
by the Supreme Court of the United States. Thus, in Mangault
v Springs⁵ it was declared that “It is the settled law of this
court that the interdiction of statutes impairing the obligation
of contracts does not prevent the state from (properly) exercis-
ing such powers for the general good of the public,
though contracts previously entered into between individuals
may thereby be affected.”

In Hudson County Water Co. v McCarter⁶ it is said that
“One whose rights, such as they are, are subject to state restric-
tion, cannot remove them from the power of the state by making
a contract about them. The contract will carry with it the in-
firmity of the subject matter.”

³ Ibid.
In *Louisville and N R. Co. v. Motley* the court quoted with approval from the *Legal Tender Cases*:

"Contracts must be understood as made in reference to the possible exercise of the rightful authority of the government, and no obligation of a contract can extend to the defeat of legitimate government authority."

It was said in *Chicago B. and Q. R. Co. v McGraw* that "There is no absolute freedom to do as one wills or contract as one chooses. The guaranty of liberty does not withdraw from legislative supervision that wide department of activity which consists of the making of contracts, or deny to government the power to provide restrictive safeguards. Liberty implies the absence of arbitrary restraint, not immunity from reasonable regulations and prohibitions imposed in the interests of the community."

And in *Atlantic Coast Line R. Co. v Goldsboro* the court said: "It is settled that neither the 'contract' clause nor the 'due process' clause has the effect of overriding the power of the state to establish all regulations that are reasonably necessary to secure the health, safety, good order, comfort, or general welfare of the community, that this power cannot be abdicated or bargained away, and is inalienable even by express grant, and that all contract and property rights are held subject to its fair exercise."

Thus, recognizing the general principle that a state may, in its sovereign capacity, abrogate rate contracts, the question arises as to the exceptions to this general statement, and under what conditions a municipality may enter into an irrevocable contract with a utility company that forbids abrogation by the state.

That a state may authorize a municipal corporation to establish public service rates by agreement, and thereby suspend for a number of years, not grossly excessive, the exertion of governmental power by legislative action to fix compensation to be paid for the services furnished by public utility corpora-

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tions, is recognized in a long line of decisions. However, the authority for a municipality to suspend legislative action and thereby make inviolable rate contracts must clearly and unmistakably appear; the presumption is against such a delegation of power, and all doubts are resolved against the municipality.

The rule was succinctly stated in Billings v Billings Gas Co. wherein the court said "Rate regulation of public utilities is distinctly a legislative function of the state, and, though the state may confer upon a city authority to enter into such a contract for specific rates for a given period, since the effect of such a contract is to extinguish pro tanto a governmental power of first importance, the courts will not indulge the presumption that such a surrender of power has been made, unless the legislative intention is expressed in clear and unmistakable language or is necessarily implied from the powers expressly granted, and all doubts will be resolved in favor of the continuance of the power."

In Woodburn v Public Service Commission it was stated. "Unless the right to exercise the police power of regulating rates is referable to an unmistakable grant, the prices specified


13 Ibid.
14 Ibid.

15 Mont. 102; 173 Pac. 799.
16 Ibid.
17 Ibid.
in the franchise are not exempt from interference by the legislative assembly."

There are some few instances where it has been adjudged that a municipal corporation has been granted the authority to make an inviolable rate contract. In Ohio the municipalities have comprehensive power under the state constitution to contract with public utilities as to rates and such contracts have been declared inviolable. Following a review of the pertinent provisions of the constitution, statutes and decisions of Ohio, the supreme court of that state, in *Columbus v Public Service Commission,* 15 said. "We have therefore reached the conclusion that the rate stipulation is, upon reason and principle, a valid condition to the consent contract. If the state has conferred upon the municipality the power to make a valid contract, including the stipulation of a rate, and if pursuant to such power so given a contract has been made in which a rate has been stipulated and no review thereof is authorized then the state has lost the power to revoke or revise such rate, because the obligation of the contract and the rate therein established is inviolable under the guaranty of both the state and the federal constitutions." Under the more recent decisions in Ohio it seems there is no authority to enable a municipality to make an irrevocable rate contract for a period of more than ten years, and the municipality cannot by a franchise for a longer period (twenty-five years for example) make such an agreement with a utility as will enable a municipality, at ten year intervals during this time, to fix the rates beyond the power of the public service commission to alter. 16 There are numerous Ohio decisions upholding the power of the municipalities to make inviolable rate contracts. 17

Under the early decisions of Virginia it was held that the municipalities had the authority to make inviolable rate contracts with public utilities. 18 However that rule must now apparently be regarded as inapplicable in that state in view of

15 103 Ohio St. 79; 133 N.E. 800.
the decision in the case of Victoria v. Victoria, Etc., Ice Co.\textsuperscript{19} to the effect that municipalities have not the power to enter into inviolable rate contracts, and that the state corporation commission has the necessary jurisdiction to determine the reasonableness of rates regardless of contracts. It will be noted that this decision places Virginia in line with the great weight of authority sustaining the right of the state commissions to alter franchise or contract rates.

