FRANCHISE PROVISIONS IN COMMISSION CHARTERS AND STATUTES

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It cannot be denied that many intelligent citizens look upon public utility corporations and managers as corrupters of political morals in cities,—not universally, but on the whole. Neither can it be denied that many public utility managers look upon aldermen and other public officials as grafters and "hold-up" men,—not in every case, but so generally as to make a really honest official a rare exception. There is no use in blinking the fact that these opinions prevail. They reflect what is perhaps the most deep-seated and most widespread malady of the American body politic. The streets and highways of a city may well be compared with the veins and arteries of the human organism. Anything that affects the control or uses of the streets or diverts them from their function of serving the entire body politic impartially, is like an infection of the blood or a choking of the arteries.

This evil of politics,—it is not exclusively an evil of city or even of local politics, but affects all politics that have to do with the control of the highways of travel and communication,—is based upon a wrong conception of the nature of the highway and its normal relation to government. The street is the open road, the common channel, the people's path, the very means of civic life free to all members of the community to use in a public, but not in an exclusive way. The free highway is the bulwark of democracy. It stands for the public weal. It is the link that binds individual men together in a community. It is the irreducible minimum of practical socialism in any well-regulated city or town. Without regard to the strictly historical and legal development of the ownership and control of public streets, we have reached a stage of political development where we can begin to see what the highway means in the political science of the world. Some lawyer or historian

may say that the highway is not an adjunct of democracy at all, but has been from the earliest times the staff of autocracy and the means of establishing commercial overlordship. But the fact that the highway has not always been free, does not disprove that the control of the highway is of the very essence of sovereignty. He that owns or controls the highway is king. The very shibboleth of democracy is, "The highways must be free."

This fundamental proposition has not been fully recognized. Cities and states have acted upon the theory that certain portions of the public easements in the highways could, with propriety, be transferred to private individuals, either perpetually or for long periods of years, to enable these private persons to exploit the streets for profit, and, incidentally, to perform a public service. Only occasionally has the moving purpose in the alienation of public franchises been the performance of a public service, with the making of private profit secondary or incidental. When the complexity of civilization and the growth of population in cities make new and complex demands upon the street,—for example, that it shall be fitted up with a special iron roadway for passenger cars; with different sets of underground pipes to convey water, sewage, gas and steam; with conduits and pole lines to accommodate wires; and with wires to convey electrical currents for light, heat, power and communication,—the government may adopt one of two policies. It may keep abreast of the times, not shrinking from the full performance of its functions, and change the structure of the street by adding these various improvements as they are needed. Or, it may acknowledge its inability to perform its own functions, and may delegate them to private parties for profitable exploitation, as the Roman emperors used to farm out the provincial taxes. Democracy will have none of this second policy. It is contrary to the very idea of free government that public functions should be delegated to private persons to be performed by them under the guidance of profit as their motive of exploitation. It is an abnormal and monstrous thing, viewed from the standpoint of democracy, that anybody should receive from the government a special privilege enabling him to *get rich* out of the performance of a public function or out of the use of public property. The recognition of this abnormal thing as the regular, established policy of American cities has had in it not merely the possibility, but the

very necessity of corruption. The thing itself is corrupt. As flies are attracted to a sugar jar, so grafters are attracted to public offices where such corrupt things are done. As unsophisticated country girls lured to a brothel and compelled to participate in immoral practices are transformed into fallen women, so honest men elected to office where they are surrounded with the atmosphere of corruption and where bribery is the logical outcome of the prevailing theory of governmental functions, are turned into grafters. Between those who seek office for the opportunity to graft and those who are made grafters by the temptations and opportunities of officeholding, American municipal politics have fallen into a condition that has long been recognized as a national menace. We cannot assume that this condition will be permanent, as that would mean the very destruction of our city civilization. We cannot let the condition alone, hoping that it will work itself out, for it will not. The only course open to us is to study it, turn the searchlight upon the fundamental causes of it and remove those causes.

