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AN INVESTIGATION INTO THE REGULATORY
POLICIES OF THE MICHIGAN PUBLIC SERVICE
COMMISSION IN THE 1950s WITH REGARD TO
THE MICHIGAN BELL TELEPHONE COMPANY AND
THE CONSUMERS POWER COMPANY
presented by

JAMES R. ANDERSON

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Master's degree in History

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AN INVESTIGATION INTO THE REGULATORY
POLICIES OF THE MICHIGAN PUBLIC SERVICE
COMMISSION IN THE 1950s WITH REGARD TO
THE MICHIGAN BELL TELEPHONE COMPANY AND
THE CONSUMERS POWER COMPANY

By

James R. Anderson

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ABSTRACT

AN INVESTIGATION INTO THE REGULATORY POLICIES OF THE MICHIGAN PUBLIC SERVICE COMMISSION IN THE 1950s WITH REGARD TO THE MICHIGAN BELL TELEPHONE COMPANY AND THE CONSUMERS POWER COMPANY

By

James R. Anderson

The purpose of this study is to ascertain the regulatory policies, developed by the Michigan Public Service Commission in the 1950s, by examining the rate orders approved for two utility companies. Rate cases were becoming a regular part of the yearly activities of the Commission, and were no longer a relatively infrequent occurrence as in prior decades.

The rate orders indicate that in the early 1950s, substantial rate increases were authorized for the purpose of supplying increased revenues to utility companies to construct additional facilities to provide services to more customers. However, rate orders issued in the late 1950s indicate a growing awareness of consumer activism aimed at keeping rates for residential users of utility services as low as possible.

Philosophically moderate members of the Commission approved more substantial rate increases than were supported by more liberal members by utilizing liberal accounting and financial concepts.

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SECTION I INTRODUCTION

The purpose of this master's thesis is to present a review of the development of the Michigan Public Service Commission (MPSC) in the 1950s; and to present an analysis of the policies of the same state regulatory agency for the corresponding period of time. The focus of this study is the 1950s, because this is the first decade for which relatively complete primary source materials are available. Many of the documents issued by the MPSC prior to 1950 are no longer in existence, due to their destruction in the early 1950s by fire which occurred in the Lewis Cass Building in Lansing, Michigan or by flooding within the State Capitol Building in Lansing, Michigan.

Prior to examining the development of the MPSC in the 1950s, a brief review of public utility regulation in Michigan prior to 1950 will be presented. This master's thesis will also review the statutory framework for public utility regulation in Michigan, and will also analyze the fiscal foundation of this commission.

Since the primary function of the MPSC is to regulate the rates and charges assessed by the public utility companies for the services they provide to the public, this study will review several different rate orders issued by the MPSC in the 1950s so as to ascertain the policy objectives of the MPSC. In order to limit the scope of this inquiry, the rate orders of two major utility companies will be examined: (1) the Michigan Bell Telephone Company (Michigan Bell), and (2) the Consumers Power Company (Consumers Power). Michigan Bell was chosen as one of the utility companies to be studied because it is the largest telephone company in the state of Michigan. Consumers Power was selected to be studied because it is the largest combination gas and electric utility in the state. However,

due to self imposed limitations on the length of this study, only the rate orders relating to the electric operations of Consumers Power will be studied. In this regard, it should be noted that Consumers Power is the second largest electric utility in the state.

A brief history of Consumers Power through the 1950s is presented in this study because the materials were available. Since no materials are publicly available regarding the historical development of Michigan Bell, no such presentation is made.

Finally, it should be noted that this study will proceed upon the assumptions developed by James Willard Hurst in his book, Law and Economic Growth.¹ Hurst's basic theme was that since the law sanctions the ultimate distribution of power in society, it can have a tremendous impact on the allocation of resources within a society. Thus, a major premise of this study is that the regulatory orders issued by the MPSC with regard to Michigan Bell and Consumers Power Company in the 1950s had a significant influence on their growth and development, inasmuch as these rate orders had an impact on where a major portion of the monetary resources of this state's residents would be channeled. It would also be appropriate to note here that it is the opinion of this writer that none of the evidence presented in this study supports on the state level the theory that has been developed on the federal level that federal regulatory agencies have been "captured" by the entities sought to be regulated.²

The "captive" theory of business regulation had its birth in the progressive era. Literature began to appear claiming that regulated corporations could directly and favorably influence the policies of the regulators through their enormous financial resources, particularly through legislative lobbying. Although the "capture" idea was abated in the period of the New Deal due to the expansion of regulatory activities, it was

resurrected in the 1950s. Scholars such as Samuel P. Huntington and Louis L. Jaffe began to analyze the ties between regulator and regulated. By the early 1960s, it was the common assumption of many historians and other scholarly observers of the regulatory process that the regulatory agencies had been captured by the industries which they were established to control and that the promotion of the "public interest" played little or no part in the formulation of regulatory policy.

Over much of the literature in the 1960s concerning the "capture" thesis, one historian, Gabriel Kolko, exerted a dominant influence. In his study of railroad regulation from 1877 to 1916, Kolko concluded that railroad men were the most important single advocates of railroad regulation in that era. The evidence indicated to Kolko that railroads relied on the Interstate Commerce Commission to attain their own ends. For Kolko, it was clear that federal economic regulation was essentially designed by regulated industries to meet their own ends, and not those of the "public interest".

A major theme of this study, is that in the 1950s the Michigan Public Service Commission endorsed rate increases in amounts that were intended to promote new investment by Michigan Bell and Consumers Power in new telephone and electric plant facilities so as to promote such utility services to an expanding customer base. While this could be construed as evidence that the Michigan Public Service Commission was a captive of the interests of the business entities they regulated, it appears to this observer that such rate increases were intended to promote the perceived "public interest" in the 1950s of providing new and improved utility services to an increasing population base within the state of Michigan. That the Michigan Public Service Commission was not a "captive" of the telephone or electric industries in the 1950s is evidenced partially by the fact that members of the Michigan Public Service Commission in this era were not generally

employed by any utility companies.

SECTION II THE MICHIGAN PUBLIC SERVICE COMMISSION

PART A: BRIEF HISTORY OF THE REGULATION OF PUBLIC UTILITIES IN MICHIGAN PRIOR TO 1950

The present condition of public utility supervision by the MPSC is the result of a process of evolution.³ In exercising its supervisory powers, the MPSC has been aided by the applicable statutory enactments of the Michigan legislature, and perhaps even more importantly, by the judicial decisions of the Michigan and federal courts.

In the decade of the 1870s, economic distress in the agricultural West, and the consequent Granger movement, brought the question of railroad rate regulation to the forefront. As a result, the state commenced to enact railroad laws. These state laws were contested in the courts upon essentially two grounds: (1) that the authority to determine the reasonableness of rates lay with the judiciary, and (2) the charters under which the railroads were incorporated granted them the power to set reasonable rates as a matter of contract immune to impairment. These arguments were eventually rejected by the U.S. Supreme Court in a number of cases.⁴

The fact that the courts traditionally could afford redress in cases of unreasonable charges for public service did not preclude legislative determination of what the reasonable charges should be. On the contrary, it was considered that price-fixing was clearly a legislative power, which, when exercised, was conclusive upon the courts.⁵ Later, in dictum which anticipated the ultimate judicial resolution of the issue, the U.S. Supreme Court defined the role of the judiciary in reviewing rate legislation, whether directly or in orders of administrative tribunals, in the following terms:

This power to regulate is not a power to destroy, and limitation is not the equivalent of confiscation. Under pretence of regulating fares and freights, the State cannot require a railroad corporation to carry persons or property without reward; neither can it do that which in law amounts to a taking of private property for public use without just compensation, or without due process of law . . . (Stone v Farmers Loan & Trust Co, 116 US 307, 29 LEd 636, 6 S Ct 334 (1886)).

Comprehensive regulation of public utilities in Michigan was initiated with railroads by the adoption of the Railroad Commission Act in 1907. Act No. 312 of the Public Acts of 1907 was reenacted, after the adoption of the 1909 Michigan Constitution, by Act No. 300 of the Public Acts of 1909. The prototype of the initial Michigan regulatory law was the Federal Act to Regulate Commerce of 1887, especially as amended and supplemented by the Hepburn Act of 1906. Until the Hepburn Act, the Interstate Commerce Commission did not possess rate making powers. The Michigan Railroad Commission Act served the primary purpose of making the provisions of the Federal Act to Regulate Commerce applicable to the intrastate rail transportation of the state. The abuses which the Michigan legislation sought to remedy and prevent were in large measure peculiar to the railroad business.

At the time the Michigan Railroad Commission was created, a much debated question was whether the delegation of legislative power to an administrative tribunal was permissible. In an effort to avoid the issue of the legality of the delegation of legislative power to an administrative agency, there had come into use a form of language which equated the process of rate making to a matter of simple factual determination. In an earlier case, the Minnesota Supreme Court had stated that the legislature had not delegated to the Minnesota commission any discretion as to what the law shall be, but had merely granted a power to determine what rates were equitable and reasonable in a particular case.⁶

This theory of fact finding seems to have been necessary at this time to sustain the vesting of rate making power in a regulatory commission, in the absence of express authority in a state constitution. In fact, it was the considered opinion of the Michigan Constitutional Convention of 1907-1908 that such a commission could not be created without constitutional sanction. For instance, the Michigan Constitutional Convention defeated a proposal to authorize the establishment of a public utilities commission, with the intention that it should not be authorized (2 Debates, Constitutional Convention 1907-1908, page 1034); and it approved another proposal which permitted the legislature to create a railroad commission with power to fix maximum freight rates (2 Debates, Constitutional Convention 1907-1908, page 1439, Const, 1908, Art XII, Section 7). Eventually, the legal system came to recognize that in certain situations legislative powers could be delegated to regulatory commissions, and no longer attempted to justify such a procedure under the suspect theory that administrative commissions were engaged merely in fact finding functions.⁷ The principles governing the delegation of power and the exercise of the delegated authority were definitively stated in 1935 by the U.S. Supreme Court:⁸

A proceeding of this sort requiring the taking and weighing of evidence, determinations of fact based upon the consideration of the evidence, and the making of an order supported by such findings, has a quality resembling that of a judicial proceeding. Hence, it is frequently described as a proceeding of a quasijudicial character. The requirement of a 'full hearing' has obvious reference to the tradition of judicial proceedings in which evidence is received and weighed by the trier of the facts. The 'hearing' is designed to afford the safeguard that the one who decides shall be bound in good conscience to consider the evidence, to be guided by that alone, and to reach his conclusion uninfluenced by extraneous considerations which in other fields might have play in determining purely executive action. The 'hearing' is the hearing of evidence and argument. If one who determines the facts which underlie the order has

not considered evidence or argument, it is manifest that the hearing has not been given.

Initially, the authority of the Michigan Railroad Commission was confined to the railroad business. However, at this time, both the telephone utility industry and the electric utility industry were in a period of considerable expansion, and there was public concern to ensure that such services could be secured at reasonable rates. To implement the element of rate regulation which was lacking under the general electric franchise law, a general statute was enacted in 1909.⁹ Thereafter, a general law for the regulation of telephone rates was enacted in 1911.¹⁰ These statutes, each independent and self-sufficient, conferred upon the Michigan Railroad Commission rate regulatory powers, together with other regulatory authority appropriate to the respective businesses.

Pursuant to the provisions of Act No. 419 of the Public Acts of 1919, the Railroad Commission was abolished, the offices were terminated, and the governor was authorized to appoint a new commission of five members to be called the Michigan Public Utilities Commission (MPUC). This statute further extended the scope of the regulatory authority to include the gas business, and it conferred, with respect to gas, electric and telephone utilities, the same measure of authority as over railroads. By subsequent amendment, the furnishing of steam was included.

By statute enacted in 1923, the business of common carriage by motor vehicle was made subject to regulation by the MPUC. Supervisory and regulatory authority over the intrastate business of transmitting natural gas was conferred under a special statute in 1929. In the same year, identical powers with respect to oil pipelines was granted by the legislature.

In 1939, the MPSC was created, the MPUC was abolished, and its functions and powers were transferred to the new commission. (Act No. 3 of the

Public Acts of 1939). Section 4 of this Act suggests why the MPUC was abolished and the MPSC was created:

The Michigan public utilities commission, having failed and refused to properly carry out the legislative mandates with respect to the public safety, and having failed and refused to properly enforce the provisions of the several acts conferring jurisdiction upon it with respect to the use of the various highways of the state in a safe and proper manner, is hereby abolished . . .

Act 3 of the Public Acts of 1939 vested the MPSC with complete power and jurisdiction to regulate all public utilities in the state, except any municipally-owned utility, and except as otherwise restricted by law. It is vested with power and jurisdiction to regulate all rates, fares, fees, charges, services, rules, conditions of service, and all other matters pertaining to the formation, operation, or direction of such public utilities. It also possesses authority to regulate the issuance of securities by public utilities; and exercise important powers over the extension of telephone, gas, and electric services into new territories, under the requirement of first obtaining from it a certificate of public convenience and necessity. Finally, it was granted the same measure of authority over railroads and railroad companies as had been granted to the predecessor commission, the MPUC.



PART B: REVIEW OF THE DEVELOPMENT OF THE MICHIGAN PUBLIC SERVICE
COMMISSION DURING THE 1950s.

