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"Harmony in
Diversity"

PORTLAND CITY CLUB BULLETIN

"Active
Citizenship"

VOLUME XIII

PORTLAND, OREGON, JUNE 17, 1932

NUMBER 7

FRIDAY, JUNE 17

HOTEL BENSON; 12:10

SPEAKER

O. E. CARR

City Manager, Oakland, California

SUBJECT

"The Administration of Municipal Affairs in Oakland"

O. E. Carr could make a fascinating talk on the more spectacular events of his nineteen years as a city manager serving six cities; but the program committee has asked him, instead, to review his work as manager of Oakland since July 1, 1931. Under his administration Oakland has been able to make retrenchments in the cost of its government without destroying essential services. He has but applied his extensive knowledge of how to secure municipal efficiency.

ROSTER INFORMATION DUE TODAY!

A new City Club membership roster with addresses and telephone numbers will be printed in next week's *Bulletin*. Please notify the City Club office before Monday noon of any changes of address or telephone number.

A TELEPHONE FRANCHISE FOR PORTLAND

A Report by the Port Development and Public Utilities Section of the City Club

To the Board of Governors of the City Club:

Since February 19, 1927, the Pacific Telephone and Telegraph Company has been operating in the City of Portland without a franchise. On that date the twenty-five year franchise granted in 1902 expired, and thus far the city and the company have not been able to agree on terms for a renewal. At the present time the company is actually operating under the terms of a revocable permit, voted by the City Council January 14th of this year. This is a purely transitional regime, a fact which is emphasized by the ordinance of the Council passed last March 16th, providing for a five per cent penalty tax to be levied on the company. This tax is designed to take effect January 1, 1933, in case the company should fail, by that time, to have accepted a franchise from the city. It is doubtful whether this penalty tax could actually be put into effect, should agreement fail before the date specified. It is certain, however, that the matter would be contested in the courts, thus involving further postponement of a final agreement.

Franchise Issue Should Be Settled

The existing situation is highly undesirable, and should be brought to an end as soon as possible by a franchise agreement between the city and the company. Such an agreement, if the terms are reasonable, would be to the advantage of all parties concerned. It would stabilize the relations between the city and the company, thus eliminating one source of local political disturbance. It would also be good business for both parties, as each would be thereby enabled to plan more intelligently for the future in terms of established financial relationships.

In this connection it ought to be pointed out that the granting of a franchise is a separate matter from that of fixing rates. Although the home rule provision of the Oregon laws, Section 61-261, adopted 1931, does permit the city to fix rates by franchise, the City Council has itself recognized the inexpediency of this procedure, for, by resolution of last December it expressed its intention to leave the problem of fixing rates to the State Public Utilities Commission.

TUNE IN KEX AT 8:30 P. M., SUNDAY

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City Club dues are \$1.00 per month, payable semi-annually on May 1st, and November 1st. There is no initiation fee.

The regular Friday luncheon meetings are held in the Crystal Room of the Benson Hotel.

CITY CLUB PURPOSE

"To inform its members and the community in public matters and to arouse them to a realization of the obligations of citizenship."

THE CITY CLUB BOARD of GOVERNORS

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APPLICATION FOR MEMBERSHIP

The following application for membership, having been approved by the Board of Governors, is hereby recommended to the Club.

If no objections are filed with the Board of Governors or the Executive Secretary prior to July 1, 1932, this applicant will, under the Constitution, stand elected.

ALBERT G. JOHNSON
City Commissioner
City Hall
Recommended by M. D. Wells

Though this resolution may be rescinded it expresses a wise policy, since the essential purpose of a franchise is the fixing of the general conditions under which the utility may use the streets and public places, and other matters strictly incidental thereto. These are functions which the local authorities can perform intelligently, for they are related to problems which are peculiarly local in character, since they grow out of the special needs of individual communities.

Local Rate-Making Is Not Feasible

The rate-making function, however, is markedly different from the above. It is not primarily local in character, for the major elements involved in determining a fair rate extend beyond the jurisdiction of the localities into the state and national field. Difficult questions arise in this connection. What portion of the assets of such a complex network and widely ramifying concern should be allocated to the local area as a basis for determining rates? What part of the company receipts taken in locally should be properly taken into account for local rate-making purposes? How can the company's operating expenses be divided between those strictly within the municipal limits and those beyond this invisible line? In what ways is the financial position of the company affected by its relations with holding companies which may be even national in their scope? Such are some of the difficult questions whose solution would have to be sought by a local rate-making authority. If the above-mentioned home-rule powers were actually sought to be acted upon by the various cities of the state it is obvious that the undertaking would not only be enormously more expensive than necessary, but would necessarily be unscientific in character owing to the different standards of appraisal involved in the respective localities.

Some competent authorities, and some members of your committee are of the opinion that the time will come when even state regulation of telephone rates will prove inadequate, and that national control will ultimately be essential. This serves to reinforce the conviction as to the inadequacy of local action in this field.