More important, probably, than any other one cause of bad city government—perhaps more important than all other causes combined—is this wrong attitude of the government toward the streets. In the use of official power to grant to private persons special privileges in the streets that ought never to be granted at all, is one of the chief sources of graft. It is, therefore, in the development of a right franchise policy that the greatest hope of improving municipal politics lies. It is especially important in the early days of a great municipal reform like the establishment of the Commission Plan of Government in the cities of the United States, that the hope of increased efficiency from the new form of governmental organization shall not be allowed to founder on the rock of corruption, which chokes the narrow channel leading into the harbor of good government, no matter by what sort of a boat we try to enter. The only safe course is to blast out the rock and clear the channel.

In the drafting of a city charter, these four fundamental propositions should be kept in mind, namely:

1. The city should take the initiative in the establishment of public utility services.

2. The city should own the streets and all the fixtures in them.

3. The speculative element should be eliminated from public utility investments.

4. The city should keep continuous control of the maintenance, equipment, location in the streets, extension, service and rates of public utilities, either through public operation, or through indeterminate franchises with adequate arrangements for public supervision.

In the first place, why is public initiative proper and necessary in establishing public utilities? Perhaps in the case of certain new and experimental utilities, such as the electrical transmission of music, where the service is limited to a comparatively few people, private initiative, under strict conditions as to the occupancy of the streets, may be permitted. But in the case of all well established utilities, such as water, gas, street railways, and electric light and power, there is no need of some private promoter to tell the citizens of a town or the residents of a particular street when they need the service. It is a common need that the people feel and the city should provide for. It can be supplied only through the laying of fixtures in the streets. The placing of these fixtures has an important relation to the construction, drainage, paving, and maintenance of the street itself and should be provided for in advance in connection with street improvement work. Moreover, all well established utilities have such a marked influence upon the physical, social, and industrial development of a city, that an up-to-date government belonging to the people and performing its full function, must actively control the installation and extension of these utilities. Furthermore, public utilities being naturally monopoly services, not subject to competition, and using public streets in a special way, cannot be left to the control of ordinary private motives. Every consideration of public policy demands that the rates for these services be kept as low as possible. Consequently, there is no legitimate room for the promoter who organizes new enterprises only for the purpose of over-capitalizing them and getting away with a big profit. This does not mean that there is no room for engineers who make a business of installing utility plants. It does mean that a city should know when it needs a water plant, a gas works, or a street railway, and should then proceed to get one, taking advantage of the best expert service available for the purpose. The necessity for public initiative is even more apparent in the case of extensions of an existing service

to outlying or undeveloped areas. It often happens that where extensions are left to private initiative, development is along lines that wholly neglect or even run counter to the most imperative demands of public welfare. This is particularly true in the case of street railways.

In the second place, why should the city own the streets and all the fixtures in them? Some reasons that apply here have already been given. In any community the streets are instruments of political control. Where the citizen is king, every street must needs be the king's highway. If these channels of the common life are encroached upon by private interests, there results, as it were, a thickening of the artery walls of the body politic, the effect of which upon the spirit of a city is like that of the corresponding human disease upon the courage and power of the individual man. Impotence is not conducive to courage and virtue, and the city whose people thread their way softly through streets whose most valuable easements have been parceled out to powerful, clutching, private interests finds itself stripped, tied hand and foot, and made the sport of the overlords of modern society. This picture is not overdrawn. An illustration of the helplessness to which the private ownership of street fixtures reduces a city is found in the case of New York, where for a dozen years many miles of horse car tracks, not used at all or only used by a "franchise-carrying" car, have cumbered the streets, while the great city whose population is equal to that of the State of Ohio, and the taxable value of whose site alone, without improvements, is four billions of dollars, and whose annual budget is now $175,000,000, has not dared to pull them up. The city official in charge of the highways of Manhattan has been afraid of going to jail if he touched these precious relics of bygone times, which serve to remind the citizens that they should be humbly thankful to be allowed to walk through the public streets of New York without paying toll. The city should own the streets and all the fixtures in them because it cannot afford to own any less and because, as a business proposition, the streets should be subject to unified and impartial control. Else the streets cannot perform their ever-increasing functions.

Practically, we have to recognize the fact that the ownership of street fixtures is already in large measure in private hands, and this condition can be changed only by condemnation or voluntary

purchase. In many cases, neither of these means is immediately practicable. It is necessary, therefore, to prepare the way in the franchise provisions of a city charter for the ultimate acquisition of these fixtures and for the ownership of all new fixtures from the beginning, or at least for their reversion to the city after a brief period of operation.