The decisions of the New York courts recognize the power of the public service commission to change contract rates, but hold that such power, as regards certain street railways, has not been delegated to the regulatory body\textsuperscript{20} The decisions of that state are in line with the general trend of authority as regards other utilities.\textsuperscript{21}

In some cities in Colorado whose charters have been framed under the "Home Rule" provisions of the constitution, it has been held that jurisdiction over public service rates is vested in such cities, and the rates fixed therein by contract cannot be abrogated.\textsuperscript{22} To a limited degree the Colorado rule has been followed in both Louisiana\textsuperscript{23} and in New Jersey\textsuperscript{24}

Kentucky being one of the few states without a regulatory body to supervise public utility rates, it necessarily follows that the exact question under consideration has never been adjudicated in this Commonwealth. Section 201 e-23 of Carroll's Kentucky Statutes, 1930 Edition, subjects any public service company which has continued its service after the expiration of its franchise to the jurisdiction and supervision of the Railroad Commission, and forbids it to withdraw such service without permission of the Commission so long as it remains in business in any part of the state. In several cases the constitu-

\textsuperscript{19}134 Va. 34, 114 S. E. 92.
\textsuperscript{23}Baton Rouge Water Co. v. La. Pub. Serv. Com., 156 La. 539, 100 So. 710.
\textsuperscript{24}Federal Ship Builders Co. v. Bayonne (N. J.), 141 Atl. 455, Aff. 144 Atl. 913.
tionality of that statute has been assailed, but each time it was adjudged that either the question was not presented or could not be raised by the parties to the action. Therefore those cases and the rulings therein will not be of any material aid in enlightening a discussion of the present question.

The specific authority to regulate the rates of public utilities in the municipalities of this Commonwealth, as set out in Carroll's Kentucky Statutes 1930 edition, is somewhat at variance, but does not in any instance confer a greater power than to "fix and regulate" such charges. Thus, the question arises whether or not the General Assembly has by clear, distinct and concise language conferred upon any municipal corporation the necessary statutory authority to enter into an inviolable rate contract. In the case of City of Ludlow v Union, Light, Heat and Power Co., the Court of Appeals in construing a section of the Kentucky Statutes giving a city of the fourth class the authority to "fix and regulate" rates, said "By its specific terms it purports to bestow on the cities power only to regulate rates and the quality of service being rendered under charters or franchises." The Supreme Court of the United States has both in the case of Home Telephone Co. v Los Angeles and in St. Cloud Public Service Company v. St. Cloud explicitly decided that words such as "fix and regulate" is no authority to "abandon the governmental power itself it authorized command but not agreement. It authorizes the exercise of the governmental power and nothing else." Under the inducement of the highest authority the logical construction to be placed upon such a delegation of power as exists in this state does no more than confer on the municipalities the right to exercise a mere delegated authority, in acting as agents of the state. It would be strange, indeed, if the state, which has the authority to terminate the powers of the municipality created by it, could not revoke authority granted by it to them, and, in the exercise of its sovereign power, cancel conditions which it had permitted them to impose

31 211 U. S. 265, 58 L. Ed. 176; 265 U. S. 352; 68 L. Ed. 1050.
upon other classes of corporations which had also been created by the state.

The Court of Appeals of Kentucky has, in many of its opinions, recognized that the fixing of rates and tolls is a legislative function, that to fix such charges comes within the governmental or police powers of the state and not under its contractual powers, that such governmental power, if it can be bargained away at all, it must be in words of positive grant, or something which is in law equivalent. In one of the early-toll bridge cases of Commonwealth v. Covington Bridge Co.\(^{29}\) it was recognized that rate making is a legislative function, and can only be bargained away by words of express grant.

"Nevertheless the power to regulate tolls, and in this class of cases, being the exercise of a governmental power, as must be conceded, its exercise may be resumed at any moment, unless by contract the state has surrendered it. The power of regulation is a power of government, and, if it can be bargained away at all, it can only be done by words of express grant, or something which is in law equivalent. If there is reasonable doubt it must be resolved in favor of the existence of the power. The rule is elementary, and the cases in which it has been considered and applied are numerous."

This case was reversed by the Supreme Court of the United States,\(^{30}\) but on the ground that the regulation of the bridge tolls was an interference with interstate commerce. Hence that ruling does not detract from the Kentucky court's reasoning and statements on that phase of the case relative to the governmental power.

The court ruled in Winchester Turnpike Co. v. Croxton\(^{31}\) that in the case of a corporation whose property is affected with a public interest and which is therefore essentially public in its nature, the reservation of the legislative authority to act is understood unless clearly negatived in express words or by necessary implication. In the course of the opinion it was said.

"But the property of the corporation in this instance is affected with a public use. Its corporate nature is essentially public, and the rule is that the charters of such corporations are not protected from legislative interference unless in unmistakably clear language the state has indicated a deliberate purpose not to interfere for all time to come."