The utility industry regulated by the MPSC at the conclusion of 1960
had a profile as follows:¹¹

TABLE 1

16	electric companies, 2 of major size
38	gas producing companies
8	gas transmission companies
11	gas distribution companies (selling directly to consumers)
96	telephone companies, 2 of major size
400	major, 1200 small bus and truck companies
14	oil transmission companies
24	railroad companies

During the 1950s, the number of telephone companies regulated by the
MPSC decreased, primarily due to mergers of smaller companies by larger
companies:¹²

TABLE 2

Number Of Telephone Companies

1954 - 133	1958 - 110
1955 - 130	1959 - 105
1956 - 120	1960 - 96
1957 - 113	

Correspondingly, the number of telephone serviced by independent telephone
companies and Michigan Bell increased:¹³

TABLE 3

Number Of Telephone Serviced By Independent Companies

1954 - 235,918	1958 - 305,131
1955 - 253,364	1959 - 323,737
1956 - 271,606	1960 - 338,831
1957 - 290,838	

Number Of Telephones Serviced By Michigan Bell

1954 - 2,247,787	1958 - 2,754,143
1955 - 2,403,653	1959 - 2,887,079
1956 - 2,556,352	1960 - 2,975,394
1957 - 2,690,885	

During the 1950s, the activities of the MPSC were generally divided into two broad categories: (1) General Commission Activities, which were concerned primarily with public utility companies; and (2) Motor Carrier Activities, which were concerned primarily with bus and truck companies. The fiscal year for the MPSC corresponded to the fiscal year for the State of Michigan: the first day of July through the thirtieth day of June of the following year. With regard to each fiscal year occurring during the 1950s, the activities of the MPSC were financed through two sources: (1) fees collected by the MPSC from the entities regulated by the MPSC; and (2) the general fund of the State of Michigan. The following table indicates the types of fees collected by the MPSC:¹⁴

- (1) Utility Investigation Reimbursements: charges are made to various utility companies for the cost of salaries and expenses for conducting original cost audits, rate case work, and property inventories.
- (2) Security Issue Fees: this fee was computed at 1/10th of 1 percent of the total amount of the security issue, based on the property located within the state. The minimum fee was \$50, except for rural telephone companies, when borrowing money, the minimum fee was \$5.
- (3) Mileage Fees: for motor carriers.
- (4) Annual Fees: in lieu of mileage fees for motor carriers.
- (5) Application Filing Fees.
- (6) Miscellaneous Fees: includes charges for transcripts of testimony, booklets, duplicate license plates, etc.
- (7) Exemption Plate Fees.

Approximately 40% of the motor carrier mileage fees collected by the MPSC were appropriated to the MPSC to defray the expenses of regulating common carriers.¹⁵ At the end of each fiscal year any unexpended and unencumbered balance of this 40% appropriation, and the remaining 60% of the fees collected were credited to the highway fund. The MPSC also received

an appropriation from the general fund. Fees paid by the public utilities for proposed security issues, were transferred to the state treasurer to be held in trust until the security issue was approved by the MPSC. As the security issue was approved, the fees were credited to the general fund. In the event the security issue was not approved, the fee was returned to the utility.

Whenever the MPSC conducted an audit or appraisal of any public utility for rate making, capitalization, or any other purpose, it had the right to make such audit or appraisal through its accounting, engineering and other personnel, and was required to keep an accurate, detailed account of all expenses incurred. The expenses of the audit or appraisal were to be paid by the utility into the state treasury. All money paid into the state treasury was credited to the general fund.

The following table presents a summary compiled from existing records of the revenues received by the MPSC from the various fees it charged during the 1950s:¹⁶

TABLE 4
REVENUES RECEIVED BY THE MICHIGAN PUBLIC SERVICE COMMISSION

<u>GENERAL REVENUES:</u>	<u>1947/48</u>	<u>1948/49</u>	<u>1949/50</u>	<u>1950/51</u>	<u>1951/52</u>	<u>1952/53</u>
Utility Investigation Reimbursements	N/A	N/A	N/A	N/A	N/A	N/A
Security Issue Fees	N/A	N/A	N/A	\$ 125,960	\$ 150,634	\$ 293,237
Filing Fees	N/A	N/A	N/A	N/A	N/A	N/A
Miscellaneous Fees	N/A	N/A	N/A	N/A	N/A	N/A
Sub-total	\$1,099,186	\$1,399,407	\$1,471,914	N/A	N/A	N/A
<u>MOTOR CARRIER REVENUES:</u>						
Mileage Fees	\$ 810,476	\$ 835,504	\$1,064,649	\$1,241,730	\$1,196,122	\$1,257,397
Exemption Plate Fees	N/A	N/A	N/A	N/A	N/A	N/A
Permit & Renewal Fees	22,280	21,300	23,500	23,725	24,900	27,300
Sub-total	\$ 832,,756	\$ 856,804	\$1,088,149	\$1,264,455	\$1,221,022	\$1,484,697
<u>GRAND TOTAL:</u>	\$1,931,942	\$2,256,211	\$2,560,063	N/A	N/A	N/A
N/A: Not Available						

TABLE 4
REVENUES RECEIVED BY THE MICHIGAN PUBLIC SERVICE COMMISSION

<u>GENERAL REVENUES:</u>	<u>1953/54</u>	<u>1954/55</u>	<u>1955/56</u>	<u>1956/57</u>	<u>1957/58</u>	<u>1958/59</u>	<u>1959/60</u>
Utility Investigation Reimbursements	N/A	N/A	N/A	N/A	N/A	\$ 30,638	\$ 50,058
Security Issue Fees	N/A	N/A	N/A	N/A	N/A	125,000	188,035
Filing Fees	N/A	N/A	N/A	N/A	N/A	38,535	40,340
Miscellaneous Fees	N/A	N/A	N/A	N/A	N/A	14,931	15,950
Sub-total	N/A	N/A	N/A	N/A	\$ 220,214	\$ 208,903	\$ 292,559
<u>MOTOR CARRIER REVENUES:</u>							
Mileage Fees	\$1,148,416	N/A	N/A	N/A	N/A	\$1,220,826	\$1,236,205
Exemption Plate Fees	N/A	N/A	N/A	N/A	N/A	33,005	36,120
Permit & Renewal Fees	42,720	N/A	N/A	N/A	N/A	-	-
Sub-total	\$1,191,136	N/A	N/A	\$1,355,159	\$1,308,263	\$1,253,831	\$1,272,325
<u>GRAND TOTAL:</u>	N/A	N/A	N/A	N/A	\$1,528,477	\$1,462,734	\$1,564,884

N/A: Not Available

As can be seen from this table, the revenues generated by the MPSC for the 1957/58, 1959/60 fiscal years were approximately \$1,500,000 in each fiscal year.

From the 1951/52 fiscal year through the 1959/60 fiscal year, the Michigan legislature steadily increased the state appropriation to the MPSC at a relatively modest rate. The state appropriation for the 1951/52 fiscal year was \$271,103 and \$406,544 for the 1959/60 fiscal year. The increase from \$271,103 to \$406,544 represented an approximate 50% growth over the decade in the state appropriation to the MPSC.

The following table, prepared from available records, presents a summary of the appropriations received by the MPSC from the legislature and the amount of the expenditures actually made by the MPSC:¹⁷

TABLE 5

APPROPRIATION AND EXPENDITURES FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

	1949/50		1950/51		1951/52	
	<u>Appropriation</u>	<u>Expenditures</u>	<u>Appropriation</u>	<u>Expenditures</u>	<u>Appropriation</u>	<u>Expenditures</u>
Salaries & Wages	\$ 345,800	\$ 332,373	\$ 315,042	\$ 317,726	\$ 373,315	\$ 349,678
Contract Services, Supplies & Maintenance	82,550	77,262	80,000	75,809	88,500	80,636
Equipment	7,260	5,492	2,000	2,190	2,000	1,679
Sub-total	\$ 435,610	\$ 415,127	\$ 397,042	\$ 395,725	\$ 481,815	\$ 431,993
State Operations Adjustments	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ 47,228	\$ -0-
1½ Salaries & Wages Adjustment	-0-	-0-	-0-	-0-	-0-	-0-
Special Programs	350,000	209,327	350,000	98,678	90,000	88,578
Sub-total	\$ 785,610	\$ 624,454	\$ 747,042	\$ 494,403	\$ 553,815	\$ 520,571
Less Motor Transport Fees	(\$ 300,000)	(\$ 300,000)	(\$ 300,000)	(\$ 300,000)	(\$ 330,000)	(\$ 246,965)
GRAND TOTAL	\$ 485,610	\$ 324,454	\$ 447,042	\$ 194,403	\$ 271,103	\$ 273,606

TABLE 5

APPROPRIATION AND EXPENDITURES FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

	1952/53		1953/54		1954/55	
	<u>Appropriation</u>	<u>Expenditures</u>	<u>Appropriation</u>	<u>Expenditures</u>	<u>Appropriation</u>	<u>Expenditures</u>
Salaries & Wages	\$ 409,050	\$ 394,994	\$ 413,352	\$ 404,357	\$ 476,798	\$ 444,607
Contract Services, Supplies & Maintenance	85,000	75,833	125,000	110,471	139,403	124,955
Equipment	25,000	24,674	5,000	4,028	2,400	2,041
Sub-total	\$ 519,050	\$ 495,501	\$ 543,352	\$ 518,856	\$ 618,601	\$ 571,603
State Operations Adjustments	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-
1½ Salaries & Wages Adjustment	-0-	-0-	-0-	-0-	-0-	-0-
Special Programs	79,837	62,810	70,384	55,794	51,131	61,094
Sub-total	\$ 599,387	\$ 558,311	\$ 613,736	\$ 574,650	\$ 669,732	\$ 632,697
Leas Motor Transport Fees	(\$ 302,337)	(\$ 273,115)	(\$ 300,346)	(\$ 267,226)	(\$ 362,705)	(\$ 310,096)
GRAND TOTAL	\$ 297,050	\$ 285,196	\$ 313,390	\$ 307,384	\$ 307,379	\$ 322,601

TABLE 5

APPROPRIATION AND EXPENDITURES FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

	1955/56		1956/57		1957/58	
	<u>Appropriation</u>	<u>Expenditures</u>	<u>Appropriation</u>	<u>Expenditures</u>	<u>Appropriation</u>	<u>Expenditures</u>
Salaries & Wages	\$ 506,185	\$ 490,663	\$ 565,444	\$ 533,866	\$ 587,720	\$ 600,459
Contract Services, Supplies & Maintenance	154,676	132,464	156,676	135,805	158,516	151,068
Equipment	4,850	4,780	8,200	7,513	2,700	2,818
Sub-total	\$ 665,711	\$ 627,907	\$ 730,320	\$ 677,184	\$ 748,936	\$ 748,936
State Operations Adjustments	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-
1½ Salaries & Wages Adjustment	-0-	-0-	-0-	-0-	-0-	-0-
Special Programs	69,354	54,572	54,149	30,103	61,926	24,556
Sub-total	\$ 735,065	\$ 682,479	\$ 784,469	\$ 707,287	\$ 810,862	\$ 778,901
Less Motor Transport Fees	(\$ 385,686)	(\$ 348,841)	(\$ 416,388)	(\$ 373,969)	(\$ 424,799)	(\$ 417,210)
GRAND TOTAL	\$ 349,379	\$ 333,638	\$ 368,081	\$ 333,318	\$ 386,063	\$ 361,691

TABLE 5
APPROPRIATION AND EXPENDITURES FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

	1958/59		1959/60	
	<u>Appropriation</u>	<u>Expenditures</u>	<u>Appropriation</u>	<u>Expenditures</u>
Salaries & Wages	\$ 642,671	\$ 619,024	\$ 728,248	\$ 706,041
Contract Services, Supplies & Maintenance	178,912	154,848	182,512	164,469
Equipment	1,500	1,495	1,500	4,221
Sub-total	\$ 823,083	\$ 775,367	\$ 912,260	\$ 874,731
State Operations Adjustments	\$ -0-	\$ -0-	\$ -0-	\$ -0-
1½ Salaries & Wages Adjustment	-0-	-0-	3,286	-0-
Special Programs	17,076	-0-	81,453	38,827
Sub-total	\$ 840,159	\$ 775,367	\$ 996,999	\$ 913,558
Less Motor Transport Fees	(\$ 463,187)	(\$ 429,885)	(\$ 590,455)	(\$ 522,811)
GRAND TOTAL	\$ 376,972	\$ 345,482	\$ 406,544	\$ 390,747

As previously indicated, the functions of the MPSC were generally divided into two main categories: (1) General Commission Activities, involving primarily the regulation of public utilities; and (2) Motor Carrier Activities. With regard to the Public Utilities Division, the expenditures listed as Special Programs in the prior table were for rate investigations of public utilities. For the fiscal year 1949/50 and 1950/51 the appropriations for the Special Programs were listed at about \$350,000. During the 1950s, the appropriations for Special Programs decreased dramatically and averaged approximately \$75,000. The Budget Report for the State of Michigan for the appropriation for the Special Programs account from former years was due to the fact that the public utility rate investigation function was incorporated into the general operating budget of the agency which resulted in a lower money figure being needed for the Special Programs Account.¹⁸ The Budget Report went on to conclude that a need still remained for a sum to be appropriated into the Special Programs account in the nature of a contingency fund to meet the expenses of expert testimony and consulting services of a statistical, accounting or engineering nature.¹⁹ The change in the appropriations for public utility rate investigations from the Special Programs account to a item within the General Operating Budget of the MPSC, together with the need for increased sums to be appropriated for expert witnesses in rate cases, indicates that rate cases for public utilities were becoming a regular part of the yearly activities of the MPSC, and were no longer a relatively infrequent occurrence as in prior decades.