In the third place, why should the speculative element be eliminated from public utility investments? If the city owned the streets and all the fixtures in them, this portion of the investment would be at least as secure as municipal bonds, and the investment represented by the stocks and bonds of the public utility corporations would be limited to rolling stock and portions of plant not in the streets. This change in itself would greatly reduce the capital value of franchise corporations, both by the reduction in the amount of physical plant owned by them, and also by the reduction in the franchise value sure to result from the increased control over the streets arising from the ownership of the street fixtures by the city. There might still be large franchise values if the city improvidently leased its street property for long periods on terms favorable to the lessees, as was the case with the original New York subway. It is a fact that under its fifty-year lease, the Interborough Rapid Transit Company, at the rate of profit realized in 1910, could pay the city's rate of interest on the entire investment for both construction and equipment of the subway and, in addition, set aside an annual sum for amortization which, accumulating at four per cent per annum, would, before the end of the lease, provide a fund four times as large as the entire capital cost of the subway and its equipment. Strange as it may seem, the speculative element in public utility securities increases with the increase in the value of the franchises. This is so because the possibility of large profit in relation to visible investment tempts security jugglers and makes the real value of the security uncertain. Hence the most important means of eliminating the speculative element in public utility stocks and bonds is to eliminate the franchise value as far as possible. That the stocks and bonds of a company performing a public service by the use of public property under a franchise or lease ought not to be subject in any marked degree to manipulation and speculative changes in value is evident, both from the obvious injustice of permitting private parties to

reap exceptional profits or to risk exceptional losses in rendering necessary public service by means of special privileges in the streets, and from the patent folly of permitting the extent and character of these public services and the maintenance of public property to be dependent upon the exigencies of private speculation. It is notorious that stock jugglers let public utility plants run down, starving maintenance to swell dividends, or swelling capital account to decrease operating expenses. It is wicked for a city to permit its public utilities to be so managed as to render unsafe the capital honestly invested in rendering service, and it is equally wicked to pass out favors in the way of franchises that enable a particular group of private individuals to amass riches by levying tribute on their fellow citizens. Bankruptcy and exorbitant profit-making in public services are alike a disgrace to the city where they are permitted.

Finally, why should the city keep continuous control of the maintenance, equipment, location in the streets, extension, service and rates of public utilities? The short answer to this question is,—because public utilities are public functions and the city has no right to abdicate the control of the performance of its own functions. In elaboration of this answer, it may be said that the available space in the streets is so limited and the demands upon it are so great as to make it imperative for the public authority to keep a continuous control of the distribution and redistribution of this space for various public uses, and that the utilities are so vitally related to the growth and welfare of the city as to render it imperative for the city to be at all times in a position to compel the maintenance of the plant at the highest practicable standard of efficiency with adequate equipment, safe and sufficient service, reasonable expansion and rates as near cost as is consistent with the gradual amortization of the capital and a fair annual return on the investment.

The first requisite of public control over franchises is that the city should possess the unequivocal right to acquire, construct, maintain and lease or operate any or all of the principal public utilities. If this right is not granted in the state constitution, it should be granted by the general statutes governing cities or by the special law constituting the city charter. The right to own and operate utilities should be broad enough to include the power

of eminent domain both within and without the city limits and the right even to distribute utility services to suburban communities to a limited extent. Care must be taken that these rights are not rendered barren by the financial limitations imposed upon the city in other parts of the constitution, general laws, or special charter. While perhaps it is proper that a debt limit should be prescribed for cities, this limit must either be a very liberal one, or the bonds issued for public utility purposes must be excluded from it. If the utilities are conducted on a thrifty basis, so that the income from them will be adequate to pay operating expenses, depreciation charges and interest on bonds, and at the same time provide a sinking fund for the gradual amortization of the capital, the debt incurred for such utilities is not a burden either upon the credit or upon the tax rolls of the city. In fact, it is directly the opposite of this. The more money a city borrows to put into public investments that will be self-sustaining, including a provision for a sinking fund, the stronger its financial position becomes.