In construing the grant of a lottery franchise in the case of Commonwealth v. Douglas,\(^{32}\) it was stated

\(^{29}\) 14 Ky. L. R. 836, 21 S. W. 1042.
\(^{30}\) 154 U. S. 224, 39 L. Ed. 970.
\(^{31}\) 98 Ky. 739, 34 S. W. 518, 33 L. R. A. 177.
\(^{32}\) (Ky.) 24 S. W. 233.
"But apart from the binding force of the decision, it seems that its logic is conclusive and convincing in drawing the distinction between the contractual power of the state, to-wit, that the provision of the federal constitution in reference to contracts only inhibits the states from passing laws impairing the obligation of such contracts as relate to property rights, but not to subjects that are purely governmental. The reason for this distinction must be apparent to all, for, when we consider that honesty, morality, religion and education are the main pillars of the state, and for the protection and promotion of which government was instituted among men, it at once strikes the mind that the government, through its agents cannot throw off these trust duties by selling, bartering or giving them away. The preservation of the trust is essential to the happiness and welfare of the beneficiaries, which the trustees have no power to sell or give away. If it be conceded that the state can give, sell and barter away any one of them, it follows that it can thus surrender its control of all and thus deprive the state of its power to repeal the grants and all control of the subjects, so far as the grantees are concerned. As said, we are bound by the construction given to the federal constitution by the supreme court, relating to the impairment of contracts by the states and that the matter of such grants being strictly \textit{within the police power of the state}, the state could not sell or barter away its control of the subject."

The rule was recognized and succinctly stated in the case of \textit{German Insurance Company v. Commonwealth}.\textsuperscript{33}

"It may also be here noted that altho the constitution of the United States forbids any state from impairing by constitution or law the obligations of a contract, there is yet the exception to this general rule that the state cannot contract away its police power or its right to abrogate or annul contracts it has made in contravention of this power, and so, altho the state may have entered into a contract that would ordinarily be binding upon it, and beyond its power to impair, it may yet avoid a contract so entered into, if by the contract the state undertook to part with its police power."

In \textit{Kentucky Traction and Terminal Company v. Murray},\textsuperscript{34} is was said

"We are unable to see that the refusal of the relief sought by the appellees will constitute such an impairment of the obligation of the contract here involved as would violate article 1, section 10, Const. U. S. The right of the states to enforce the provisions of its constitution and those of its statutes enacted in pursuance thereto, looking to the proper exercise of the police power, cannot be questioned, and those provisions are to be considered as carried into and made a part of every contract between a common carrier and an individual. The contention of the appellee that the contract was valid when made and that its performance was enforceable disregards the fundamental rule of contracts referred to, \textit{viz.}, that all laws in existence when the contract is made or thereafter enacted in pursuance of the police power of the state, necessarily enter into and form a part of it as fully as if they were expressly incorporated into its terms. An excellent statement of it will be found in Pinney and Boyle v. Los

\textsuperscript{33}141 Ky. 606, 133 S. W. 793.

\textsuperscript{34}176 Ky. 593, 156 S. W. 1119.
Angels Gas and Electric Corporation, 168 Cal. 12, 141 Pac. 620, L. R. A. 1915C 232, Ann. Cases 1915D 471. "A word perhaps should be added touching the asserted violation of the provisions of the contract between the company and the plaintiff by the enforcement of the terms of the regulatory ordinance. Upon this it is sufficient to say that it will be conclusively presumed that the parties contracted in contemplation of the power of the proper board or tribunal to fix rates in every case where such power exists and may have been thereafter legally exercised" (citing cases).

From the foregoing excerpts of the Kentucky cases it is easily discerned with what jealousy the courts look upon a delegation of the governmental or police power of the state. It naturally follows that when a municipality enters into a contract with a public service corporation, in its legislative capacity, it is presumed that the parties entered into the contract with the knowledge that the right of the state to exercise the police power in the future is reserved, and that, where the common weal and the interest of the public demand that the provisions of the contract thus entered into shall be modified, it can be done without any violation of the provisions of the Constitution of the United States with reference to the impairment of the obligations of contracts.

Altho any decision of a Federal District Court, in construing a state statute, is not binding on the State Court, it is, however, highly persuasive. In the case of *Kentucky Power and Light Company v City of Maysville,* from the Eastern District of Kentucky, the Court commented on the surrender of the rate regulatory power of the state. There the state, in 1854, had given to the Maysville Gas Company the right to furnish gas to the inhabitants of the City of Maysville upon such terms as "may be agreed upon." Later, in 1886, the Citizens Gas Light Company was created by the General Assembly and a part of its charter provided that it be allowed to furnish gas to the citizens of the City of Maysville "by contract with them." These two companies, heretofore mentioned, were finally merged into the Kentucky Power and Light Company. In May, 1929, the City of Maysville enacted an ordinance fixing a maximum rate to be charged by the Kentucky Power and Light Company. The latter company sought to enjoin the enforcement of the ordinance on the theory that under the charter provisions of the Maysville Gas Company and Citizens Gas