The Budget Report for the State of Michigan for the Fiscal Year Ended June 30, 1954, indicated that since the activities for the MPSC were financed from two sources, the General Fund and Motor Carrier Fees, the budget recommendations for the fiscal year 1953/54 and succeeding years would be

presented in two parts. One part, General Commission Activities, reflected the recommendation covering the expenses properly chargeable to the General Fund, and the second part, Motor Carrier Activities, reflected the recommendation covering costs attributable to the enforcement of the Motor Carrier Act and financed from the motor carrier fees. This Budget Report then went on to note that the personnel of certain divisions within the organization of the MPSC were properly financed wholly from the General Fund, or wholly from the motor carrier fees. Certain divisions, however, had overlapping assignments as far as general commission activities and motor carrier activities were concerned, and the Salaries and Wages recommendations were split as to the appropriate source. The breakdown of the Salaries and Wages recommendation for the 1953/54 fiscal year as between General Commission Activities and Motor Carrier Activities was based on the following percentages gained from the 1951/52 fiscal year expenditure experience:²⁰

TABLE 6

	<u>GENERAL COMMISSION ACTIVITIES</u>	<u>MOTOR CARRIER ACTIVITIES</u>
1. MPSC Commissioners	40%	60%
2. MPSC Secretaries	40%	60%
3. Accounting Division	40%	60%
4. Administrative Division	50%	50%
5. Utilities Division	100%	
6. Railroad Division	100%	
7. Rates & Tariffs Division		100%
8. Enforcement Division		100%
9. Motor Carrier Division		100%
10. Motor Carrier Audit Division		100%

According to the Budget Report for the Fiscal Year Ended June 30, 1960, the allocation of Salaries and Wages recommendation for the 1959/60 fiscal year, was based on the following percentages gained from the expenditure experience of prior years in the 1950s:²¹

TABLE 7

	<u>GENERAL COMMISSION ACTIVITIES</u>	<u>MOTOR CARRIER ACTIVITIES</u>
1. Unclassified	40%	60%
2. Administration	45%	55%
3. Utilities	100%	
4. Railroad	100%	
5. Transportation		100%

Thus, the allocation between Salaries and Wages with regard General Commission Activities and Motor Carrier Activities remained fairly constant throughout the 1950s.

The following table summarizes the workload for the Utilities Division as determined from presently available records:²²

TABLE 8

	<u>1947</u>	<u>1948</u>	<u>1949</u>	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>
Employee Man Hours	295	595	567	457	315	-	-
Formal Cases Rendered (orders)	187	191	224	191	214	261	252
Letters Written Re Complaints, etc.	2,520	2,560	4,526	4,950	4,940	4,016	4,368
Telephone Boundary Revision Orders	53	31	109	95	40	80	53
Formal Rate Orders	48	75	59	43	33	32	37

As determined from the presently available records, the workload for the Motor Carrier Division was as follows:²³

TABLE 9

	<u>1947</u>	<u>1948</u>	<u>1949</u>	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>
No. of Carriers	1,850	2,100	2,400	2,600	2,700	2,706	2,840	2,904
No. of Certificated Vehicles	70,000	75,000	90,000	108,000	118,000	123,939	142,057	145,280
No. of Inspections	N/A	N/A	N/A	22,632	23,902	33,248	34,116	N/A
No. of Special Investigations	N/A	N/A	N/A	2,684	3,119	3,640	4,136	N/A
No. of Summonses	N/A	N/A	N/A	2,713	4,076	5,270	5,338	N/A
No. of Warnings	N/A	N/A	N/A	295	318	850	1,656	N/A
Fines Assessed	N/A	N/A	N/A	\$ 42,444	\$ 78,004	\$ 99,737	\$ 108,136	N/A
Costs Assessed	N/A	N/A	N/A	\$ 12,031	\$ 18,180	\$ 22,722	\$ 25,971	N/A
Violations Checked	13,863	13,385	10,124	8,923	15,444	N/A	N/A	N/A
Average No. of Inspectors	N/A	N/A	15	15	16	18	18	N/A

During the 1950s, the actual hearings of various types of utility cases were held with one or more of the commissioners actually presiding and listening to the testimony. At the end of the decade, this task was becoming quite time consuming, and the Budget Report for the State of Michigan for the Fiscal Year Ended June 30, 1961, recommended that as to the routine motor carrier hearings, which required the time equivalent of one full-time commissioner, that these should be handled by a hearing examiner, thereby permitting the three commissioners to concentrate on decision and policy making activities. The same Budget Report also noted that although it was not being recommended at that time in view of the financial situation, a strengthening of the enforcement function of the Motor Carrier Division was needed to cope with problems arising from the competitive struggle for business in the motor carrier industry, which had resulted in illegal leasing arrangements and price cutting by many trucking concerns.

With regard to the activities of the Public Utilities Division at the end of the mid-century decade, the Budget Report for the Fiscal Year Ending June 30, 1961 noted that given a more favorable financial climate, an increased appropriation should be granted to permit the Public Utilities Division to be more active in checking consumers' complaints on the quality of service of various utility companies. The Budget Report went on to note that adequate staff was not then available to investigate those complaints, and that they currently were being referred to the utility company to perform its own investigation. The Budget Report for the Fiscal Year Ended June 30, 1962, noted that during the 1950s, there had been a growth in the overall workload of the Public Utilities Division, particularly with the activity involving rate case preparation.²⁴ For example, as of December 31, 1956, there was \$1.4 billion of utility plant additions and retirements

to be audited by the staff of the MPSC. By December 31, 1959, this figure had risen to \$2.6 billion. The Budget Report observed that the auditing performed to determine original cost of public utility plant was essential in preparing for frequent, major rate cases. The determination of the appropriate original cost for public utility plant was crucial for the MPSC Commissioners to make a determination as to rates which would be fair to both the public and the utility companies.

In order to more readily evaluate the issues discussed in the various rate orders involving the Michigan Bell Telephone Company and Consumers Power Company in the 1950s, it will be useful to become acquainted in a preliminary fashion with various regulatory concepts employed by the MPSC in the 1950s. The constitutional right of a public utility to a just and reasonable return requires the establishment of a rate base, or an evaluation of the property devoted by the utility to public service, on which an appropriate rate of return will be allowed by the regulatory agency, resulting in the amount of money which the utility may attempt to earn from the marketing of its utility services.²⁵

In the 1950s, three principal methods of determining the rate base of a public utility were considered.²⁶ The first of these is original cost. The Federal Power Commission has defined this as the cost of the utility plant to the person first devoting it to the public service. This is the definition most commonly accepted for regulatory purposes. There are some variations on the original cost method. The "prudent investment" method is based upon the valuation of the plant at the cost of the original investment if prudently made. "Historical cost" is an estimate of the prudent investment made when actual cost figures are not available.

The second method of computing the rate base of a public utility is at its fair value, on the theory that the public utility is entitled to a

return based on the value of its property at the time of the inquiry as to rates and at the time the property is being used in the public service.

The third method of valuation for setting a rate base is by determination of the reproduction cost of the existing plant. In its original form, reproduction cost was ascertained by assuming that the existing plant was to be reconstructed or a whole, in one operation, at prices applicable on a chosen date, or averaged over an appropriate construction period. In recent years, cost trending has frequently been utilized to update existing reproduction cost figures, or to reach a rate base by applying specific price indices to original cost.

The measurement of the rate base is merely the first step in the calculation of a fair return on the cost of "value" of the property of the public utility. The second step is the allowance of a "fair" or "reasonable" annual rate of return on this rate base. A great deal of the conflict in the testimony of various expert witnesses in a rate case revolves around the issue of what constitutes a "fair" rate of return or the relative weights that should be given to multiple standards of fairness. Most regulatory commission accept the basic standard that a fair rate of return should cover the cost of capital for a utility. The twofold rule that a public utility may charge rates designed to cover its operating costs plus a fair return has been converted into the apparently singular rule that the rates of charge shall cover the company's total costs including its costs of capital. The costs of capital are the fixed costs of long-term debt and preferred stock, plus a provision for reasonable dividends on common stock. A fair rate of return must enable a utility to cover its cost of capital so as to enable the utility to maintain its credit standing and enable it to attract new capital on terms favorable to the utility and its customers.²⁷ In addition, regulatory commissions may also evaluate four additional

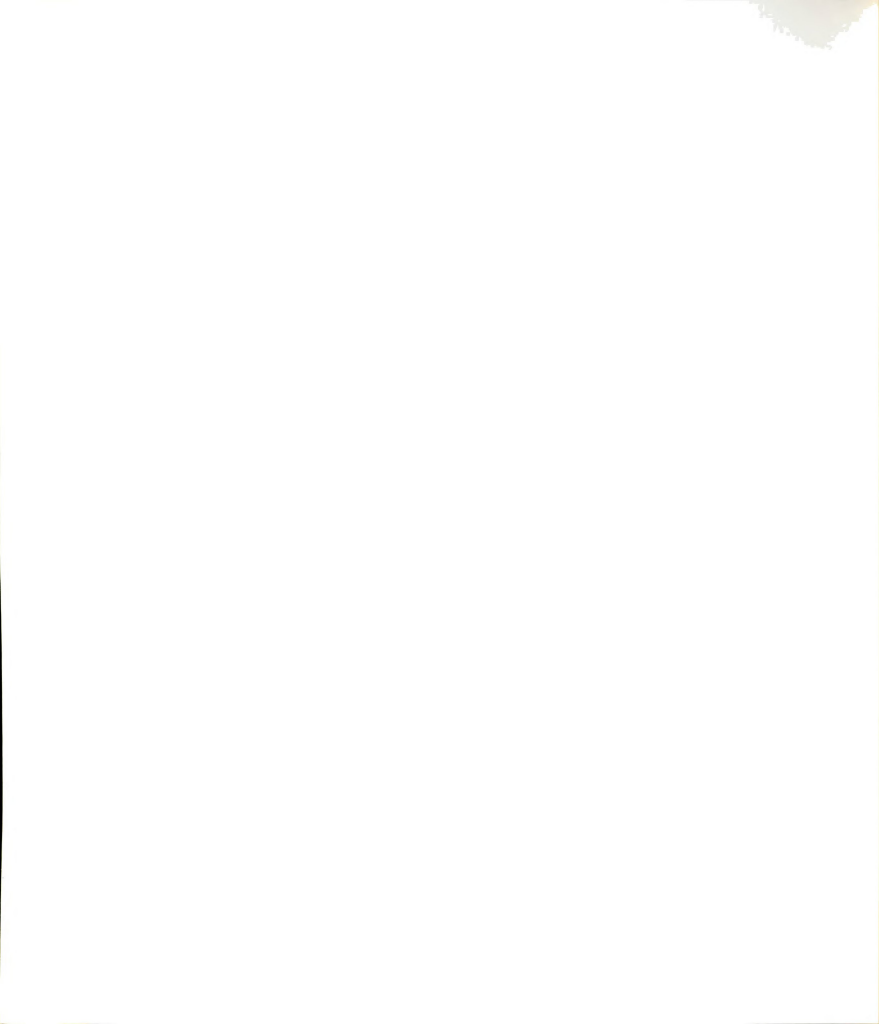
criterion in arriving at a decision as to what constitutes a fair rate of return on investment for a particular utility: (1) stimulation of managerial efficiency; (2) maintenance of rate level stability; (3) promotion of "consumer-rationing" through rates designed to encourage all consumption for which consumers are ready to pay escapable, marginal costs; and (4) provision of sufficient profits to insure "fairness" to investors.²⁸ A determination of a fair rate of return requires a balancing of these various criterion, since the various criterion are not necessarily compatible with each other.

Once the level of the reasonable and prudent operating expenses, and an appropriate rate of return on total plant investment has been determined for a utility company, the next issue to be addressed is what rate structure is to be adopted by the regulatory commission for the collection of these revenues. Essentially, there are three basic categories of customers from which to collect revenues: residential customers, commercial customers, and industrial customers. What proportion of the total revenue requirement for the utility company each of these customer categories will be responsible for can be determined by essentially two methods. The most commonly accepted method is the establishment of reasonable rates based on the standard of cost of service. Under this approach an attempt is made to attribute to each customer category only those investments and operating costs which are directly associated with providing utility service to that particular category of customer. Under a cost standard, the price per unit of service is supposed to be equal to the cost per unit. This is not true under the second method of rate determination: the standard of value of service. Under this approach, weight is also given to the "value" of the utility service to each of the categories of customers as distinct from the cost of production to each category of customer. Pricing under the value of service concept would be similar to the process whereby the tailor determines

a price to charge a customer for a suit of clothes or a department store for a lady's hat.

Whether the regulatory commission has used a cost of service or a value of service approach to rate making, it is generally conceded that industrial and business users of utility services have been charged rates for service that are higher than strictly cost justified. Thus, business users of utility services have traditionally subsidized the provision of lower than cost justified rates to residential customers. This is true in the telephone industry, where rates for local service used primarily by residential customers have been kept at extremely reasonable levels because the overall cost of providing service by the telephone utility have been subsidized by higher than cost justified rates being charged for toll services primarily used by business customers. In the 1950s, higher than cost justified rates were not a problem for businesses as evidenced by the fact that no business groups formally intervened in the telephone or electric utility rate proceeding before the Michigan Public Service Commission. Higher than cost justified rates for utility services were no major problem for businesses because these costs were included in the cost of the product and were a small percentage of the total cost involved in producing most products. Since utility costs were a small percentage of total manufacturer costs and easily included in the price of the product, the fact that products may have been sold in a competitive market was not a problem for most manufacturers in the 1950s. This situation would change in the late 1960s and beyond when the rates for most utility services experienced a dramatic increase.

In the 1950s, the issue as to the appropriate levels of rates to be charged to various customer categories was not a source of conflict between residential and business interests or between business and the utility



company. Business generally accepted that rate levels set for utility services by the various regulatory agencies. It was only toward the late 1950s that one can discern a conflict of interest as to the rate levels between residential customers and the utility companies. Although residential customers were generally receiving utility services at less than cost justified rates, in the late 1950s some residential customers noted that utility expenses were taking a significantly higher percentage of their own personal disposable income.