Franchise Should Be First Step

Aside from the above considerations, it is plain that even though the city attempted to fix rates, the other points relating to conditions of service and rate of taxation under the franchise should be first determined. Fixing the franchise conditions, in other words, is a necessary preliminary to fixing rates, and the two problems should be kept separate.

In this connection, it ought to be pointed out that State Commissioner Charles M. Thomas has publicly announced his intention of proceeding at once to the settlement of the rate question as soon as a franchise has been agreed to by the city and company. The city's representatives should, and indeed according to the commissioner's statements, would be allowed to participate in the hearings in this matter, and to contribute all relevant material at their command.

Long-Term Franchise Is Favored

A franchise may be perpetual, indeterminate, short-term or long-term. Owing, however, to the requirements of the Portland city charter, limiting franchises to twenty years, only the relatively short-term and relatively long-term types are matters of practical politics at this time. Assuming that powers are reserved to the city to deal adequately with changing conditions, the relatively long-term franchise, with right of acquisition of the company's property by condemnation or otherwise, is preferable to the short-term grant. More advantageous financing and more systematic planning by the company are obviously facilitated under long-term conditions. If, as indicated, local rights are safeguarded, the city also benefits from such a situation by reason of the fact that its relations with the company are stabilized on a regular business basis, and that a fruitful source of friction is removed from local politics. In the present case the fact that rates are not frozen in the franchise is a major safeguard. Indeed, the city will be free to bring the rate question before the State Commission any time it chooses to do so, when once the preliminary franchise conditions are settled. Until these are settled the State Commissioner regards himself as unable to proceed with the rate problem. Another safeguard is the above-mentioned right of acquisition possessed by the city on six months' notice. Reservation of its regular police powers over the company, and various other supervisory powers seem to be fairly adequate for the protection of the local public interests.

Favoring the general principle of a properly safeguarded long-term grant, your committee feels that in the present situation a satisfactory solution would be realized by an agreement upon a twenty-year franchise beginning February 19, 1927, the date of expiration of the previous grant.

Utility Taxes Are Paid By Users

The question as to what is a proper franchise tax to be levied on a public utility such as the telephone company is likely to give rise to misapprehensions. Such a tax levied on the gross revenues of the utility is a peculiarly tempting means of obtaining revenue, and from the standpoint of the tax collector, the utility's earnings are an ideal source of revenue. But from the standpoint of equity there are important objections to a tax for revenue purposes. The public is likely to ignore the fact that all such charges and exactions must necessarily be included in those items which go to determine the basis of rates. Thus they inevitably tend to support a case for higher rates, and ultimately fall upon the ratepayers. The result of this procedure is that, in effect, money is transferred from the pockets of the telephone ratepayers into the pockets of the taxpayers. Unless this

policy rests on a sound social theory that the telephone ratepayers, a special group of citizens, should contribute to the public treasury in behalf of the general taxpayers, it seems to have little justification. In any event exaggerated importance is attached to the exaction of a relatively high tax rate from the company when it is realized that after all the company collects the money but really does not ultimately pay the bill.

It should also be noted, in this connection, that the additional charge placed upon the telephone ratepayers will be actually greater in total amount than the total sum yielded by the tax to the city and thus removed from the shoulders of the taxpayers. This is due to the fact that, for various reasons, such taxes always tend to be pyramided in relation to the ultimate consumer.

Should Pay Policing Costs

The use of the streets and public places by the company does, nevertheless, cause some expense to the city and therefore to the taxpayer. The erection of poles, wires and structures requires inspection and policing to see that the public is not endangered. Charges sufficient to cover these costs of administration should be paid by the users of the service and not by the taxpayers. Such charges are merely the repayment of expenses incurred, and are not a source of net revenue to the city.

At the present time the city and the company have entered into an agreement for a 2% tax on gross revenues from local exchange service. Though the payments by the company on this basis undoubtedly more than satisfy the above policing requirements, we feel that the existing arrangement is satisfactory, especially in view of the fact that a precise determination of such costs of administration has not been made, and since, indeed, precision in such a matter would be difficult, if not impossible.

Provision For Breach of Franchise Terms

The franchise presented to the Council last March proposed (1) that in case of breach of its terms by the company the city should have the full right "to assume charge and control" of all of the company's property and to operate it during the period of the company's delinquency; and (2) that alternatively the city might declare the rights of the company forfeited. The present proposal before the Council provides only for forfeiture.

We believe that neither of these proposals adequately meets the requirements of the situation. The proposal for taking over and operating the property of the company is obviously impracticable, owing to the necessity for unified control and operation of such a utility that depends very largely for its value to the individual subscriber on its state-wide and nationwide character. On the other hand, we feel that mere provision for forfeiture is unsatisfactory, since, in effect, it would simply cause the relations between the city and company to revert to somewhat the same nondescript status as that in which they now are.

Hear DOC, DAD and JUDGE discuss
 "THE NEXT STEP
 IN TERMINAL UNIFICATION"
 next Sunday evening at 8:30.
 Tune in KEX.