*36 Fed. (2nd) 816.*
Light Company power was conferred on those two corporations to charge such rates as "may be agreed upon" between the two such companies and the citizens, and that the Kentucky Power and Light Company, as successor to the two former companies, enjoyed the same right, and that any attempt on the part of the Commonwealth, or any agency thereof, to interfere with such right, by a regulation of the rates charged, constituted the impairment of the obligation of a contract. It was held that the authority bestowed upon the City of Maysville by a state statute giving the city the authority to regulate rates superseded any rights granted by charter to the Gas Companies. In the course of the opinion it was said:

"The power to regulate rates of public utilities is inherent in every sovereignty. It is legislative in character and is a part of the police power. The state may, within limits, contract with a utility as to the rates to be charged, yet it may well be doubted if, under the modern rule, it can irrevocably surrender all regulatory power. Certainly no such surrender is to be presumed. On the contrary every presumption is against any such surrender. (Citing cases.)" It does not seem to me, however, that the two charter provisions relied upon irresistibly compel the conclusion that it was the intention of the legislature to forever surrender the power of the state, by legislative action, to regulate the rates of the two companies referred to, and to leave the question of the reasonableness of such rates to be dealt with by the courts as the occasion might arise. A more reasonable construction is that these two charter provisions conferred upon the two corporations the right to make valid and enforceable contracts as to the rates to be charged, subject always to the rate regulatory power of the state

Both municipal and private corporations are but creatures of the state and can exercise only such powers as are expressly granted or may be necessarily implied from the charter. Thus, a corporation, under this decision, may have specific authority to contract as to rates, yet such contracts are always under the supervision of the state and may be changed, abrogated or regulated at any time by the state or its agent. As hereinbefore stated, this decision would not be binding on the state court, yet it is highly inducive to the view that it would have great weight in the decision of a similar question by the state court.

In many instances the contention has been made that the power of a municipality to control the use of its streets and to forbid the operation and construction of designated public utilities without its consent, gives to the said municipality the right to enter into inviolable rate contracts. However, the
courts, with few exceptions, have decided that such a right did not deprive the legislature of its authority to fix rates or to authorize a public service commission to do so. The trend of authority is to the effect that a constitutional or statutory provision stating that the consent of the local authorities, having control of the streets and highways sought to be occupied, is required in order that a public utility may construct its lines, pipes, conduits, etc., is but a limitation of the general powers of the legislature and in one particular only. It does not by implication or otherwise attempt to divest the state of its paramount authority and control of the streets and highways, nor does it deprive the legislature of its authority to fix rates for such companies. The various courts’ reasoning is to the effect that the streets and highways are for the use and benefit of all the citizens of the state, that the question of rates of public utility companies is not one of local concern, merely, or local politics, and that it would be a strained and unreasonable contention to say that any such provision of the law was intended to give to the corporate authorities the right to fix rates under varying conditions and to thus supersede the sovereign power of the state.

In Missouri it was held that a constitutional provision against granting the right to construct and operate a street railway within any city without the consent of the local authorities is rather a limitation on the power of the legislature and cannot be construed as a delegation of power to fix and regulate rates.36

In Illinois it was decided that constitutional provision requiring municipal consent to the construction and operation of street railways does not confer on the corporate authorities the right to contract as to rates free from legislative authority, and that it would be unreasonable to say that the legislature had such power.37

The great weight of authority is to the effect that the power of a municipality to make irrevocable rate contracts is not to be inferred or implied from the power granted to such munici-

pality to control its streets or to regulate the use thereof by public utilities.\textsuperscript{38}

The decisions of Maryland and North Dakota have sustained the view that when conditions, such as the fixing of rates, are coupled with the permission or grant to use the streets, and such permission or grant is accepted by the utility company, then, all conditions or restrictions attached thereto become binding; thus, the rates so fixed are controlled by the obligations resulting from the contract. However, in the North Dakota case the court held that the power to change contract rates had not been delegated to the public service commission, and the question as to whether the commission could change the rates if such authority had been delegated was not decided.\textsuperscript{39} In this connection it is to be noted that some reliance has been place on section 163 of the Kentucky Constitution in attempting to sustain the view that the jurisdiction of a public service commission, if established in this Commonwealth, could not be successfully exerted to the extent of abrogating existing rate contracts. That section of the Constitution reads as follows

"163. Streets not to be taken by private corporation without consent; exception.

No street railway, gas, water, steam heating, telephone, or electric light company, within a city or town, shall be permitted to authorize or construct its tracks, lay its pipes or mains, or erect poles, posts or other apparatus along, over, under or across the streets, alleys or other public grounds of a city or town, without the consent of the proper legislative bodies or boards of such city or town being first obtained; but when charters have been heretofore granted conferring such rights, and work has in good faith been begun thereunder, the provisions of this section shall not apply."

The Court of Appeals of Kentucky has never decided whether or not the foregoing section gives to a municipality the authority to enter into an irrevocable rate contract. However,


\textsuperscript{39}Chas. Simons Sons Co. v. Maryland Tel. Co., 99 Md. 141, 57 Atl. 193; Chrysler Light and Power Co. v. Belfield (N. D.), 224 N. W. 871, 63 A. L. R. 1397.
in the case of *Winchester v Winchester Waterworks Company*,\(^\text{10}\) appealed from the Eastern District of Kentucky, and involving a section of the Statutes of this State, it was said.