With regard to the various members of the MPSC during the 1950s, three of these are particularly important to the analysis put forth in this study: (1) Chairman James McCarthy; (2) Chairman Otis Smith; and (3) Commissioner James Lee. None of these particular persons was employed by a utility company either before or after serving on the MPSC. Chairman McCarthy was employed by the State of Michigan as a highway engineer prior to being a member of the MPSC. When he left the MPSC he was employed as a highway engineer by a private firm. Chairman Smith was the Auditor General of the State of Michigan prior to joining the MPSC. After leaving the MPSC, he was appointed a Justice of the Michigan Supreme Court and eventually became Vice-President and General Counsel of General Motors. Commissioner Lee was an attorney engaged in the private practice of law before joining the MPSC. He eventually entered retirement when he left the MPSC.

With regard to the other members of the MPSC during the 1950s, none were employed by or affiliated with utility companies, except for William Elmer. Mr. Elmer was an attorney, who engaged in the private practice of law after leaving the MPSC. Mr. Elmer, however, only represented various motor carrier clients, and never represented any of the major gas, electric, or telephone companies.²⁹ This evidence as to the employment history of the various members of the MPSC in the 1950s would lend support to the tentative

conclusion that the MPSC was not a captive of the utility companies that it regulated in the 1950s.

SECTION III
REVIEW OF THE POLICIES OF THE MICHIGAN PUBLIC SERVICE COMMISSION
 WITH REGARD TO THE MICHIGAN BELL TELEPHONE COMPANY IN THE 1950s

PART A: BRIEF HISTORICAL REVIEW OF THE DEVELOPMENT OF THE TELEPHONE³⁰
 INDUSTRY IN MICHIGAN PRIOR TO 1950

In order to attain a proper perspective as to the operations of Michigan Bell, it is helpful to provide a picture of the telephone industry in Michigan around the year 1950. The records of the MPSC show that in 1951 there were three major telephone companies operating in the state. A total of 2,039,259 telephones were connected with the wire lines of these companies. Approximately 93% of these were operated by Michigan Bell. Next in size was the Michigan Associated Telephone Company (now the General Telephone Company of Michigan), with 83,303 telephones (4%), while the Union Telephone Company had 59,849 (2.9%). In addition to these three large companies, a total of 141 "independents" were registered with the MPSC. This figure compares with 183 such companies in 1938, indicating a tendency for these small companies to be absorbed by the larger ones, or to merge among themselves. The total number of telephones connected with the 141 "independents" as of May 26, 1952, was 26,933, or only a little over 1% of the number connected with the wire lines of the major companies. Generally, the independent telephone companies were organized in Michigan shortly after 1893, when the Bell patents expired.

The independent telephone companies varied widely in character and size. Among the smallest was the Alger Telephone Company with only 15 telephones. Several of the independent telephone companies had no rate tariffs on file with the MPSC, apparently being maintained and operated on a voluntary basis.

Although the charges of the "independents" were generally lower than those of the major companies, their service was usually much inferior. For example, few offered their subscribers dial service. At the close of 1951, almost one-half of the telephones in the Michigan Associated Telephone Company were dial operated, while just under one-quarter of those of the Union Telephone Company were so operated.

The Michigan Associated Telephone Company had its main office in Muskegon. Muskegon was the largest city in the state not served by Michigan Bell. The service area for Michigan Associated reached north from Muskegon as far as Ludington, and included a major portion of St. Joseph and Branch counties, scattered exchanges in southwest Michigan, six in central Michigan, and several in the thumb area of Michigan. The Union Telephone Company absorbed the Tri-County Telephone Company (Van Buren, Cass, and Allegan counties) after World War II. Its main offices were in Owosso. Aside from this tri-county area, the Union exchanges were situated in the central and northeast portion of the Lower Peninsula. The largest concentration of rural and independent companies was found in the southeastern and south central counties of the Lower Peninsula, the northwest part of the Lower Peninsula, around Saginaw Bay, and in the Upper Peninsula. Large areas of the northeastern part of the Lower Peninsula and in the Upper Peninsula were classified as "unassigned" by the MPSC.

At the mid-point of the 20th century, improvements in telephone service had been numerous since the first crude exchange was installed in Detroit in 1887. At first, a single instrument, placed alternately at the mouth and the ear, was used for talking and listening. Shortly, however, it was found desirable to furnish the user with two identical instruments, one for talking (the transmitter) and one for hearing (the receiver). For many years, batteries were required at each subscriber's station to furnish the

current for actuating the transmitter. Later, the common, or centralized battery system of operation was devised, with a storage battery at the central office. In the early days it was necessary to turn a crank in order to get the central office. When the operator responded, you gave her the name (later the number) of the subscriber whom you desired to reach. Dial telephone systems were becoming common in Michigan in the 1920s. The first dial central office was placed in operation in Detroit in 1923. By 1930, a little over 46% of all the telephones in the Michigan Bell system had dial service. By 1951 over 87% were operated by the dial system. The provision of dial service was slower by the independents, and most of the small rural independents at mid-century were still without this type of service. The evolution of various types of telephone instruments was also striking. The old time wall telephone gave way to the desk models, consisting of a pedestal rising from a substantial base and supporting the transmitter, with the receiver hung on a hook. In the 1930s, the desk set was giving way to the hand set, in which the transmitter and the receiver were attached to the opposite ends of a handle, which rested on a cradle surmounting a base. Elaborate switchboard systems, connected with the "outside" lines served thousands of Michigan industrial and commercial firms at the mid-century.

PART B: REVIEW OF THE REGULATORY ORDERS ISSUED BY THE MICHIGAN
PUBLIC SERVICE COMMISSION DURING THE 1950s WITH REGARD
TO THE MICHIGAN BELL TELEPHONE COMPANY

Michigan Bell was incorporated on January 26, 1904 under Act 129 of the Public Acts of 1883, as amended. At the time of its incorporation, and throughout the period of this study, Michigan Bell was a subsidiary corporation of American Telephone & Telegraph Company (AT&T). Control by AT&T over Michigan Bell was exercised by the ownership of a majority of the

shares of the common stock of Michigan Bell. AT&T is a corporation existing under the laws of the State of New York. The activities of AT&T fell into three categories. It acted as a holding company; as a servicing company; and as an operating company.

On July 18, 1944, the MPSC gave notice to Michigan Bell (and other utility companies in Michigan subject to its jurisdiction), that an investigation would be conducted to determine if during the year 1944 it had paid any federal "excess profits taxes"; and if so, that adjustments would be made in its rates and charges to avoid the incurring of any such liability and the subsequent payment of any such tax.

After an investigation conducted in the fall of 1944, in which the Attorney General, the staff of the MPSC, and Michigan Bell were parties thereto, the MPSC issued an Opinion and Order on December 28, 1944, in Case No. T-252.90. In this Opinion and Order, the MPSC made note that the issue of the appropriate regulatory treatment of the corporate interrelationship between AT&T and Michigan Bell had been before the Michigan Supreme Court on more than one occasion. In the case of People v Michigan Bell Telephone Company, 246 Mich 198, 204, 205, the Michigan Supreme Court determined that Michigan Bell was a mere agent or instrumentality of AT&T. The court held "where a corporation is so organized and controlled and its affairs so conducted as to make it a mere instrumentality or agent or adjunct of another corporation, its separate existence as a distinct corporate entity will be ignored and the two corporations will be regarded in legal contemplation as one unit". In a second case, Michigan Bell Telephone Company v Public Utilities Commission, 297 Mich 92, 113, the Michigan Supreme Court held: "The companies are so closely interwoven through the use of joint facilities, they must be considered together for regulatory purposes, notwithstanding that the forms of separate entities are maintained."

In this proceeding, and in subsequent rate proceedings before the MPSC, the two corporations were considered together for regulatory purposes.

In Case No. T-252.90, the MPSC ordered Michigan Bell to reduce its annual revenues by approximately \$3,500,000 because it found Michigan Bell's gross revenues for the year 1944 to have been excessive by that particular amount. It also ordered Michigan Bell to make a refund to its customers of the said \$3,500,000 for the year 1944. The \$3,500,000 excessive revenues were based on a finding that Michigan Bell had paid an excess profits tax to the U.S. Government in the total amount of \$4,404,000 of which \$3,000,000 was deemed to have been avoidable. The MPSC also found \$250,000 paid by Michigan Bell to AT&T under a license contract to have been excessive. The license contract with AT&T required that various legal, accounting and management services be rendered by AT&T to Michigan Bell. The amount of the license contract payments was based on a percentage of Michigan Bell's gross revenues for a particular year. The MPSC expressed its opinion that in order for such services to be properly chargeable to Michigan Bell's ratepayers, the services should not be based on a percentage of Michigan Bell's gross revenues, but on a specific value for each service category, with the specific value being based on evidence relating thereto which had been introduced and cross-examined at a rate hearing.

This particular order of the MPSC was subsequently reversed by the Michigan Supreme Court as being one that the MPSC had no statutory authority to render. This conclusion was based on the fact that the MPSC had no authority to make retroactive rates, and therefore, an order issued in December of 1944 could not reset rates for 1944 and could not require a refund of that portion of the rates collected in 1944 that were found to have been excessive.

Approximately one year later, on December 13, 1945, the MPSC rendered

its final order in Case No. T-252.90, wherein it determined that Michigan Bell's rates for 1944 had been excessive in the amount of \$3,500,000, and that Michigan Bell's rates subsequent to the date of the order would be reduced by that amount. Thus, in compliance with the mandate of the Michigan Supreme Court that rate reductions were to be prospective in nature, and not retroactive. The particular elements of Michigan Bell's rates that were found to be excessive were: (1) \$3,000,000 of excess profits taxes that were avoidable; (2) \$250,000 of excess depreciation that was also avoidable; and (3) \$250,000 of excessive payments made to AT&T under the license contract.

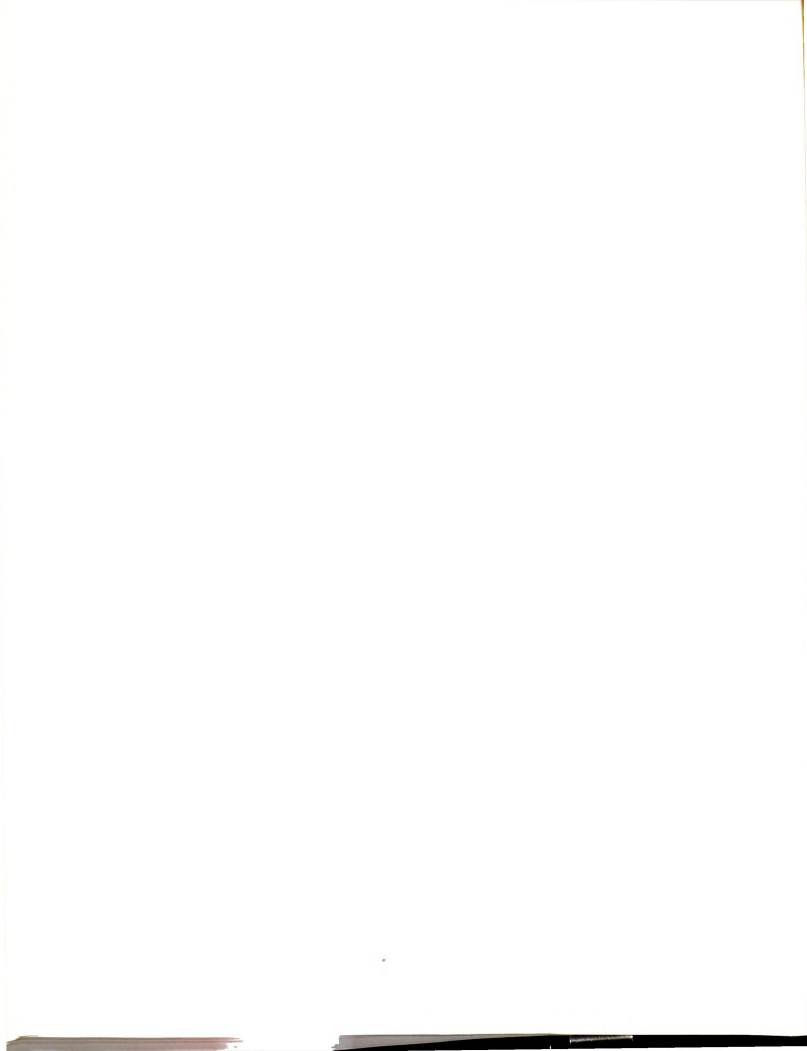
In 1948, the MPSC issued several regulatory orders regarding Michigan Bell. Each of these orders was issued by the MPSC because Michigan Bell was facing a condition of increasing demand for its telephone services. The decision with the least amount of immediate financial impact was issued on September 18, 1948 in Case No. T-252-48.14, wherein the MPSC authorized Michigan Bell to offer in the Detroit metropolitan area mobile radio telephone services and established a rate therefor. A more important decision was rendered on April 1, 1948 in Case No. T-252-48.7, whereby the MPSC evidenced its desire to see that telephone service in rural areas would be technologically upgraded, even if it meant higher rates to the rural area subscribers. The MPSC adopted a plan whereby short-haul toll traffic previously handled by manually operated switchboards would now be handled by direct dial automated switching equipment. Rates for this service would be immediately increased in rural areas due to increased investment for the automated equipment, but would eventually be reduced in five years to the benefit of the rural subscribers. It was the conclusion of the MPSC that under the proposed rates, thousands of customers would pay no more, whereas others, to whom the cost would be increase, would be the



ones who would benefit the most by being brought into the larger trading centers and who eventually would save the most in toll bills.³¹

The most important order issued in 1948 by the MPSC was on September 28th of that year in case No. T-252-48.16. In that case, the MPSC authorized Michigan Bell to increase its annual revenues by \$8,210,000 above the revenues then being collected, to effectuate a net return of 6% upon its net intrastate telephone plant investment. The application in this case had been filed by Michigan Bell on April 27, 1947. In the application, Michigan Bell requested a rate increase of approximately \$10,500,000. All three of the commissioners on the MPSC voted to approve an increase of \$8,217,000, which was approximately 80% of the rate increase requested by Michigan Bell. Participants to this proceeding were the Attorney General, the Staff of the MPSC, Michigan Bell, and numerous representatives of civic, business and labor organizations, including Division 43 of the Communications Workers of America.