It is a common reproach against municipal ownership and operation that cities, by means of slipshod accounting methods and political financial reports, cover up the real cost of the utilities they operate and thus mislead the public into thinking that a great saving is being made where the fact may be just the contrary. For this reason, as well as on account of the inherent necessity of orderly administration, the charter should specifically require a city to keep distinct books of account for each public utility owned or operated by it, showing the true and complete financial results of city ownership or operation. Every unit of service rendered, whether to individuals or to other departments of the city, should be accounted for, and all the necessary allowances for operating expenses, depreciation, sinking fund charges, insurance and even taxes should be made in the utility accounts, so as to make the results of city ownership comparable, directly and in detail, with the results of private ownership.

It is not possible or desirable in a general statute or a city charter to describe in detail the provisions of the franchises to be granted from time to time by the city to private companies. It is necessary, however, that the procedure to be allowed in granting franchises should be specifically prescribed. Some charters go to the extent of requiring that every franchise shall receive the

affirmative vote of the electors before going into effect. This policy is advocated chiefly with the idea of safeguarding the public rights and minimizing the possibility of corruption. The submission of all franchises to popular vote gives rise to greater difficulties in some cities than in others. Where the relation of the city to public utilities has been worked out in a rational way, so that each utility is treated as a natural monopoly, and, if operated by a private company, is operated under a single comprehensive franchise, no harm can result from a charter provision requiring that every franchise grant shall be submitted to popular vote. If, however, the city has to grant a new franchise whenever an extension into a new street or a readjustment of tracks or pole lines is to be made, then the policy of the obligatory referendum may become burdensome and ineffectual. It seems that, under such conditions, it is sufficient to provide that a franchise grant shall not go into effect until, say, sixty days after its passage, and that in case a certain specified percentage of voters ask, within that time, to have it submitted to popular vote, then it shall not go into effect until ratified by the people. The council, or board of commissioners, ought to have the clear right, on its own motion, to submit franchise ordinances to popular vote.

The question of the advisability of providing for the popular initiative on franchise grants is a more difficult one. It must not be forgotten that franchises are contracts and in that respect are quite different from ordinary laws and regulations, which may be repealed from time to time if they prove unpractical. It is essential to the public welfare that all franchise ordinances should be scrutinized by experts and carefully worked out in detail before they are finally adopted. The only reason for permitting the use of the initiative in franchise grants is the fact that the legislative body may be so strongly under the influence of established public utility companies as to be unduly conservative in regard to making new grants. Such conservatism, however, is usually in the line of maintaining a unified service and preventing the logical wastes of competition. Nevertheless, it is so important for the people of a city to have complete and ultimate control of their governmental affairs, that the popular initiative may be permitted even in the granting of franchises if the exercise of the initiative is properly safeguarded. It is obvious, both from reason

and from experience, that a public service corporation with large financial ability and a great staff of employees can much more readily draft a franchise satisfactory to itself and secure sufficient signatures to get the franchise submitted to the people, than anybody else, working in the interest of the general public, can do these things. It is important, therefore, to guard against a subversion of the real purpose of the initiative and to prevent its being used as an instrument to curtail rather than to extend the continuous public control of the city streets, which is necessary to a well governed community. No franchise, whether granted by the legislative body, with or without the referendum, or granted by the electors on popular initiative should ever go to vote until it has had complete and prolonged publicity, nor until its provisions have been carefully examined and publicly reported on by a responsible and competent public expert, commission or committee. In the case of franchise ordinances initiated by petition, it would be best to require that, before being submitted to a vote, they be referred to the legislative body or the city's utility experts, and to provide that amendments or a substitute ordinance may be submitted by the city authorities at the same time with the ordinance initiated by petition. In all cases provision should be made for the publication of a proposed franchise several weeks in advance of its final adoption. Such publication should be either in a newspaper of general circulation or in pamphlet form properly advertised.

Public control over franchise utilities cannot be intelligently or effectively exercised except on the basis of detailed and intimate knowledge of facts. If the city is to maintain adequate control of the streets, so as to be able to apportion the available spaces economically to the several uses to which the streets must be devoted, a complete record of existing street structures and measurements is necessary. One of the fundamental requisites of the city's policy—one that is of sufficient importance to be prescribed in considerable detail in the city charter—is the keeping of systematic records relating to the streets. There should be, first, a street record containing maps, documents, diagrams and indices to show for every street in the city the location and history of all the utility fixtures above, below, or on its surface. There should be, second, a franchise record containing complete and correct copies of all franchises or grants for public utility purposes, with an index showing

the names of the grantees and of their assignees. In this record should also be contained references to all judicial proceedings and decisions affecting in any way the validity or the meaning of the franchises. There should be, third, a public utility record for each separate person or corporation owning or operating a public utility within the city. This record should contain all the franchises granted to or acquired or controlled by such person or corporation together with copies of annual reports, inspection reports and all other available information relating to the rates, property, and operation of such utility.