"Independently of a right to control and regulate the rates to be charged for public service reserved in a grant of a franchise or right to use the city streets, a city or other municipality has no power to regulate the rates to be charged by water, lighting, or other public service corporations in the absence of express or plain legislative authority to do so. 3 Dill. Mun. Corp., 5th Ed., sec. 1325. Nor does such authority arise from the power to regulate the opening and use of streets, nor a grant of the general right to control and regulate the right to erect works and lay pipes in the streets of the city" (citing cases).

An analysis of the numerous cases is highly indicative to the belief that in this instance the majority view is the better view and that, by analogy, the Kentucky Court will follow the great weight of authority.

To uphold the principle of law enunciating the inviolability of rate contracts, greatest reliance is placed on section 164 of the Kentucky Constitution, which reads as follows

"164. Franchise or Privilege Not To Be Granted For Longer Than Twenty Years; Sale Of; Exception.

No county, city, town, taxing district or other municipality shall be authorized or permitted to grant any franchise or privilege, or make any contract in reference thereto, for a term exceeding twenty years. Before granting such franchise or privilege for a term of years, such municipality shall first, after due advertisement, receive bids therefor publicly, and award the same to the highest and best bidder; but it shall have the right to reject any or all bids. This section shall not apply to a trunk railroad."

The words "franchise or privilege, or make any contract in reference thereto," of the foregoing section, affords the principal and basic ground for the belief that this Commonwealth cannot, itself or thru an agency, abrogate existing rate contracts. This impression is derived in main from the words "or make any contract in reference thereto," and it is the belief that this language is so used to denote any contract that may be made or that may arise from the granting of a franchise, including rate contracts. In other words, the contention has been made that the foregoing provision gives to a municipality the authority to enter into an inviolable rate contract which is beyond the power of the state to alter in any degree. In the light of the great weight of authority, and the principles ap-

\(^{10}\) 251 U. S. 192; 64 L. Ed. 221.
Applicable to the construction of statutes or constitutional provisions delegating such power, this position is not tenable.

The legislature may, unless prohibited by the constitution of the respective state, delegate authority to a municipality to contract as to rates for a period not unreasonable in point of time so that future legislative action cannot, in any way, alter such contract rates.\(^4\) However, it is settled beyond controversy that a municipal corporation cannot enter in an inviolable rate contract which will be beyond the power of the state to alter unless the authority to enter into such an agreement has been conferred in such strong and positive language as will necessarily warrant a finding that such power has been delegated.\(^4\)

It has been stated by the Supreme Court of the United States, speaking thru Mr. Justice Day, that "The fixing of rates which may be charged by public service corporations is a legislative function of the state, and while the right to make contracts which shall prevent the state during a given period from exercising this important power has been recognized and approved by judicial decisions, it has been uniformly held, by this court, that the renunciation of a sovereign right of this character must be evidenced by terms so clear and unequivocal as to permit of no doubt as to their proper construction." Many times in the application of this general principle, the courts have held that the language used in a statute or other provision was not sufficient to clearly portray the intention of delegating the sovereign power. For example, in Wisconsin it was decided by the state supreme court, and affirmed by the Supreme Court of the United States, that power conferred upon a municipality to grant permission to construct and operate street railways in its streets "upon such terms as the proper authorities shall determine" did not give to the municipal corporation the power to make a binding contract as to rates so as to prevent interference by the state.\(^4\)

In *Freeport Water Company v Freeport City*,\(^4\) it was held that a statute authorizing a municipality "to contract for a supply of water for public use for a period not exceeding

\(^{a}\) See notes, 11.
\(^{b}\) See notes, 38.
\(^{c}\) *Milwaukee R. Co. v. Railroad Com. of Wis.*, 238 U. S. 174, 59 L. Ed. 1254.
\(^{d}\) "Ibid.
\(^{e}\) 180 U. S. 587; 45 L. Ed. 679.
thirty years" and to authorize private persons to construct waterworks and "maintain the same at such rates as may be fixed by ordinance, and for a period not exceeding thirty years" did not confer authority upon the municipal authorities to contract so as to exempt the water company from the exercise of the governmental power to fix rates.

Also where charter authority was granted to the common council of a municipal corporation "to regulate telephone service and the use of telephone within the city and to fix and determine the charges for the telephones and telephone service and connections" it conferred no authority to enter into a contract fixing rates so that they could not be changed, and the court said. "This is an ample authority to exercise the governmental power of regulating charges, but it is no authority to enter into a contract to abandon the governmental power itself." 46

The rule was likewise stated in St. Cloud Public Service Company v. St. Cloud, 47 as follows. "And we do not think that this contractual power was limited by the proviso that the council should have the right to 'regulate and prescribe' the rates and charges of the companies to which it might grant the right of constructing such works. It is true that standing alone this proviso, in the absence of any state decision to the contrary would, under the construction given similar language in Home Telephone Co. v. Los Angeles be regarded as conferring authority merely to exercise the governmental power of regulating rates, and not authority to enter into a contract."