All parties to this particular proceeding were in agreement that Michigan Bell was rendering service in abnormal times, but that such condition was a healthy one in that it required Michigan Bell to expand its telephone facilities throughout the state. In fact, Michigan Bell was engaged in an extensive construction program in an effort to supply telephone service for all those persons who desired it, and to relieve existing congestion in both its local exchange and toll plant. The net additions for the year 1948 were estimated by Michigan Bell to be \$60,087,000, and for the year 1949 at \$57,000,000. Michigan Bell's program included the conversion of all its manual offices to dial operation; and it expected to have this conversion completed by the end of 1951. Under this program, Michigan Bell anticipated that it would furnish extended area service to all but 37 of its 242 exchanges.



In its written order, the MPSC noted that Michigan Bell had had a large growth since 1941, having added a total of 581,465 telephones between December 31st of 1941 and December 31st of 1947. Such growth constituted an increase of 62.6%. Over one and one-half million telephones were being served as of December 31, 1947. As of June 30, 1948, there had been a station gain of 82,761. This was an increase of 32,729 stations over the gain for the same period in the year 1947. The MPSC observed that the demand for telephones continued, and because of the increase in this demand, hold orders for service as of January 1, 1948 were 50,972, and as of June 30, 1948 this had decreased only to 33,558. None of the parties to this case, including the labor unions, or the three commissioners on the MPSC, questioned this need for Michigan Bell to construct additional facilities to provide additional services in the amounts that were represented by Michigan Bell to be necessary.

In view of the acceptance of the fact that Michigan Bell had to have additional funds to construct these additional facilities, the MPSC unanimously granted substantially all of the rate increase requested by Michigan Bell. The major item of reduction between the request of Michigan Bell and the amount of the increase eventually authorized by the MPSC was the appropriate amount of the fees to be paid to AT&T for services provided under the license contract. In this case, there was no disagreement as to whether to utilize an original cost rate base or a fair value rate base. All parties agreed on using an original cost rate base, despite the fact that later decisions of the MPSC would indicate that legal precedent appeared to require the use of a fair value rate base. As with the case of Consumers Power in the setting of electric rates, the MPSC determined to utilize a state-wide method of rate making for Michigan Bell, despite the request of the City of Detroit to be considered separately for rate making purposes.

It is important to note that in 1948, all the commissioners on the MPSC, both Democrats and Republicans, approved a substantial rate increase for Michigan Bell primarily for the purpose of providing monies for additional investment in telephone plant to meet the increasing demand for telephone service. None of the commissioners, nor any of the parties to this rate increase proceeding, were concerned with the effect of the increased rates on residential users of telephone services. Thus, it appears that at this time the MPSC was almost wholly concerned with the financial integrity of Michigan Bell, and paid little attention to any possible divergence in interest of residential users of telephone services from the interests of Michigan Bell. A review of the parties to these various rate proceedings and a reading of the orders issued by the MPSC at this time gives no indication that there was a divergence or conflict of interest between residential users of local exchange telephone services and business users of toll services. Apparently, the business subscribers to toll telephone service were of the opinion that rate increases that were applied to them could be passed on to the users of their services and products without any slippage in their competitive position in the market place.

On June 19, 1950, the MPSC granted its first rate increase of the 1950s to Michigan Bell. The rate increase was authorized in Case No. T-252-50.6, which case was the companion case to an earlier decision by the MPSC in Case No. T-252-49.14. The decisions in Case Nos. T-252-49.14 and T-252-50.6 were the result of an application filed by Michigan Bell requesting authority to increase its annual gross revenues by \$20,400,000. With regard to the total requested rate increase of \$20,400,000, Michigan Bell sought from the MPSC immediate authority to increase its rates by \$9,800,000 prior to the holding of any evidentiary hearings in this matter. In Case No. T-252-49.14, the MPSC granted immediate rate relief to Michigan Bell in

the amount of \$4,861,000, or approximately one-half of the amount requested by Michigan Bell. In Case No. T-252-50.6, the MPSC granted final rate increases in the amount of \$8,200,000. The two rate increases of \$4,861,000 and \$8,200,000 granted by the MPSC, were approximately 65% of the \$20,400,000 rate increase originally sought by Michigan Bell.

With regard to the order issued on June 30, 1949 in Case No. T-252-49.14, all three of the commissioners on the MPSC approved the immediate annual rate increase in the amount of \$4,861,000. To produce this increase in gross revenues, rate increases were authorized in the toll message telephone services provided by Michigan Bell, but not in the local exchange service rates. Increased rates in toll services were authorized because the MPSC found that the testimony and exhibits filed with the application of Michigan Bell demonstrated that the earnings from the toll telephone services were such that Michigan Bell found itself in a "severe" financial position. At page 6 of the order, the MPSC stated the following: "The evidence indicates that the Company is earning considerably less than a 6 percent rate of return on its net plant investment and that intrastate toll rates are producing gross revenues considerably less than the cost of such services." In fact, the MPSC stated in a later portion of its order that Michigan Bell was only earning 3.73% from its toll telephone services. Such a situation constituted an "emergency" in the opinion of the MPSC, and on this basis it granted an immediate rate increase in toll services in the amount of \$4,861,000, so as to produce a 5.3% return upon net plant investment for toll services.

With regard to the order issued in case No. T-252-50.7 on June 19, 1950, the MPSC granted a final rate increase to Michigan Bell for both toll and local exchange telephone services in the amount of \$8,200,000. Although the application had been filed in 1947, the increased rates were based on

projections for the operating results in 1950. In addition to Michigan Bell, the Attorney General, and the staff of the MPSC, other parties to this proceeding were various municipalities located throughout the state of Michigan. Two commissioners on the MPSC, both Republicans, voted for the final rate increase of \$8,200,000. One Commissioner, Chairman James H. McCarthy, a Democrat, wrote a dissenting opinion wherein he expressed his belief that no increase should be authorized.

The most significant factor accounting for Chairman McCarthy's conclusion that no rate increase was merited, as opposed to the approval of the rate increase by Commissioners Stuart B. White and Schuyler L. Marshall, was the difference of opinion as to how to determine the value of Michigan Bell's investment in facilities to provide telephone service (i.e. rate base). Before determining a specific value for Michigan Bell's facilities for 1950, the majority opinion set forth certain principles to be utilized in determining rate base:

It is a fundamental principle of regulation, with respect to the fixing of rates, that the utility in question shall be entitled to earn a fair return upon its property used and useful in its business. A utility is a public service corporation and, as such, its property is devoted to public use which, in turn, subjects it to the regulation of the state. Conversely, the constitution guarantees that property of the utility shall not be taken for public use without just compensation. At the same time, the utility may not be permitted to charge rates which are exorbitant or unreasonable from the standpoint of the ratepayer. Accordingly, between a return which is fair and a charge which is unreasonable lies a zone of reason within which the regulatory body must, in the end result, establish and fix the rates to be charged for the service rendered.³² (Emphasis added).

Michigan Bell presented evidence which utilized a reproduction cost method to determine a value for its estimated 1950 rate base. This value was \$399,457,000. The staff of the MPSC calculated the 1950 rate base on the basis of an original cost approach. The value it derived was \$296,379,000.

Commissioners White and Marshall were of the opinion that the state and federal legal precedents mandated the utilization of a "fair value" rate base, and that this value would be somewhere between the original cost estimate of the staff and the reproduction cost calculation of Michigan Bell. Accordingly, they arrived at a value of \$350,000,000, to which they applied a 6% rate of return, so as to arrive at the amount of yearly revenues Michigan Bell would be entitled to for providing public utility telephone services. These commissioners determined that Michigan Bell was not presently earning the amount of annual revenues to which it was entitled by their calculations, and therefore, authorized Michigan Bell to increase its rates by \$8,200,000 on an annual basis.

On the other hand, Chairman McCarthy was of the belief that state and federal legal precedents required the MPSC to utilize an original cost approach to rate base valuation, and adopted the staff's estimate of \$296,370,000. He also disagreed with the other two members of the MPSC who thought that 6% was a fair rate of return on investment. Chairman McCarthy stated that 5.7% was a fair rate of return for a regulated telephone company. Applying the 5.7% rate of return to the rate base of \$296,379,000, Chairman McCarthy concluded that the revenues that Michigan Bell would be entitled to by such a computation were less than the revenues actually being earned by Michigan Bell, and therefore, Michigan Bell was not entitled to a rate increase.

Chairman McCarthy made some interesting observations concerning what he characterized as the "arbitrary nature" of the fair value rate base approach used by the other two members of the MPSC:

The conclusion of my colleagues is that 'Upon a careful consideration of all the elements entering into the formation of a sound judgment' they deem to decide the present fair value to be \$350,000,000. They also state that they have made "due allowance" for depreciation and depreciation reserves but do

not divulge the amount nor the way in which they arrive at this "due allowance". I find these nebulously arrived at concepts to be difficult to reconcile with the decision in the Consumers Power Company (Gas) Case D-2948-49.2 (1949), in which they participated, which stated that "The determination of fair value of utility property requires a consistent standard". Where is the standard in this instance, and where is the consistency in view of previously cited cases where net investment rate bases were adopted? On what is their "fair value" based and on what study have they made to determine the amount of existing depreciation in the property?³³

In addition to dissenting as to the amount of the rate increase granted to Michigan Bell, Chairman McCarthy also dissented as to the method of distributing the increases among customers by his two colleagues. The other members of the MPSC had adopted increased rates which would be proportionately higher for certain classes of customers in the Detroit area than for similar classes of customers in other parts of the state. Chairman McCarthy was of the opinion that this would result in legally prohibited rate discrimination. The rate discrimination to which Chairman McCarthy objected was essentially a geographical one between the Detroit metropolitan area and the out-state areas, as opposed to a rate discrimination between various classes of customers such as residential and business classes. In his dissenting opinion, Chairman McCarthy stated the following:

The rates and charges approved by the majority are based on arbitrary selection related to the "value" of the service. The rate schedule of the Company as proposed and adopted includes specific rates for different classes of service in Detroit and suburban zones and in several outstate groups determined by number of stations.

It is the duty of this Commission not only to prescribe reasonable rates for the Company on an over-all basis, but also as to test the reasonableness of individual rates. Discrimination exists if the differences in price between two classes of service or different groups is greater or less than the differences in the conditions surrounding the service. Mere difference in price is not a criterion for the determination of discrimination. Such differences may



be justified upon both the basis of the cost and other economic conditions affecting price differential. In theory, prices for each service should be predicated upon actual costs for rendering services. It is apparent that the application of rate increases in the majority opinion have been predicated upon bases other than cost, since there was no basis before them for determining them on costs. The results of a determination of increases on the so-called value basis will impose upon the Detroit area unequitable rates unless it can be shown that the determinations are properly related to the costs of the service.³⁴

From this particular case, one can discern in the majority opinion as opposed to the dissenting opinion, a difference in approach to rate making by the various members of the MPSC. It is my opinion that these differences in approach to rate making reflect differences in political philosophy among the commission members. Chairman McCarthy, a Democrat, appears to be of a more liberal philosophy than his other two colleagues. This is reflected by the fact that his dissenting opinion reflects a concern with the impact of increased rates on the ratepayers of Michigan Bell, and a sensitivity to the issue of discriminatory rate treatment with regard to users of telephone services situated in the Detroit metropolitan area. McCarthy's conclusions that Michigan Bell did not need a rate increase, indicates that he was not as concerned with the promotion of Michigan Bell's financial integrity so as to provide the necessary revenues for increased investment in telephone facilities to meet increasing demands for services, as were his other colleagues on the MPSC. In order to minimize the need for a rate increase for Michigan Bell, McCarthy was more willing to employ conservative methods of financial analysis, such as original cost rate base, than were his colleagues. On the other hand, Commissioners White and Marshall, both Republicans, were more inclined to utilize the more liberal analytical tool of fair value rate base, so as to provide additional revenues to Michigan Bell for expansion purposes. These two commissioners appear to

have been more politically conservative than McCarthy, since their majority opinion reflects no consideration of the impact of increased rates on the current subscribers of Michigan Bell's telephone services.

On May 14, 1951, Michigan Bell filed another application with the MPSC seeking an increase in its gross annual revenues of approximately \$22,000,000. The application requested that this increase be implemented immediately. Parties to this proceeding were Michigan Bell, the Attorney General, the staff of the MPSC, and various municipalities purporting to represent rate payer interests. The municipalities requested that the MPSC dismiss the application. The MPSC, with all of its members concurring, issued a written opinion in Case No. T-252-51.19, which denied an immediate rate increase to Michigan Bell, but which authorized further hearings to be held in the near future for the purpose of taking additional evidence.

The MPSC in Case No. T-252.51.9 made note that one of the arguments advanced by Michigan Bell to justify increased rates was that telephone rates, on the average, had increased 21% since the end of World War II while the "earnings of the public generally" had increased 100% and price levels had increased 84%. Michigan Bell also noted that the weekly pay rate in the manufacturing industries had increased by about 136% between 1940 and February of 1950 as contrasted with the 21% increase in telephone rates for the same period. The MPSC determined that these comparisons were relatively meaningless for the purpose of establishing rates for telephone service for the following reasons:

The statute charges this Commission with finding rates that are 'just and reasonable' which we have always interpreted to mean that the rates should be adequate to cover total costs of providing service, including a fair return and reasonable return on the capital investment necessary to supply the service. This is entirely independent of what wages, prices, or other costs might have done except as these enter into the cost of providing telephone service.³⁵ (Emphasis added).

