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THE LEGAL RELATIONS OF CITY AND STATE WITH REFERENCE TO PUBLIC UTILITY REGULATION

BY HAROLD F. KUMM*

EXTENT OF THE COMMISSION'S CONTROL OVER FRANCHISES

III

In a preceding section we sought to determine to what extent the federal constitution will protect a municipal corporation, in its ownership of public utilities, against the state. In that connection we examined a number of federal and state cases and concluded that the city, when acting in a proprietary capacity, was entitled to a considerable degree of protection under the contract and due process clauses of the constitution. It is now our object to see whether the fixing of rates by a state public service commission is an impairment of such municipal rights.

The particular provisions under which the city most often claims contract rights are usually embodied in a franchise agreement. It will therefore be necessary to inquire briefly into the nature of franchises. During the first half of the nineteenth century, it was customary to grant them their privileges by special act of the legislature. As might be expected, such a system was subject to abuse, and during the latter half of the century there was a tendency toward incorporation under general laws, with the franchises to be obtained from the local councils.¹ Thus a great number of existing franchises are the result of municipal grants.

A franchise has been defined as "a particular privilege which does not belong to an individual or corporation as of right, but is conferred by a sovereign or government upon, and vested in, individuals or a corporation." The following have been held to be franchises: the right to construct and operate a street railway;² right to construct and maintain a public bridge;³ or a ferry;⁴ right

*Instructor, Department of Political Science, University of Minnesota. Continued from 6 MINNESOTA LAW REVIEW, 32.
¹King, The Regulation of Municipal Utilities 78-80.
²Dillon, Municipal Corporations 1906.
³Joyce, On Franchises, 42.
⁴Ibid p. 43.
⁵Ibid p. 45.
to dig in the streets of a city or town to supply the inhabitants with water; or with gas; right to use the streets for the purpose of transmitting electricity. It is a generally accepted principle that such a grant when accepted and acted upon by the grantee becomes, as to him, a contract within the meaning of the federal constitution. Because of this, the regulation of public utilities is accompanied by constitutional questions, which must be investigated. We may suppose the city has granted to a private corporation the right to sell water to its inhabitants for a certain specified rate, and under certain conditions. On the establishment of the state commission questions will arise as to the commission's power to regulate the rates and services stipulated for by such agreement.

It is essential that the franchise be a grant from a sovereign authority, and in this country none are valid unless derived from a law of the state. But while the state may make the grant directly, it is equally competent for it to delegate this power to a municipal corporation. That in every instance the privilege is to be considered as originating with the state is shown by the fact that the state may grant a public service corporation the use of a city's streets without the consent of the city and even against its will. Nor need it make any compensation to the municipality for such concession. It is true that the general practice has been to allow the city a voice in the granting of such rights. But while this may have led some courts to regard the franchise as emanating from the municipal corporation, it must be kept in mind that the city is here acting as the agent of the state, and that any municipal authority in this matter "is purely derivative and must flow from the legislative fountain."

Since the city in the granting of true franchise privileges is acting merely as the agent of the state, for the purposes of government, it is evident that it cannot get a vested right in such powers as against the state. The term "franchise" as here used, refers to

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*Ibid. p. 49.
*Ibid. p. 50.
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*Joyce, Franchises 261-62; L. R. A. 1918D 315 note.
**Dillon, Municipal Corporations 1915 6, 1925, 2137.
**Dillon, Municipal Corporations 2140. "The source of a franchise is the state whatever the agency employed." Joyce, Franchises 239.
the grant of those privileges which do not belong to any citizen as of common right but can come only through a grant from the sovereign; and is not used, as in the popular sense, to mean all those various provisions that appear in the document that sets forth the agreement between city and company. The grant of franchise rights is a purely governmental function, but the agreement may contain in addition various provisions made in a proprietary capacity. As noted in a preceding section, the city's purely governmental powers are held at the will of the legislature. There would consequently be no difficulty in the state resuming the franchise granting power in order to place it in the hands of a public service commission. Neither should there be any difficulty in the state giving up governmental benefits derived by the municipal corporation from previous contracts, for in the final analysis the agreement is not between the city and company but between the state and the company. If the state foregoes benefits which the municipality has gained under the contract, it is merely giving up that which has been gained for it by its agent, the city. Though the municipal corporation may have private rights beyond the reach of the legislature, it has no such governmental privileges. Hence the principle that a franchise when acted upon becomes a contract must not be so interpreted as to include powers exercised by the city as governmental agent of the state.