From the language used in the foregoing cases upon which the right was claimed to enter into an inviolable contract, it is discerned that the authority to make such a contract must be specific or necessarily implied. Generally speaking, and logically understood, the reason for a strict construction of such a delegation of power seems to rest on the fact that it tends to suspend the sovereign right to regulate the service and to alter the rates of public service corporations as changing conditions warrant or justify, and, which, but for the contract would always be available to change when necessary, also that any delegation of governmental power is viewed with jealousy and disfavor. If

46 211 U. S. 265; 53 L. Ed. 176.
47 265 U. S. 352; 68 L. Ed. 1050.
the position of those who challenge the authority of the state, or its agent, to abrogate rate contracts be sustained it would have to be on a mere inference, not necessarily implied from a reading of section 164, supra, nor in conformity with the rule prevalent in practically every jurisdiction in strictly and closely scrutinizing such a delegation of power. It is to be noted that the term rate, or any term synonymous, is not anywhere mentioned in either section 163 or 164 of the Kentucky Constitution. The latter section relates to the sale of franchises only, and necessarily the authority to make a contract, as mentioned in that section, is such as relates only to the franchise. A contract in strict reference to the franchise is necessary and is universally separate and apart from the question of rates. Nowhere in the Constitutional Debates of 1890 can be found any word that will intimate it was the intention of the framers of that instrument to delegate to the municipalities of this Commonwealth the authority to enter into irrevocable rate contracts, on the contrary it seems the intention of that body was to obtain money for the municipalities from a sale of a franchise as mentioned in section 164. The following statement, made by the Hon. Bennett H. Young, is taken from pages 2131 and 2132 of the Debates.

"In this state most valuable municipal franchises have been bestowed upon favorites or schemers, and the municipal treasury robbed of millions of dollars. The franchises in the city of Louisville, given away or secured by an improper influence over its council, would today pay over one half of its ten millions of debt. Almost every street has been covered with railways, every sidewalk lined with telephone and electric poles, many passways filled with conduits for wires, and never a single dollar gone into the treasury of the city. Thus great population has not been gathered without vast outlay, and these streets have only been built by the expenditure of millions of money, and many franchises must be of enormous value. Upon what system of government or what process of reasoning can the granting of franchises worth millions to aliens or favorites be justified? These franchises honestly and justly belong to the people at large, to the municipality itself, and they should be disposed of for the benefit of the body-politic, and not handed over to a few unscrupulous municipal leeches in the name of decent, honest and respectable government, let us declare by the organic law that the value of such franchise shall go into the public treasury, and not be farmed out to corruptionists and robbers."

This seems to have been the idea that was prevalent in the minds of the framers of the Kentucky Constitution, and, thus, was the legislative intent. Further the very fact that this section of the Constitution has never been regarded by any of the
General Assembly of this Commonwealth as a grant of authority to municipalities, or as a complete delegation by the state of its sovereign power, to regulate rates and by contract, franchise or otherwise, to agree upon a scale of charges which would operate as a bar to the exercise of the governmental power by the state, is convincingly shown in the various acts expressly conferring authority upon the municipal corporations to merely regulate rates, and also in the regulatory powers conferred on the Railroad Commission to hear complaints and fix the rates to be charged by those utilities and under those conditions named in section 201-e et sequens of Carrolls Kentucky Statutes, 1930 edition, and supplement thereto.

Further, it is entirely proper and competent for the legislature, in granting a public utility franchise, to control the grantee in its exercise, and where one of the conditions of the grant is that the legislature may alter or revoke the franchise or privilege, the enactment of such a law, abrogating the provisions of the grant, cannot be said to impair the obligations of a contract.

By the decision in the earliest and leading case of Dartmouth College v Woodward it was established that a grant from a state to a private corporation created a contract within the meaning of that clause of the federal constitution forbidding any state from impairing the obligation of a contract. Mr. Justice Story in his concurring opinion in that case, took occasion to say "If the legislature means to claim such an authority (authority to change the provisions of a grant), it must be reserved in the grant." After that decision many of the states in the Union, in order to secure to its legislative body the exercise of a fuller parliamentary power over corporations than would otherwise exist, inserted either in its statutes or in its constitution a provision that privileges thenceforth granted should be subject to revocation, alteration or repeal at the pleasure of the legislature. Thus, though under the Dartmouth College case, supra, a legislative grant to a private corporation of special privileges may be a contract, but, where one of the provisions or conditions of the grant is that the legislature may alter or revoke the grant, the enactment of such a law will not impair the character of such privileges and cannot be regarded

48 4 Wheat 518; 4 L. Ed. 629.
as one impairing the obligation of a contract. Whatever may be the motive of the legislature, or however harshly such legislation may operate in a particular case or upon the parties interested, the corporation, by accepting the grant subject to the legislative power so reserved by a constitutional or statutory provision, must be held to have assented to such a reservation of authority. Corporations are but creatures of the state and are endowed with only such faculties as the state bestows, and are subject to such restrictions and conditions as the state imposes, and, if the power to alter or amend privileges granted to such corporations is reserved, the reservation is a part of the contract, and no change within the legitimate exercise of that power can be said to impair its obligations. This rule has been clearly and succinctly stated and upheld in numerous decisions. 49

Thus, with the rule heretofore stated in mind, we come to an inspection of the provisions of the statutes and constitution of the Commonwealth of Kentucky relative to the power of the General Assembly to abrogate, in any manner, the provisions of a franchise, whether granted by the state, or its properly delegated agency, the municipality.