One of the most interesting observations made by the MPSC for rejecting the use of the comparisons presented by Michigan Bell for the purpose of making rates, was that the use of such comparisons would be of little consolation to the ratepayer who would be required to pay higher rates which were not related to increased operating expenses. Thus, the MPSC expressed the following conclusion in its order:

It is granted that the cost of living has increased from earlier days. We do not see that this is any argument that telephone rates should increase proportionately without regard to increased usage, advancements in the art, technological improvements, operating economies or other factors. Would the company be happy with unconsidered rate reductions proportionate to any decline that might take place in the customer's price index in the future?³⁶

Despite the sound reasoning put forth by all the members of the MPSC for not setting rate increases on the basis of comparisons with price increases in other sectors of the economy, Michigan Bell in its annual reports for the years 1955 through 1958 continued to present such dubious comparisons to its stockholders as reasons justifying continuing requests to the MPSC for rate increases. For instance, in its 1957 annual report, Michigan Bell stated the following:

Since 1940, rate increases have raised our revenues by only 21 percent while the price of most things has about doubled. . . . Since we have not been permitted by regulation to reprice our service in a realistic manner, Michigan Bell has been earning a rate about half that of typical industrial companies with which it competes for capital necessary to meet the public demand for service.³⁷

A major reason why the MPSC denied Michigan Bell's request for a rate increase in Case No. T-252-51.19 was that certain evidence indicated a substantial improvement in the financial position experienced by Michigan Bell, as indicated by the fact that since 1948, operating revenues had increased 18 percent, operating expenses and taxes 10 percent, and net operating income 108 percent.

TABLE 10

<u>Year</u>	<u>Operating Revenues Per Telephone</u>	<u>Expenses and Taxes</u>	<u>Net Income Per Telephone</u>
1945	\$71.62	\$61.85	\$ 9.77
1946	67.44	62.03	5.41
1947	71.14	65.40	5.74
1948	75.35	67.36	7.99
1950	79.96	68.54	11.42
1951	84.03	72.07	11.96

From the above table, the MPSC concluded that although prior to 1948, the operating expenses per telephone were increasing faster than revenues, thereby reducing net income to Michigan Bell, under the rates then in existence in 1951, net operating income, after all operating expenses and taxes, were still increasing. In such a situation, all members of the MPSC felt that there was no need to provide a rate increase to Michigan Bell.

On June 5, 1952, the MPSC issued an order in Case No. T-252-52.13, wherein it evaluated the \$22,000,000 rate increase applied for by Michigan Bell on May 14, 1951, and concluded that Michigan Bell was only entitled to an increase of \$7,221,882, or approximately one-third of the Michigan Bell request. This rate increase was approved by all three members of the MPSC, including Chairman McCarthy. Although a small portion of the rate increase was due to the need of Michigan Bell for additional revenues to construct new telephone facilities to meet increased demand for service, most of the rate increase was related to specific increases in operating expenses:

- (a) Federal income taxes had increased from 47% to 52% of Michigan Bell's taxable net income due to a revision of the Federal Revenue Act.
- (b) State income taxes had increased due to new legislation.
- (c) Increased wages and pension costs for employees due to a new labor contract.

Because the rate increase was related almost wholly to increased operating expenses, even Chairman McCarthy, a Democrat, approved this substantial increase. If the increase had been primarily for construction of additional telephone facilities, it is my opinion that McCarthy might not have approved the rate increase.

One of the most important elements necessitating the increase in rates was the MPSC's conclusion that Michigan Bell was entitled to an increase in the rate of return on its rate base from 6.0% to 6.45%. Such an increase in the rate of return was endorsed by Chairman McCarthy as necessitated by changed economic conditions. As further justification for the rate increase, the MPSC noted that in 1951 the net operating income per telephone was \$11.34, but that this figure had declined in 1952 to \$9.74. As an indication that the mid-1950s would be a period of inflation which might require Michigan Bell to seek frequent rate increases, the MPSC stated the following in its order:

Rate making, it has been said, looks to the future. However, because of the tempo of present economic conditions, the discernible distance ahead approaches zero. Under such circumstances the pragmatic adjustment of rates and charges seems most reasonable. Suffice it to say that applicant's net revenues for the year 1952, will permit it a reasonable return that the rates and charges required to produce such return are presently just and reasonable. It is possible that future events may render such rates and charges unjust and unreasonable and in that event, we have adequate power to correct the situation. . . .³⁸

Having only been granted a rate increase in 1952, Michigan Bell filed an application with the MPSC on June 9, 1953 seeking a rate increase of \$22,283,481. By unanimous consent of all three commissioners, this particular application was denied on May 11, 1954 in Case No. T-252-54.10, inasmuch as the MPSC determined that net earnings for the test period were in excess of 6.5% and such a return was deemed to be adequate.

Subsequently, on June 10, 1954, Michigan Bell filed a petition for rehearing, setting forth new evidence regarding its need for increased revenues. Michigan Bell noted that the value of its telephone plant had increased about \$25,000,000 since the last rate case; expenses had increased about \$6,800,000; but, that intrastate operating revenues had increased only \$5,600,000.

By order dated July 28, 1955 in Case No. T-252-55.15, all three commissioners of the MPSC approved a rate increase for Michigan Bell of \$2,802,000. This rate increase was less than one-tenth of the \$22,282,481 rate increase requested by Michigan Bell on June 9, 1953. The rate increase was justified by the MPSC on the basis that Michigan Bell had experienced a decline in its earnings whereas its telephone plant had increased in value. This increase in the telephone plant was based on the utilization of the original cost method. All three of the commissioners felt that the use of an original cost rate base was appropriate since this was the valuation method employed by Michigan Bell in its application. Thus, the issue of the original cost rate base versus fair value rate base did not need to be addressed in this particular proceeding. The MPSC concluded that a rate increase of \$2,802,000 would produce a rate of return of 6.22% or better, and that such a rate of return was well "within the regulatory zone of reasonableness".

On November 16, 1956, Michigan Bell filed another application for a rate increase with the MPSC, requesting additional annual revenues in the amount of \$12,542,000. On August 6, 1957, the MPSC issued an Opinion and Order in Case No. T-252-57.26, wherein it authorized a rate increase of \$2,835,000, or approximately one-sixth of the amount sought by Michigan Bell. This rate increase was approved by two of the three commission members: Democrats Otis M. Smith and James H. Lee. The third member of the



MPSC, Republican Maurice E. Hunt, dissented from the Opinion and Order of his colleagues on the basis that the evidence demonstrated that Michigan Bell was entitled to a much larger rate increase. The majority opinion written by the two Democrats, utilized an original cost rate base whose value was determined to be \$445,711,535. Republican Hunt thought that a larger rate base value was warranted, based on a fair value approach. Hunt was of the opinion that legal precedent required the use of a fair value rate base, while the Democrats were of the opinion that an original cost rate base was appropriate since this was the approach used by Michigan Bell in this proceeding. The Democrats determined that a 6.6% rate of return was necessitated from the evidence introduced at the hearings, which was an increase from 6.5% in 1954. Republican Hunt thought that economic factors indicated that an even higher rate of return would be appropriate.

As a final reason for providing less of a rate increase than was sought by Michigan Bell, the Democratic majority reviewed the income taxes that Michigan Bell was paying with regard to its existing capital structure, and concluded that Michigan Bell could have avoided a certain amount of these income taxes if it had a more appropriate capital structure. At page 15 of the order issued in Case No. T-252-57.26, the MPSC observed that Michigan Bell's actual capital structure at the end of 1956 consisted of the following:

		<u>Ratio</u>
Long Term Debt	\$105,000,000	21%
Notes	5,000,000	1%
Equity	383,235,000	78%

Because the long term debt ratio was only 21%, the MPSC noted that Michigan Bell had paid greater amounts of income tax than it would have if the long-term debt ratio had been higher. Thus, the MPSC employed the accepted regulatory practice of adopting a hypothetical capital structure, increasing



the debt ratio when it was clearly low and decreasing it when it was too high. The MPSC then concluded that a 40% long term-debt structure would be appropriate for Michigan Bell, and made a determination as to what the avoidable income tax expense would have been in 1956 if such a long-term debt ratio had in fact existed. Republican Hunt dissented from the use of a hypothetical capital structure, and thought that Michigan Bell was entitled to recoup all of the income taxes it had paid on the basis of a 21% long-term debt ratio.

From an analysis of the rate cases for Michigan Bell through the year 1957, one might be tempted to conclude that the Democratic members of the MPSC were more inclined to approve smaller rate increases for Michigan Bell than were their Republican colleagues. This observation would be correct through 1957, but with the advent of Otis M. Smith as Chairman of the MPSC, this pattern was to change slightly with the next rate case decided in 1958. Although Smith was a black, he tended to be a moderate conservative Democrat, whose interests were more aligned with the protection of the financial interests of utility companies than with the interests of residential ratepayers for the lowest possible rates. Thus, with the alignment of Smith with his Republican colleagues in some of the rate cases, the analysis must move from Democrat versus Republican, to political liberals versus political conservatives.

As a follow up to the rate increase approved by the MPSC on August 6, 1957 in Case No. T-252-57.26, Michigan Bell filed a petition with the MPSC on September 11, 1957, for a reopening and rehearing of the case. This petition was granted by the MPSC, and additional hearings were held. On June 26, 1958, the MPSC Issued an Opinion and Order in Case No. T-252-58.23, wherein it concluded that although it had previously granted a rate increase in Case No. T-252-57.26 in the amount of \$2,835,000, a review of the record

on rehearing indicated that such a rate increase was not totally adequate and that Michigan Bell was entitled to additional revenues on an annual basis. Thus, the MPSC approved an additional rate increase for Michigan Bell in the amount of \$2,212,000.

This particular rate increase was approved by two commissioners, with one commissioner dissenting. Approving the rate increase were Chairman Otis M. Smith, a Democrat, and Commissioner Thomas M. Burns, a Republican. Dissenting was Commissioner James H. Lee, a Democrat. The majority opinion adopted a fair value rate base, valued at \$506,693,000. Smith and Burns also adopted an increased rate of return on telephone plant investment of 6.60%. When the 6.60% rate of return was applied to a rate base of \$506,693,000, the result was an income requirement of \$32,379,886, the majority calculated that Michigan Bell was experiencing an income deficiency of \$1,061,852. Such a deficiency, when adjusted for the effect of Federal Income Taxes, resulted in an additional revenue requirement of approximately \$2,212,000. As previously discussed in this thesis, a Republican and a moderate Democrat, evidenced a conservative approach to utility rate making by giving primary concern to the financial growth of Michigan Bell. To provide additional revenues to Michigan Bell, the majority members were willing to utilize liberal financial concepts of fair value rate base and increased rates of return in excess of those recommended by the staff of the MPSC.

The more politically liberal member of the MPSC, Democrat James H. Lee, revealed in his dissenting opinion his primary concern was the effect that the increased rates would have on the residential users of telephone services, rather than with the financial improvement of Michigan Bell. Lee was of the opinion that the evidence demonstrated that Michigan Bell should be required to reduce its revenues by approximately \$3,000,000 per year.



The staff of the MPSC recommended that Michigan Bell be limited to a 6.50% rate of return on rate base, not 6.60% as adopted by the other two commissioners. Lee supported the staff on this issue. The MPSC staff also supported the use of an original cost rate base, rather than a fair value rate base. Staff valued the original cost rate base at \$518,805,588. Commissioner Lee supported the use of the original cost rate base. Applying a 6.50% rate of return to a rate base of \$518,805,962, Lee calculated that Michigan Bell was entitled to annual revenues of \$30,855,962, or approximately \$3,000,000 less than it was presently earning. Thus, the more liberal member of the MPSC was willing to utilize conservative financial concepts of original cost rate base and a stable rate of return as recommended by the staff of the MPSC.

A review of the various Michigan Bell rate cases decided by the MPSC in the 1950s indicates that Michigan Bell requested rate increases totaling \$77,270,481; but, that it was granted only \$28,931,882, or approximately slightly less than 40% of the amount sought by Michigan Bell. The financial data for Michigan Bell for the 1950s indicates continued growth for Michigan Bell, particularly with regard to the continued construction of new telephone facilities to meet a growing demand for services. For instance, the 1957 Annual Report for Michigan Bell states:

Michigan Bell backed its faith in the economic future of the state with a record \$105 million expansion and improvement program in 1957, which was \$19 million greater than in 1956.

In the dozen years since the end of the war, Michigan Bell has spent nearly \$674 million in new construction.

* * * * *

Fifty-seven new buildings, building additions, or major alterations were completed during the year, including major structures at Detroit, Dearborn, Flint, Jackson, Lansing, Pontiac, and Wyandotte, and work was started on 59 others . . .

Nearly \$32 million was spent on new central office equipment to provide more and better service. Thousands of miles of aerial and underground wire and cable were installed, along with additional carrier circuits and micro-relay channels . . .³⁹

Despite a record of continued growth in both gross and net income, and record breaking construction programs to meet increased demands for telephone service, Michigan Bell contended in its Annual Reports for 1957 and 1958 that it needed additional rate increases.⁴⁰ Due to the recession in Michigan in 1958, Michigan Bell did experience a decline in the demand for telephone service, which only lasted until the commencement of 1960. Although earnings did decrease in 1958, Michigan Bell was still a very profitable utility company. In its Annual Report for 1958, Michigan Bell utilized the untypical financial data of 1958 to try to illustrate the validity of its tenuous position that the rate increases approved by the MPSC throughout the 1950s had been inadequate and unjustifiably low:

A continuing postwar problem of this company has been to obtain adjustments in the price of its service more closely related to the heavy increase in the costs of doing business. In June, the Public Service Commission granted the company authority to increase revenues, through rate adjustments, by \$2,212,000 a year - an increase of only one percent. The amount was less than a quarter of what the company asked.

Since 1940, increased revenues to this company, through adjustments in the price of its service, have amounted to only 32 per cent while the price of most things the public buys has more than doubled.