But it has been suggested that the franchise agreement, using that term in its broadest sense, may include private as well as public provisions; that though made by the city primarily in its governmental character, the agreement may incidentally contain stipulations of a private nature. The city has exercised each of its dual capacities in a single franchise contract, acting in one character with respect to certain matters, and in a different character with respect to others. It is often a matter of great difficulty to determine in what capacity a particular provision has been made. Consider, for instance, a franchise stipulation for free water for the city. McBain is of the opinion that this right should be regarded as a proprietary one, if any is. The court's refusal so to regard it is cited by this writer as additional proof of his contention that the city is entitled to no protection under the contract clause while

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25An exception to this principle exists in a particular class of cases where it has been held that the power to fix rates may be suspended for a term of years, as will be brought out later.
engaged in a private undertaking." But it is to be observed that in incorporating this provision the municipality is seeking to further its governmental rather than its proprietary interests. The water is to be used mainly, if not wholly, for fire and street purposes and in buildings held in a public capacity such as the city hall, hospitals and the city schools. The public service commissions have found no trouble in ordering payment in such cases. Their decisions, however, are generally based on the ground that free water for cities is a form of discrimination in that a public burden is placed on resident users only, rather than on the whole public."

The case of Chicago v. O'Connell indicates the nature of the provisions which may be regarded as establishing proprietary rights. Here the court was considering the rights accruing to city and street railway under an ordinance of the city of Chicago. In its opinion the court says:

"Appellees contend, however, that the settlement ordinances, having been accepted and acted upon by the railway companies, constitute binding contracts between the city and the railway companies, and that their obligation cannot be impaired by any act of the legislature or by any act of the State Public Utilities Commission. Appellee's contention is undoubtedly sound so far as the contracts relate to matters which do not affect the public safety, welfare, comfort and convenience. Thus . . . the agreement to divide the net receipts between the railway companies and the city and the option given to the city to purchase the railway properties at a certain price are all matters which do not affect the public safety, welfare, comfort or convenience, because it is immaterial to the public what person or corporation operates the street railways, or what disposition is made of the profits and over these matters neither the State nor the State Public Utilities Commission has any control by virtue of the police power."

Thus the same franchise may contain both public and private provisions. As we have seen the public are held wholly at the will of the state, but in its private rights the city has a considerable degree of protection. We are now prepared to examine the rate stipulations commonly included in franchises, to see whether the city has there any right which is entitled to constitutional protection against the activities of the state public service commission. It may 

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*See article by H. L. McBain in 3 Nat. Mun. Rev. 284.


be that the agreement fixes a certain rate as the only one to be charged during a fixed period. On the establishment of a state commission with the power to regulate rates the question naturally arises, has that body the power to alter the rate in such a case as this where the period has not yet expired? The answer so far as the city is concerned must depend on one or both of the following elements: (1) on the nature of the power to regulate rates; (2) on the capacity in which the city entered into the rate-fixing agreement.

The regulation of rates is an exercise of the police power of the state. This broad power is not limited in its application to regulations in the interest of the public health, morals or safety, but extends as well to those which are designed to promote the public convenience, or general welfare or prosperity. Since the regulation of public utility rates is for the public convenience and general welfare, such rate-fixing must be deemed a proper exercise of this power. It is one of the great sovereign rights of the state. It may be delegated to a municipal corporation, but since the power is governmental, it must in such case be exercised directly by the municipality, and cannot be further delegated.

It is well settled that ordinary contracts are subject to an exercise of the police power, that the prohibition against their impairment does not prevent the state from exercising this great power. This must be so when we consider that the power is a governmental one and of a continuing nature. Private persons cannot by contract between themselves limit the exercise of such a function. Rather, their agreements are supposed to have been made with reference to a probable change than an exercise by the state of a continuing power. Accordingly, contracts between private consumer and public utility which lay down a certain rate for a definite period are subject to change by the commission, even though the period named therein has not yet expired.
If private persons cannot through agreement tie up the exercise of the rate-making power of the state we may assume that the city in its private capacity is likewise limited. We have already noted that the municipality in that character has rights approaching but not equalling those of a private person engaged in a similar undertaking. We should hardly expect to find it with greater rights in the case of rates.

Not only is it beyond the competency of private persons to suspend the police power, but it is a general principle that this sovereign right cannot be permanently alienated or suspended even by the state itself. Even though there has been no express constitutional reservation of the rate-fixing power, the state may ordinarily resume it. The right to regulate rates, being a portion of the police power, is inherent in the state, and is not dependent on the reservation of a right of alteration or repeal.

We must, however, note one important exception to the general principle that the police power may not be alienated or suspended. This is where the public utility and the state, or its agent, have made a contract for a term of years, wherein it is expressly provided that the rates there established shall not be lowered during the period of the agreement. It has been held by the United States Supreme Court on several occasions that the effect of such a contract is to suspend during its term the power of the state to regulate rates so as to affect adversely the utility company. This is in effect a suspension for that period of a portion of the police power of the state. Since the courts have always held that the renunciation of sovereign rights must be by terms so clear and unequivocal that there can be no doubt as to their proper construction, the sus-

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Ibid, p. 2226, note.

pension of this power will not be acknowledged unless the power and intention to suspend are clearly shown. Only where the contract is properly made, is clearly expressed, and is not ultra vires, will it be upheld against the rate-making activities of the state or its agencies. Where it complies with these conditions it will be upheld, and the public service commission must, during the term of the agreement, be held powerless to alter the rates to the detriment of the utility. Thus the public service company may under certain contracts be exempt from the rate-making activity of the state commission.