Money Penalty Is Proposed

We therefore suggest that some form of money penalty would be a desirable additional provision. This might well take one of two different forms; or indeed, both forms might be employed. It might take the form of an excise tax penalty. Thus, in the section providing for a 2% tax on gross exchange service revenues on local business, the following clause might be added:

"Provided that such compensation during the period of any default by the Company in performance of any of the obligations imposed upon it herein shall be at the rate of 3 per cent. Such additional compensation shall be paid out of the company's net revenues and not charged to its operating expense."

Another form which this money penalty might take would be in the form of a certain sum of money, in the nature of liquidated damages, which might be assessed against the company for each day of its delinquency. Thus, in the section providing for possible declaration of forfeiture by the city, a paragraph somewhat as follows might be added:

"In the event of a violation of the terms and conditions of this franchise by the Company, in all cases where the amount of the damages is not definitely ascertainable, the City shall be entitled to recover from the company, as liquidated damages, the full sum of \$..... for each such violation, and where the violation involves delay in performance by the Company, the sum of \$..... per day for the period during which such default continues; and the City, at its election may, on behalf of the Company, perform any affirmative act or acts, which by this franchise the Company shall be required to perform, and shall be entitled to recover from the Company the reasonable expense incurred or paid by it in so performing the duties of the Company in this respect. Such additional compensation shall be paid out of the company's net revenues and not charged to its operating expense."

"The City shall have the right to enforce one or more remedies hereunder, successively or concurrently, and nothing herein shall be construed as depriving the City of any other remedies to which it may be entitled by law."

The above types of penalties might be regarded as alternatives, or, indeed, both of them might be resorted to, since one is in the nature of an additional excise tax, and the other is in the form of liquidated damages. These suggestions are made by the committee in the conviction that such a levy on the company would not be passed on to the ratepayers. Since it must be viewed as a penalty, rather than a legitimate item in the expense account, the company stockholders should bear the loss, should it arise, rather than the users of telephones.

Provision For Purchase By the City

Although the possibility that the city will itself ever purchase the properties of the telephone company is very remote, in view of the afore-mentioned interlocking character of the utility throughout the nation, we feel justified in calling attention to the basis of valuation laid down in the present franchise proposals. The relevant section provides that the city may, on six months' notice, purchase the company's property upon "fair value lawfully ascertained." Mr. John Bauer, director of the American Public Utilities Bureau, has appropriately pointed out that "valuations are of basic importance... The basis of compensation to the company should be definite and beyond dispute."

The term "fair value," however, has been the source of much confusion and ambiguity, and, as Cassius M. Clay, legal authority on public utility regulation, says, not only has it mystified lower courts and commissions, but it has "prevented any public understanding of the real

issues of rate-regulation." Justice Brandeis has well stated that the fair value rule, however attractive in appearance, is actually delusive and unworkable in practice.

Prudent Investment Theory Is Advanced

There is a growing belief that the nearest approach to a fair, as well as objective basis of valuation is that of prudent investment. That is the valuation of the property shall be fixed at the amount actually invested in it, on affirmative showing that each successive portion of the investment was made at a time and in a manner necessary for the maintenance of good service to the public, and that all expenditures were made with prudence and economy. Not only is it believed that there is less of the element of guess-work in this method of valuation, which takes into account those sums actually wisely invested, but it has the obvious advantage of fairness to all concerned, in that it steers a middle course between the inconveniences of changing price levels. Furthermore it is the opinion of competent authorities that only valuation on this basis is capable of being "kept up to date without much dispute, endless litigation and an enormous expenditure of money."

Your committee believes that the franchise granted to the company should embody this principle as a wise basis of social policy. Nor do we believe that the City Charter precludes the inclusion in the franchise of this basis of valuation. Although Section 177 of the Charter refers to purchase on the basis of "fair valuation" this would not seem to forbid an agreement whereby fair valuation would be rendered specific by reference to the principle of prudent investment.

RECOMMENDATIONS

Your committee therefore has reached the following conclusions:

- (1) That further delay in reaching an agreement between the city and the telephone company is not compatible with the public interest.
- (2) That the franchise should be for a term of twenty years, beginning at the date of the expiration of the previous franchise,—February 19, 1927.
- (3) That the existing agreement between the city and company for a levy of 2% on gross exchange service local revenues is satisfactory.
- (4) That a money penalty should be included in the franchise in the case of a violation of the franchise terms, either in the form of an additional excise tax or in the form of liquidated damages, or both.
- (5) That the principle of "prudent investment" should be included in the franchise as the basis of valuation should the city ever desire to purchase the property of the company.

Respectfully submitted,

EARL R. ABBETT,
LAMAR TOOZE,
J. P. NEWELL,
MERTON R. DELONG,
G. BERNARD NOBLE, *Chairman.*

Approved by George W. Friede, chairman of the Port Development and Public Utilities Section.

Accepted by the Board of Governors and ordered printed and submitted to the membership for consideration on Friday, June 24, 1932.