In allowing the rate increase, the Commission has determined the company was entitled to a return of 6.6 percent on net plant investment. The company does not regard such a return as sufficient to permit it to undertake the improvements that, in the long run, would provide the best service for our customers while keeping down its costs. It is significant, moreover, that Michigan Bell was unable to earn even the 6.6 percent return to which the Commission said it was entitled.

Through the postwar inflationary year, the company has been faced with a constantly increasing investment per telephone in addition to rising costs of doing business.

The average investment for all telephones in service rose to a new record of more than \$300 at the end of the year against \$288 a year ago and \$230 in 1948.

* * * * *

The company earned only 6.08 percent on the investment in 1958 - the approximate level of its earnings throughout the postwar era. In contrast, the postwar profit performance of typical industrial firms has been far above this company's, even including the recession.

A company with the year-after-year financial results in the low area of 6 percent return on investment hardly can assume risks and heavy outlay of funds on projects that can be postponed. That's true because heavy expenditures, even though leading to improvements and lower costs in the long run, temporarily depress the return on investment that is already too low.⁴¹

This plea by Michigan Bell in its 1958 Annual Report for increased rates that would provide an adequate return on investment from Michigan Bell's perspective, and hence the borrowing power to finance new facilities, appears to be somewhat exaggerated. As previously stated, a review of the financial performance for Michigan Bell in the 1950s, appears to indicate a company that had been provided sufficient increases in rates by the MPSC to earn respectable profits and have sufficient monies available to attract new investment monies to construct additional telephone plant facilities. Throughout the 1950s, the Republicans on the MPSC, together with the moderate Democrat, Otis M. Smith, in the late 1950s, approved rate increases for Michigan Bell with the primary purpose of facilitating the construction of additional telephone facilities. It wasn't until the appearance of the Democrat James H. Lee on the MPSC in the late 1950s that one can discern a member of the MPSC who was primarily concerned with the financial impact of the rate increases on the existing residential users of telephone services. Even Chairman McCarthy, a Democrat in the early 1950s, who dissented against certain rate increases approved by the MPSC, did so not so much from the



perspective of the impact of the rate increases on the residential customers, as on the basis that the financial condition of Michigan Bell did not warrant the particular rate increase that had been approved. Thus, from the perspective of the eventuality that there would be consideration given to the financial interests of residential customers as well as the financial integrity of Michigan Bell, one can discern a movement in the rate orders for Michigan Bell in the 1950s toward a political awareness in the late 1950s of the financial impact of the rate increases on the residential customers.

TABLE 11

SUMMARY OF OPERATING INCOME AND EXPENSESFOR THE MICHIGAN BELL TELEPHONE COMPANY

<u>OPERATING INCOME</u>	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954</u>
Local Service	\$ 99,187,927	\$109,953,156	\$119,713,642	\$132,252,852	\$138,383,534
Toll Service	37,046,274	41,524,213	44,971,316	51,122,541	52,463,201
Misc. Revenues	7,864,402	8,822,039	10,891,238	13,158,932	14,904,305
Less: Uncollectible Operating Revenues	411,976	147,355	414,398	324,520	648,823
Total Operating Revenues	143,686,627	160,152,053	175,161,798	196,209,805	205,102,217
OPERATING EXPENSES	\$102,743,337	\$111,934,962	\$122,789,647	\$139,505,623	\$144,518,002
NET OPERATING REVENUES (Before Taxes)	\$ 40,943,290	\$ 48,217,091	\$ 52,372,150	\$ 56,704,181	\$ 60,584,216
OPERATING TAXES	\$ 20,429,743	\$ 26,720,837	\$ 24,418,245	\$ 32,485,152	\$ 34,933,876
NET OPERATING INCOME	\$ 20,513,547	\$ 21,496,254	\$ 27,953,905	\$ 24,219,029	\$ 25,650,340

Source: Annual Reports Filed With The
Michigan Public Service Commission, 1950-1959.



TABLE 11

SUMMARY OF OPERATING INCOME AND EXPENSES
FOR THE MICHIGAN BELL TELEPHONE COMPANY

<u>OPERATING INCOME</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>	<u>1959</u>
Local Service	\$152,431,920	\$165,845,994	\$176,909,069	\$183,225,217	\$195,590,018
Toll Service	61,048,936	67,814,545	72,342,392	71,850,678	80,038,535
Misc. Revenues	16,210,742	18,729,581	20,905,233	22,032,065	21,853,895
Less: Uncollectible Operating Revenues	364,416	714,753	938,724	1,093,484	1,048,032
Total Operating Revenues	229,327,181	251,675,367	268,398,971	276,014,476	296,434,416
OPERATING EXPENSES	\$159,379,686	\$176,409,999	\$186,601,484	\$186,465,028	\$194,320,128
NET OPERATING REVENUES (Before Taxes)	\$ 69,947,495	\$ 75,265,368	\$ 81,797,487	\$ 89,549,448	\$102,114,288
OPERATING TAXES	\$ 40,561,440	\$ 44,431,584	\$ 47,004,428	\$ 51,965,480	\$ 58,471,986
NET OPERATING INCOME	\$ 29,386,055	\$ 30,833,784	\$ 34,793,059	\$ 37,583,968	\$ 43,642,302



TABLE 12

SUMMARY OF TELEPHONE PLANT INVESTMENTFOR MICHIGAN BELL TELEPHONE COMPANY

	1950	1951	1952	1953	1954
Telephone Plant in Service	\$454,616,942	\$482,210,034	\$512,056,897	\$551,209,421	\$591,913,810
Telephone Plant Under Construction	4,651,920	7,794,906	8,604,502	7,843,071	8,874,425
Property Held for Future Telephone Use	438,339	408,481	699,974	291,737	239,878
Subtotal	\$459,707,201	\$490,413,421	\$521,361,373	\$559,344,229	\$601,028,113
Less: Depreciation Reserve	\$120,669,198	\$133,606,265	\$145,464,548	\$156,718,119	\$169,003,680
Total Telephone Plant	\$339,038,003	\$356,807,156	\$375,896,825	\$402,626,110	\$432,024,433
	1955	1956	1957	1958	1959
Telephone Plant in Service	\$636,544,694	\$695,675,582	\$774,298,352	\$834,401,219	\$888,133,125
Telephone Plant Under Construction	8,029,904	15,525,601	21,109,254	8,658,953	11,309,496
Property Held for Future Telephone Use	184,756	918,306	373,847	335,431	376,849
Subtotal	\$644,759,355	\$712,119,489	\$795,781,453	\$843,395,603	\$899,819,470
Less: Depreciation Reserve	\$182,594,791	\$195,231,839	\$207,177,554	\$218,464,381	\$235,861,693
Total Telephone Plant	\$462,164,564	\$516,887,650	\$588,603,899	\$624,931,222	\$663,957,777

Source: Annual Reports filed with the Michigan
Public Service Commission



TABLE 13

SUMMARY OF CAPITAL STOCK, SURPLUS AND LONG-TERM DEBT
FOR THE MICHIGAN BELL TELEPHONE COMPANY

	1950	1951	1952	1953	1954
<u>CAPITAL STOCK AND SURPLUS</u>					
Capital Stock (actually outstanding)	\$220,000,000	\$235,000,000	\$265,000,000	\$282,000,000	\$310,000,000
Earned Surplus	9,118,993	9,652,670	9,322,860	9,172,959	9,453,467
Total	\$231,118,993	\$224,652,670	\$274,322,860	\$291,172,959	\$319,453,467
<u>LONG-TERM DEBT</u>					
Funded Debt (actually outstanding)	\$ 75,000,000	\$ 75,000,000	\$ 75,000,000	\$ 75,000,000	\$ 75,000,000
Advances from Affiliated Companies	11,700,000	10,500,000	10,000,000	8,800,000	10,100,000
Total	\$ 86,700,000	\$ 85,500,000	\$ 85,000,000	\$ 83,800,000	\$ 85,100,000

Source: Annual Reports Filed With The
Michigan Public Service Commission, 1950-1959.

TABLE 13

SUMMARY OF CAPITAL STOCK, SURPLUS AND LONG-TERM DEBT
FOR THE MICHIGAN BELL TELEPHONE COMPANY

	1955	1956	1957	1958	1959
<u>CAPITAL STOCK AND SURPLUS</u>					
Capital Stock (actually outstanding)	\$343,000,000	\$366,000,000	\$379,000,000	\$409,000,000	\$409,000,000
Earned Surplus	14,065,651	17,235,253	21,953,258	26,160,719	34,870,118
Total	\$357,065,651	\$383,235,253	\$400,953,258	\$435,160,719	\$443,870,118
<u>LONG-TERM DEBT</u>					
Funded Debt (actually outstanding)	\$ 75,000,000	\$105,055,250	\$145,126,700	\$145,080,400	\$175,034,500
Advances from Affiliated Companies	6,100,000	5,000,000	12,800,000	15,700,000	14,700,000
Total	\$ 81,000,000	\$110,055,250	\$157,926,700	\$160,780,400	\$189,734,500



TABLE 14

SUMMARY OF NUMBER OF SHARES OF COMMON STOCK OUTSTANDING AND
DIVIDENDS DECLARED FOR THE MICHIGAN BELL TELEPHONE COMPANY

	1950	1951	1952	1953	1954
Number of Shares of Common Stock Outstanding	2,200,000	2,350,000	2,650,000	2,820,000	3,100,000
Number of Shares Controlled by AT&T	2,199,860	2,349,870	2,649,860	2,819,870	3,099,870
Amount of Dividends Declared	\$ 13,750,000	\$ 18,200,000	\$ 19,800,000	\$ 21,700,000	\$ 22,840,000
	1955	1956	1957	1958	1959
Number of Shares of Common Stock Outstanding	3,430,000	3,660,000	3,790,000	4,089,870	4,090,000
Number of Shares Controlled by AT&T	3,429,870	3,659,870	3,789,870	4,089,870	4,089,870
Amount of Dividends Declared	\$ 22,855,000	\$ 24,797,500	\$ 25,620,000	\$ 27,842,500	\$ 28,630,000

SUMMARY OF LICENSE PAYMENTS TO AT&T

	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959
	\$1,323,071	\$1,496,921	\$1,461,822	\$1,821,649	\$1,881,768	\$2,086,820	\$2,301,699	\$2,455,000	\$2,527,757	\$2,713,961

Sources: Annual Reports Filed With The
Michigan Public Service Commission, 1950-1959.



TABLE 15

STATISTICAL DATA REGARDING GROWTH OF
MICHIGAN BELL TELEPHONE COMPANY

	1949	1950	1951	1952	1953
Telephones	1,751,273	1,841,206	1,951,007	2,044,619	2,147,228
Families with Service	80.0%	80.7%	82.3%	83.5%	85.0%
Calls Per Day	9,073,000	9,762,000	10,085,000	10,308,000	10,705,000
Payroll	\$ 75,500,000	\$ 74,000,000	\$ 80,200,000	\$ 88,500,000	\$101,500,000
Employees	22,630	22,395	22,840	24,513	25,908
Earnings on Investment	4.32%	6.02%	5.79%	5.79%	6.02%
	1954	1955	1956	1957	1958
Telephones	2,247,787	2,403,653	2,556,352	2,690,885	2,754,143
Families with Service	85.4%	86.9%	88.2%	88.9%	87.4%
Calls Per Day	11,165,000	11,921,000	12,526,000	13,349,000	13,659,000
Payroll	\$104,400,000	\$116,600,000	\$127,700,000	\$132,800,000	\$130,500,000
Employees	24,088	27,476	27,537	26,896	24,291
Earnings on Investment	6.01%	6.40%	6.12%	6.17%	6.08%

Source: 1958 Annual Report of the
Michigan Bell Telephone Company.

SECTION IV
REVIEW OF THE POLICIES OF THE MICHIGAN
PUBLIC SERVICE COMMISSION WITH REGARD TO
THE CONSUMERS POWER COMPANY IN THE 1950s.

PART A: BRIEF HISTORICAL REVIEW OF THE DEVELOPMENT OF
CONSUMERS POWER COMPANY THROUGH THE 1950s. 42

Consumers Power is one of the nation's ten largest investor-owned operating utilities, and is the third largest that sells both electricity and gas. The roots of Consumers Power go back to the mid-19th century when gas was first used for public lighting purposes in Michigan. Gas had first been used for public lighting purposes in Baltimore, Maryland in 1816, when the Baltimore city council passed an ordinance authorizing the Gas Company of Baltimore to go into business. However, this new invention was very slow to spread, and as late as 1850 only 30 American communities had gas plants.

In western Michigan, Kalamazoo was the key city in the early history of the Michigan utilities industry. On May 8, 1856, twenty individuals and business firms subscribed to \$27,000 of a proposed \$30,000 capital stock issue of a firm to be known as the Kalamazoo Gas Light Company. Sometime in 1856, the village council for Jackson, Michigan granted to Edward Coen the right and privilege to erect and maintain the gas works and conduits for public distribution. Kalamazoo Gas Light Company and Coen's company were the two earliest predecessor companies of Consumers Power. Five additional gas companies were formed in Michigan before 1870 and were also predecessor companies of Consumers Power in the gas field: (1) Pontiac Gas Light Company - 1856; (2) East Saginaw Gas Light Company - 1863; (3) Saginaw Gas Light Company - 1868; (4) Bay City Gas Light Company - 1868; (5) City of Flint Gas Light Company - 1870.

Even more important were the electric company predecessors of Consumers Power: (1) Grand Rapids Electric Light and Power Company - 1880; (2) The Swift Electric Light Company in Saginaw, Michigan - 1881; (3) Peoples Electric Light Company in Flint, Michigan - 1882; (4) Jackson Electric Light and Power Company - 1884; (5) Kalamazoo Electric Company - 1885; (6) Battle Creek Electric Light and Power Company - 1887; and (7) Edison Electric Light & Motor Company in Pontiac, Michigan - 1888.