The control of public utilities requires so much special knowledge and such constant observation on the part of the public authority charged with such control that it becomes almost a matter of necessity, in all cities of considerable size, to establish a franchise bureau, or a department of public utilities, with a high grade expert at its head. This bureau, or department, should be charged with the keeping of the several records just described, with the issuance of permits for opening the streets in connection with the construction, repair, replacement or removal of utility fixtures, with the supervision of all street franchise work, with the examination and criticism of all proposed franchise ordinances, with the handling of complaints by public utility patrons, with the supervision of public utility accounts and with the enforcement of all the provisions of laws, ordinances, and franchise grants relating to the equipment of public utilities and the service rendered by them.

In order to insure effective public control, it is necessary that franchises should be indeterminate, at least to the extent of reserving to the city the right to terminate them within a comparatively short term of years after they have been granted and at brief succeeding intervals. With perpetual franchises, adequate control is impossible. They are not to be thought of. With term franchises, not terminable prior to their expiration, control is made difficult by the companies' fixity of tenure. No matter what safeguards may be put into a franchise for the purpose of insuring adequate service at all times at reasonable rates, it seems to be impossible to devise any method that will foreclose the problem against the tedious uncertainties of complex and long-drawn-out litigation, unless the city is in a position simply to throw

the company out of the streets and either take over the utility itself or let somebody else take it who will be amenable to control. The indeterminate franchise, as it is known in Massachusetts and the District of Columbia, makes no provision for the purchase of the physical property in case a company's grants are revoked. The American's sense of fair dealing, as well as the insuperable intrenchment of property rights in the constitution of the United States and in the constitutions of many of the individual commonwealths, makes an intermediate franchise of this kind almost perpetual. Practically nobody desires to destroy private property invested in good faith in public utilities. It is, therefore, essential to the effectiveness of the indeterminate franchise that it should contain a clause requiring the city to purchase or find a purchaser for the physical property whenever a grant is revoked.

The reservation to the city of the right to purchase a public utility or to transfer the utility to a new grantee upon the payment of the purchase price by the latter, brings us to one of the most difficult and important points in the whole problem of municipal franchises. Here is the point of most determined conflict between the public interest and the private interest involved. It is of the very essence of intelligent public policy to keep down the debt that is represented by public utilities, if they are owned by the city, or the capitalization of them, if they are owned by private companies. If the purchase clause of a franchise is not carefully drawn, the city is likely to find itself in the unhappy position where it will become less and less able as time goes on, instead of more and more able, to take over the utility in question. It is obvious that a purchase clause which, for financial reasons, cannot, as a matter of fact, be used is useless in maintaining public control. It is the universal instinct of public utility corporations to pile up capitalization, issuing bonds with no expectation of ever paying them off except by the issuance of other bonds. When it comes to a matter of fixing the purchase price for a public utility or of determining the method by which the purchase price shall be fixed at some future time, a private corporation is doggedly persistent in trying to force up the valuation. This tendency may manifest itself in one of two directions. The company may, by neglect of maintenance and depreciation charges, let the property deteriorate while extraordinary profits are being

taken out of the enterprise. A company knows very well that, even if its plant is in ramshackle condition, the city will have to pay a good round sum for it. If the utility is being operated under strict control, the company is more likely, however, to attempt to increase the aggregate purchase price by insisting on a bonus for the termination of the franchise and by adding further percentages to physical valuation on account of good-will, going value, brokerage charges, insurance, superintendence, contractor's profits, and a dozen and one other things for which an argument can be made. Often, what is really the same item is included under several different names. It is fatal for the city to adopt the attitude of compromise in dealing with public service corporations, in the sense of following the path of least resistance. The only way for the city to become and remain master of the situation is to follow the path of greatest resistance and to hammer capitalization and purchase price down to the minimum.