Section 3 of the Bill of Rights in the Kentucky Constitution reads, in part, as follows: “and every grant of a franchise, privilege or exemption, shall remain subject to revocation, alteration or amendment.” Under this provision it was plainly the intent of the drafters of the Kentucky Constitution to reserve to the law making body of this State supreme control over franchises whether granted by the state or a municipality. This is evidenced by a reading of the Constitutional Debates of 1890 where, in several of the Debates, the point was explicitly

brought out that it was the intention of that body to take all grants and privileges from under the rule of the Dartmouth College case and place such grants under the supervision of the state in its sovereign capacity.

The following statement was made in volume one, page 472 of the Constitutional Debates of 1890, by the Honorable Proctor Knott:

"Let us have no more of it here. Let every franchise be revocable at the will of the legislature, whenever it shall see proper, but place those to whom it may have been granted precisely in the position they were before the grant was made. Rob them of nothing. Save to them and their legal representatives all property rights they have acquired thereunder. This can injure no man, while it is but just to the people that any franchise should be recalled whenever its exercise shall become hurtful to the public interest."

He again expressed that view on page 739 of the same volume:

"I would say, what he seems not to have observed, that the very object of this provision is to avoid the disastrous consequences of the celebrated Dartmouth College case, to which he alludes."

On page 594 of the Debates, the Honorable Leslie T. Applegate said:

"That law means simply that the Legislature in the future shall have the right to control all grants that are given by them; that in other words, when you create or incorporate a company of any kind, that they hold their incorporation subject to the sovereign will."

Honorable George Washington, on page 710 of volume one of the Debates, quoted from Cooley on Constitutional Limitations in the following language:

"Perhaps the most interesting question which arises in this discussion is, whether it is competent for the legislature to so bind up its own hands by a grant so as to preclude it from exercising for the future any of the essential attributes of sovereignty, in regard to any of the subjects within its jurisdiction."

Further:

"It would seem therefore to be the prevailing opinion, and one based upon sound reason, that the State cannot barter away, or in any manner abridge or weaken, any of those essential powers which are inherent in all governments, and the existence of which, in full vigor, is important to the well-being of organized society; and that any contracts to that end are void upon general principles, and cannot be saved from invalidity by the provision of the national Constitution now under consideration."

Obviously, from a reading of the Constitutional Debates of
1890 on Article 3 of the Bill of Rights, it was intended that the legislature should have the right of revocation and amendment, and that whomsoever took a franchise or privilege should take it subject to that right.

By section 1987 of Carroll's Kentucky Statutes, 1930 Edition, enacted a year after the present Constitution was adopted, it is further shown that the legislature wanted it unequivocally understood that all franchises and privileges should always be subject to the sovereign powers of the state. That section reads as follows:

"All charters and grants of or to corporations, or amendments thereof, enacted or granted since the fourteenth of February, one thousand eight hundred and fifty six, and all other statutes, shall be subject to repeal at the will of the general assembly, unless a contrary intent be therein plainly expressed: Provided, that whilst privileges and franchises so granted may be repealed, no repeal shall impair other rights previously vested."

From the quotations, supra, the intent is logically deduced that the drafters of the state Constitution and the General Assembly of 1893 wanted the rule clearly enunciated and placed in the laws of this Commonwealth that the state could not barter or contract away its legislative or governmental powers, and thus under no conditions could grant an irrevocable franchise or privilege. Thus, it follows as a natural sequence that such reserved authority affects the entire relationship between the state and a public service corporation and places under legislative control all rights, privileges and immunities derived from such grant. So, the right of a public utility company to operate and to charge rates for the service rendered being dependent upon the franchise, it follows, the legislature having the supreme authority over the franchise itself, that it would have control over the rates of such company.

Even aside from the power of the state to vary or annul the franchise of a utility company, there is further authority in the Kentucky Constitution that amply retains to the legislative body of that state complete control over the rates of such companies. Section 195 of the Constitution reads in part as follows:

"... and the exercise of police powers of this Commonwealth shall never be abridged, nor so construed as to permit corporations to..."

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Cooley Const. Lim., supra and note—also cases to note 49.
conduct their business in such manner as to infringe upon the equal rights of individuals."

There was very little argument on the foregoing section in the Constitutional Debates of 1890, but there were several statements made relative to the police power of the Commonwealth of Kentucky. On page 3686 of volume three of the Debates, Hon. Hansom Kennedy made the following statement: "It is a well established doctrine that the state cannot surrender the power of eminent domain, nor can the state surrender the exercise of its police power." On the same page and in the same volume, the Honorable J. F. Askew said: "that the police power of the state remained intact, and nothing could be done by one legislature to impair it. That being true, now is a good time for us to put it beyond doubt in our Constitution."