But no such exemption is recognized in the case of the municipality. It is obvious that in the making of such a contract the city is acting in its governmental character since it could not in its private capacity suspend the operation of the rate-making power. But agreements made by the municipal corporation in its public capacity are subject to the will of the state, whose agent the city is. Those who would give the municipality a contract right in rates fixed by agreement are thus confronted with this dilemma: If the agreement was made by the city in its private character, the police power has not been suspended, and subsequent regulation is not an impairment of contract. On the other hand, if the agreement was made by the city in its governmental character so as to suspend the operation of the power in behalf of the utility, the city holds its rights as agent of the state which may if it desires give up the rights so gained. In such a case where the public service commission grants an increase of rates, that may be taken as indicating an intent on the part of the state to forego whatever rate privileges it may have gained through its agent, the city.

It is true that the same franchise agreement may contain both public and private provisions, some made by the city in one capacity, some in the other. But it is hard to conceive of the municipal corporation as having dealt in both capacities with a single matter, such as that of rates. It is difficult to see how it could in its governmental character make with itself in its proprietary character an irrevocable contract as to rates. The presumption against the suspension of the rate-making power is so strong that it can be

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29See note on “Power of Public Utility Commissions to Alter Rates of Public Service Corporations Fixed by Contract Between the Municipality and the Public Service Corporation” in 4 MINNESOTA LAW REVIEW 526.
overcome only by showing a clear power and intent to suspend. The doubt surrounding the city’s power and intent to grant itself an irrevocable rate contract in its private capacity is such that it would seem that the presumption has not been overcome. In such cases the city can have no valid objection to subsequent rate regulation by the public service commission. Thus though the municipality may have contract rights protected by the federal constitution, an agreement for certain rates for a specified period is not to be included among such rights.

When we turn from the problem of rates to the broader questions of regulation we may find many privileges of city and public utility that are entitled to constitutional protection. The nature of the city’s rights has been indicated in the extract quoted from the opinion in Chicago v. O’Connell.9 The company likewise may have been granted many private privileges. Such contract rights are held free from an unwarranted exercise of power by the state, but are of course subject to a proper use of the state’s police power, with the exception noted above. It is well established that the exercise of the power must be at all times reasonable.81

CONCLUSION

In conclusion, we may summarize the points considered in this paper. The rapid rise of public utilities, and the public’s dependence on them, made some sort of control necessary. Many different methods were suggested, and several were tried. The failure of political control, and the inability of the courts to remedy the evils of such control, led in many cases to municipal ownership of public utilities. The commission control idea was also brought forward and tried in both local and state commissions. It appeared that exclusive state control was more desirable than exclusive local control, and the state commission for the control of public utilities found rapidly increasing favor. It is possible that a division of powers between state and city is more desirable than the exclusive control of either, and a suggested division of powers has accordingly been presented.

Connected with these problems of policy are legal questions of great interest, especially constitutional questions in respect to the relations of city and state where the utilities are municipally owned. While it appears that the city in its governmental capacity is entitled to no protection against the state, it appears from a study of

9p. 143, supra.
813 Dillon, Municipal Corporations 2062; 6 R. C. L. 236.
the cases that in its proprietary capacity the city is entitled to constitutional protection against the state approaching that extended to a private person engaged in a similar undertaking. This seems to be supported by the weight of authority, though the law cannot be regarded as definitely settled on this point. If protection is given the city in its proprietary undertakings, its rights in such enterprises must be respected by the state commission in the same manner as that body would respect the rights of a private person engaged in similar undertakings.

We noticed that franchises are derived from the state, whatever may be the agency employed in granting them, and that in the granting of pure franchise privileges the city acts in a governmental capacity. It cannot get any vested rights in the powers which it has used in this character. However, the franchise agreement may contain many items not governmental in their nature, and as to them the city and company may get private rights. Privileges of this nature, while protected against abuse of power, are generally held to be subject, as other rights are, to the police power of the state. The fixing of rates is considered an exercise of the police power and may generally be exercised by the commission, notwithstanding previous rate-fixing agreements. An exception to this has been noted. Where the city plainly has been given the power to make an irrevocable contract for rates for a term of years, and has made a contract in which it is clearly evident that the city intends to suspend the rate-making power for a term of years, that contract will be upheld during its term against the rate-making power of the state.

Granting to the city a full measure of protection in its proprietary capacity, the powers of the commission are still almost as great as before. The majority of the city's powers are held in a governmental capacity and we have seen that as to those the power of the state is at all times supreme. The remaining rights of the municipality are in large measure subordinate to the police power, so that the commission may regulate in such matters as rates and service. The city as owner of a business affected with a public use can have no greater rights than a private person, and we have noted that it may have less through the power of the state to deprive it of its existence and thus of its capacity to hold property. Consequently, while the question of rights is of great importance in particular cases, in general it will not affect in any great degree the powers of the state commission in the control of public utilities.