One of the points of honest difference of opinion among students of public utility regulation is the question of whether or not a public service company should be required actually to amortize and thereby reduce its capital out of earnings. It is one of the results of the movement for the regulation of rates, with the uniform and scientific accounting required to make rate regulation rationally possible, that companies are no longer permitted to conceal their profits by investing surplus earnings in the improvement or extension of plant. The very effort that is made to bring about a reduction in rates tends, therefore, to constant increase of the capital account. It should not be supposed, of course, that a company which has built up its plant in large measure out of earnings and has thus either maintained a small nominal capitalization or has made good a capitalization that was originally well watered, will consent to the purchase of its property on the basis of the capital actually supplied by its stock and bond holders. A company always claims the benefit of the additions to plant made out of surplus earnings whether the question at issue is the regulation of rates or the purchase of the property. It is logical, therefore, to provide, as public regulation now does, that all new investment shall be charged to capital account. A careful consideration of the nature of public utility enterprises, especially from the point of view of the desirability of ultimate municipal ownership,

makes it clear, however, that the desire to regulate rates down to a minimum should not be carried so far as to prevent the amortization of capital. A city that built its streets, its water works, its docks, its schoolhouses, and all other public improvements out of borrowed money and never set aside a sinking fund to pay off the debt, but continually increased its bond issues for all additions and betterments of its plant would be considered as more improvident and reckless than even the worst governed city *now* dares to be. It seems obvious that the same rule in regard to the amortization of capital investment should be applied to public utilities occupying the public streets, even though they happen to be owned and operated by private parties under public franchises. It should therefore, be a fundamental item in the franchise policy of every city, so fundamental as to be inserted in the city charter, that provision be made in every grant for the gradual amortization of investment out of earnings. This policy, if prudently followed, would make the purchase clause practically effective and make it easier instead of more difficult as the years go by, for the city to acquire the various public utilities.

It has already been noted that public control is dependent upon a complete knowledge of facts. This necessity includes not only a knowledge of the extent, location and value of physical structures, but also a detailed knowledge of the financial transactions and results of operation. The regulation and publicity of public utility accounts are fundamental, and should be provided for in every city charter. The forms of books and accounts to be kept by the companies should be prescribed by the Board of Commissioners on the recommendation of the public utility department or bureau. Where there is a state authority charged with the supervision of public utility accounts, the forms prescribed by the city authorities should not be in conflict with the forms prescribed by the state. It will often happen, however, that the city will desire to supplement the state requirements in matters of detail. All public utilities operated by private companies should make, yearly or oftener, statements to the city showing the status of their property, accounts and finances in such detail as may be required by the proper authorities.

It is still regarded in many quarters as a sign of civic thrift to require public utility companies to make heavy payments to

the city in compensation for their franchises. This idea is founded upon the theory that public utilities are private enterprises using public property for profit. With the recognition of the fact, which becomes more obvious every passing year, that public utilities are, in theory as well as by practical necessity, public enterprises, it becomes more and more clear that the policy of exacting heavy money compensation for franchises is a mistaken one. A public utility should be operated so as to give the most widely distributed and best service practicable, substantially at cost. If it is necessary as an incident of private operation, to permit an increment of profit over and above the minimum return upon capital invested, the city should provide for a division of net profits with the operator, the city's share to be put into a sinking fund or to be added to the amortization fund, so as to hasten the day when the investment can be wiped off and the cost of the service reduced, or the quality and extent of service increased, or both. The public nature of the principal utilities, such as water works, street railways, gas works, electric light plants and telephone systems, is so inherent that it would even seem best not to tax public utility plants at all, at least not to tax those portions of the plants consisting of street fixtures. There seems to be no more reason for taxing street railway tracks than for taxing asphalt pavements, and no more reason for taxing electric light conduits than for taxing sewers. It should be noticed, however, that this policy is to be applied only in the case of utilities operated under modern franchises so conditioned as practically to eliminate the value of the franchise itself. The franchise slogan of an up-to-date city would be: Compel public utility corporations to render such good service at such low rates as to take all of the monopoly value out of their privileges, but do not tax them, unless it is for the purpose of establishing a fund supplementary to, or in lieu of, an amortization fund.