It has been stated, supra, and is now settled beyond all doubt that rate-making is a governmental function and comes within the police power of the state. In no state in the Union has the police power been more zealously guarded than in this Commonwealth. In *German Insurance Co. v Commonwealth*, supra, it was said "the state cannot contract away its police power or its right to abrogate or annul contracts made in contravention of this power." In *Kentucky Traction and Terminal Company v Murray*, supra, the following statement was made: "all laws in existence when the contract is made or thereafter enacted in pursuance of the police power of the state, necessarily enter into and form a part of it (the contract) as fully as if they were expressly incorporated into its terms."

In *Northern Pacific R. Company v Duluth*,51 the court said: "The exercise of the police power cannot be limited by contract for reasons of public policy, nor can it be destroyed by compromise, and it is immaterial upon what consideration the contracts rest, as it is beyond the authority of the state or the municipality to abrogate this power so necessary to the public safety" (citing cases).

In *Atlantic Coast Line R. R. Co. v Goldsboro*,52 it was stated: "For it is settled that neither the 'contract' clause nor the 'due process' clause has the effect of overriding the power of the state to establish all regulations that are reasonably necessary to secure the health, safety, good order, comfort, or general welfare of the commu-

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51 208 U. S. 583; 52 L. Ed. 630.
52 232 U. S. 548; 58 L. Ed. 721.
nity; that this power can neither be abdicated not bargained away, and is inalienable even by express grant; and that all contract and property rights are held subject to its fair exercise."

Again in *L. and N R. Company v Mottley*,53 which involved rates, the court said.

"If the legislature has no power to alter its police laws when contracts would be affected, then the most important and valuable reforms might be precluded by the simple device of entering into contracts for that purpose. No doctrine to that effect would be even plausible, much less sound and tenable."

In view of the pronouncements of the Court of Appeals of Kentucky, section 195 of the Kentucky Constitution, and the rulings of the Supreme Court of the United States, coupled with the discussion supra of the police power, the mandatory result is that every contract entered into fixing rates between a municipality of this Commonwealth and a public utility company is always subject to change by the paramount power of the state. It is equally as well settled that though the franchise may be granted and the rates contracted for by a municipality of the state, yet it would be only acting as agent of the state, and, as principal, the state may at any time waive any of its rights therein and vary the contract under its sovereign authority.

Following a discussion of the foregoing legal principles, it may be said, in addition, that rules of law do not stand alone, separate and apart from other rules and motives that govern and guide our daily life. Correct rules of law are based upon and supported by moral and economic principles. Thus, we are confronted with the query—In what manner is public convenience, prosperity and public welfare benefited by the abrogation of public utility rate contracts?

The representatives of the people were able to convince the courts that if the consumer had no recourse, under the police power, to change rate contracts, then he was at the mercy of the public service corporations in cases where, thru fraud or political manipulation, unfair or unjust rates had been contracted for a long period of time, or when, thru science or invention or a decrease in prices, the cost of rendering the service had been materially lessened so that rates fixed by the contract

53 219 U. S. 467; 55 L. Ed. 297.
were unreasonable and exorbitant. This argument was both understood and practised by the public, and was recognized and sustained by the courts.

However, it is very difficult to convince a consumer that an increase in rates fixed by contract will, in any way, enhance the prosperity, public convenience and general welfare of the community. This, however, to an extent, is true. The service rendered by a public utility company is necessary, likewise the quality and continuity of that service must be maintained. It requires capital to render the service and unless the business is remunerative, or has a good prospect to earn a fair return on the physical value of the property, capital will avoid that particular public service corporation, so as to make it impossible for the corporation to make those improvements and those extensions necessary to the needs of the community. Further if economic conditions have so radically changed that the rate fixed by contract has become confiscatory and there appears no immediate relief therefrom except by an increase in rates, then the utility corporation should receive the increase, or, upon failure to do so, will either go into a receivership, cease operation or reduce the quality of the service so that it may continue to operate under the confiscatory rate. A receivership would result in added expense to be paid out of the rates received, cessation of operation would entail a loss to the community, and a reduction in the quality of service would be necessarily detrimental to the consumer. Where an increase in rates is requisite to attract capital necessary to make extensions and improvements, or to insure the quality and continuity of the service rendered, such an increase could logically and reasonably be said to promote the public welfare and convenience.

However, aside from the aforesaid reasons it is only just and equitable that a public service corporation be entitled to earn a fair return upon the physical value of the property devoted to the public use, no more, no less. It would seem that the rules of law casting the duty upon the various state regulatory commissions to increase or decrease so-called rate contracts, as the exigencies of the time may demand, are founded upon sound economic principles.

In conclusion it may be said that in consonance with the advanced text and judicial authority, it is equally beneficial to
the consumer and to the public service corporation that a state regulatory commission have complete control over rates, however fixed, and that such control comes within the undoubted police and sovereign powers of the state.