Often during this early period, competing companies were organized to render the same services in the same territory. By 1900, Grand Rapids had four competing utility operations. This competition, coupled with technological change, made this period one of great financial danger linked at best to a very small monetary reward. At this time there was no regulatory agency designed to supervise the entrance of competitors into a geographical territory. It wasn't long, however, before competition was eliminated through the process of consolidation. The result was a period of phenomenal growth for the utility industry coupled with rising profits.

The leader of this early period of consolidation in the utility industry was William Augustine Foote, who was the founder of Consumers Power. His younger brother was James Berry Foote, and he provided the financial expertise that was necessary to put together the various gas and electric companies that eventually formed Consumers Power. W. A. Foote built his business reputation as a promoter of electric light companies within the state of Michigan. In 1887 he organized the Battle Creek Electric Light and Power Company, and the Albion Electric Light Company. In March of 1888, he organized the Jackson Electric Light Works as a corporation, based on a capitalization of \$100,000. In 1878, W. A. Foote and his associates bought the controlling interest in the Kalamazoo Electric Company; and in 1900, Foote became a one-third partner in the Grand Rapids - Muskegon Power Company.

Between 1905 and 1910, the demand for power increased significantly. The biggest factor in this increased demand was the traction business. Electric streetcars were then called tractions lines, and they played an important roled in the development of the early electric companies, including Foote's Jackson Electric Light Company. While the early traction lines in the southern part of Michigan had no actual corporate relationship with Consumers Power or its predecessor companies, they were affiliated organizations and later became part of the same holding company. Electric companies had been started primarily for public streetlighting purposes, but it wasn't very long before their most important function became that of providing electricity for trolleys. For a significant period of time, this was their most stable business, and it was often impossible for them to obtain bond financing unless they could show that they had traction contracts. W. A. Foote first became involved in the electric railway business when the Jackson street line went bankrupt, and Foote as its major creditor became the receiver for the defunct firm. When the electric railroads started to boom, they soon constituted the financial backbone of the electric utilities business.

In 1907, Foote had gained effective control of the electric business in five major Michigan cities; Jackson, Albion, Battle Creek, Kalamazoo and Grand Rapids, as well as several smaller communities including Big Rapids, Grandville and Coopersville. Foote also had a substantial position in the Muskegon utilities market. Foote's business operations were affected by the depression that hit the country in 1907. The answer to his money problems was to be found in the company named Hodenpyl-Walbridge & Company, with headquarters on Wall Street in New York City. What made Hodenpyl-Walbridge unique as a money house in New York was that it had started business in 1889 in Grand Rapids, Michigan as the Michigan Trust Company

with \$200,000 in capital. Anton Hodenpyl and Henry D. Walbridge were to form a partnership in 1903 that eventually grew into one of the nation's most important utility companies. When Hodenpyl-Walbridge moved their offices to New York, the fulcrum of Michigan's utilities was shifted to New York and remained there until the end of the holding company period. The Hodenpyl-Walbridge move initiated a period of time when Consumers Power would no longer be a local business, but would be the principal operation of a utilities complex that would cover many parts of the nation.

Hodenpyl and the E. W. Clark Company of Philadelphia cooperated in 1903 to form the Saginaw-Bay City Railway & Light Company, a consolidation of all the utilities and traction lines then operating in Saginaw and Bay City. Hodenpyl-Walbridge soon controlled most of eastern Michigan's power outside of Detroit. At the same time Foote's utilities empire was taking shape in western Michigan in the form of the Commonwealth & Southern Company. The Foote and the Hodenpyl-Walbridge interests were merged in 1909. Eventually these interests were transformed into the Commonwealth & Southern Corporation, one of America's utility giants in the coming holding company days. The Commonwealth & Southern Corporation would ultimately have utility interests in the eastern, middle western and southern parts of this country.

The legal consolidation of the Foote and the Hodenpyl-Walbridge interest was completed in 1910 by the incorporation of Consumers Power in Maine as a holding company for all the electric operations in Michigan. Consumers Power remained a Maine corporation until 1968, when it became a Michigan corporation. The Michigan Light Company was organized as a holding company for the various gas operations. In 1915, the Michigan Railroad Commission permitted both Consumers Power and the Michigan Light Company to become electric and gas operating companies in the state. Both Consumers Power



and the Michigan Light Company were subsidiaries of the mammoth multi-state holding company, Commonwealth Power, Railway & Light Company. The birth of Consumers Power was complete on June 24, 1922, when the gas properties of the Michigan Light Company were conveyed to Consumers Power.

During the second decade of the 20th century, Michigan was rapidly developing into an urban, industrial state. Its population had grown from 2.4 million in 1900 to nearly 3.7 million in 1920. This growth was also marked by a shift of the population from rural areas to the emerging automobile cities. In 1890, when Michigan had about 2 million inhabitants, only 35% of them lived in towns of 2,500 or more population. By 1920, this situation was practically reversed, with 61% of the state's more than 2.2 million people living in towns and cities. The population growth and shift in the living situation created an increased demand for electric service.

During World War I, Consumers Power's capacity soon became inadequate. Staggering amounts of capital were needed for new construction. The cost of money increased with inflation. The price of labor, fuels and materials doubled, and in some cases tripled, without commensurate increases in electric and gas rates. Prior to the war years, the financial position of Consumers Power between 1910 and 1914 had been sound. Its income, both gross and net, and increased rapidly, and so had its capitalization - from \$12 million to \$23 million. Because the state regulatory commission would not increase electric rates during the war years, Consumers Power could not earn enough from its electric rates to cope with inflation and earn an adequate return on its investment. The low rates also contributed to Consumers Power's troubles by inducing people to purchase increased amounts of electrical energy. Persons at this time were encouraged to use more energy by the utilization of flat rates, which was necessitated by the fact that no equipment existed for measuring service. During the 1920s, meters



were developed and measured rate service was implemented.

With a complex of hydro and steam generators feeding a single transmission system for distribution in the various localities, costs became statewide rather than local. Consequently, it seemed logical that rates should also be statewide rather than differ from community to community. The Michigan Railroad Commission authorized such statewide rates, and with very minor exceptions this statewide structure for rates has been carried through to the present.

Inasmuch as rates were not deemed by Consumers Power as being sufficient to provide the necessary capital to finance the construction of additional generating facilities, after World War I, Consumers Power tapped a new source of capital by selling investment bonds to its customers, with its employees acting as the sales force. Thus, Consumers Power was in the process of becoming, to a small degree, a customer owned utility.

The 1920s were a period in which Consumers Power grew in terms of assets and number of customers served. A significant part of this expansion was due to the acquisition of a large number of municipally owned utilities in the state. The earnings of Consumers Power also grew. Starting in 1922, Consumers Power's earnings grew every year. Even in 1920, the year of the stock market crash, there was a rise in revenues. Gross earnings grew from \$15 million in 1922 to \$33.4 million in 1929, and Consumers Power's net income rose from \$4.2 million to \$14.3 million over the same period.

During the 1920s, the era of competition amongst rival utility enterprises ceased. More often than not, companies competing for new territory worked out an informal gentlemen's agreement that carved up territories between them. This was the situation whereby it was agreed that with regard to the provision of natural gas, Consumers Power would be permitted



to supply Oakland County while the Detroit Gas company (later Michigan Consolidated Gas Company) would supply Wayne County. With the tremendous expansion of population in subsequent years, this became a significant agreement for Consumers Power since Oakland County became its most lucrative service area for gas sales.

In 1921, Consumers Power's gas customers had numbered 60,590. By 1929, they totaled 162,590. Over the same period, the number of electric customers increased from 130,421 to 296,036. In the period 1921 to 1932, kilowatt sales rose from 294,408,610 to 979,542,316. Gas sales in cubic feet increased from 2,289,078 to 6,786,105. During the 1920s, Consumers Power's holding company, the Commonwealth Power, Railway & Light Company, grew to such an extent that at the conclusion of the decade its utilities properties operated in Michigan, Illinois, Indiana, Tennessee, Alabama, Georgia, Mississippi and Florida. In 1922, Commonwealth acquired the Tennessee Electric Power Company. This acquisition was significant because this particular company would later become the direct target of President Franklin Roosevelt's attack on privately owned public utilities. The Tennessee Valley Authority would eventually provide the impetus to the federal government to break up the utilities complex initiated by Foote and Hodenpyl-Walbridge at the turn of the century. With the breakup of the Commonwealth empire, Consumers Power would become, in 1949, a totally independent operating company, functioning wholly within the state of Michigan.

On May 23, 1929, the Commonwealth & Southern Corporation was formed under the laws of the state of Delaware. This corporation absorbed all of the utilities properties of the Commonwealth Power, Railway and Light Company; and consequently, became the holding company for Consumers Power. Although the utilities industry came under extensive government scrutiny



during the 1930s, Consumers Power was fortunate to be part of the Commonwealth holding company system. Congressional hearings in the 1930s severely criticized the utility holding company system developed by Samuel Insull in the Chicago area. The congressional investigations ultimately led to government regulation of utility holding company systems with the adoption in 1935 of the Public Utility Holding Company Act. In the era of customer ownership of utilities, Insull had sold shares in his holding companies rather than the operating companies. This had the unfortunate effect of separating his shareholders from the actual source of income and involved them in several speculative gambles on the part of the holding companies.

Consumers Power and Commonwealth had no relations with the Insull group. In essence, Commonwealth was innocent of the three cardinal sins charged against utility holding companies. The first, was overcharging operating companies for the functions performed by the holding company for the particular group. Commonwealth avoided this evil by distributing the shares in the holding company to the operating companies in proportion to their gross earnings. The second, was that holding companies arranged for "upstream loans" from the operating companies, so that, in effect, the underlying utility properties financed the parent company instead of the other way around, as was supposed to be the basic purpose of the structure. Commonwealth did not engage in this practice. The third sin was that holding companies frequently wrote up the asset values of the operating companies, commonly called "loading the rate base", which made it possible to charge exaggerated rates to customers. The congressional hearings eventually exonerated Commonwealth of engaging in this practice. Despite the fact of this exoneration, and the fact that Commonwealth charged some of the lowest rates for utility services in the country, Wendell Wilkie as Chairman of the Board of Directors of Commonwealth was to eventually lose



his battle with Roosevelt to keep the Commonwealth system intact.

During the 1930s, Wilkie did win another legal and political battle on behalf of the Commonwealth interests. In that era, the J. P. Morgan Co., along with several other investment banking houses, formed the United Corporation. The United Corporation was designed to be a super holding company for utilities, and attempted to take over the Commonwealth operating companies. Wilkie was able to utilize his political accumen to frustrate this attempt by the large investment banking houses to take over the Commonwealth complex. The only purpose of such a take over would have been to enable the investment houses to charge double commissions on the issuance of utility bonds, a practice which had been criticized in the congressional hearings.

In 1933, when Wilkie became President of Commonwealth, Consumers Power was caught in the depression which affected all of the country. Michigan was particularly hard hit by the depression. For several weeks the company was forced to operate on a cash basis; and not much cash was coming in, and wouldn't for several years. Between 1929 and 1933, gross revenues dropped 22%, from \$33,420,000 to \$26,000,000. Over the same years, common stock earning dropped 66%, from slightly over \$8 million to less than \$3 million, and most of this had to be held in reserve. Strict economies were enforced within the company, including a 10% pay cut for all employees and officers.

The bleak year of 1933 was the turning point. In 1934, revenues were almost back to the 1929 levels, although net income still lagged far behind. During wilkie's reign, the number of electric and gas customers for Consumers Power increased steadily; and the amount of its electric and gas sales also increased, except for a small dip in 1938. During the 1930s, electric and gas sales increased because Consumers Power promoted the use of more appliances in the household. One reason appliance sales were so important,

especially in the early years of slow economic recovery, was that the company's generating equipment and its transmission and distribution systems, both gas and electric, had been built for the prosperity demands of 1929 and 1930. Thus, Consumers Power found itself with excess capacity. The overriding consideration was to generate sufficient sales volume so that rates could be drastically reduced, so as hopefully to avoid the government dissolution of the Commonwealth system. To this end, Consumers Power promoted the "objective rate". If a householder was using X number of kilowatthours in an average month, under the objective rate, he could add electric cooking and still not pay more for several months. After a time, the total bill he paid was raised, but the unit cost was lowered. From the standpoint of Consumers Power, the objective rate permitted putting into effect immediate rate reductions without decreasing sorely needed revenues; from the point of view of the consumer, it allowed the use of more electrical energy without a corresponding increase in the bill.

Total revenues per customer did increase as expected. In the seven years from 1935 to 1942, despite a drastic drop in the price per kilowatthour, the average customer's monthly power purchase rose nearly 35%, from \$28.52 to \$38.41. While the customer's bill was higher by one-third, his use of electricity nearly doubled.

In 1936, the Battle Creek division was the first at Consumers Power to achieve the goal of 1,000 kilowatthours per customer per month. By 1937, the average for the whole Consumers Power's system was 1,004 and in 1939 it reach 1,150, almost double what it had been in 1933. During this period, Consumers Power's kilowatthour sales per household rose far more sharply than national consumption, while the average rates charged by Consumers Power fell faster than the national norm. In 1939, Consumers Power's rates averaged 3.01 cents, as compared with the national average of 4.05 cents.

In terms of percentages, this meant that the company sales exceeded the national utility average by 28% at a price that gave Consumers Power's customers a 26% break.

Wilkie's drive to lower the rates of the operating companies in the Commonwealth system almost got Consumers Power into serious financial trouble. Wilkie pushed the rates so low that despite an increase in total revenues, there was too little income in relation to expenditures. With the increasing use of electricity it was necessary to expend generating and transmission facilities, and as a result, the company found itself in a cash squeeze. Consumers Power did not completely recover from this situation until after World War II, and then only because Michigan's population increased, which resulted from defense production and the growth of the automotive and chemical industries that came with the postwar boom. Meanwhile, much of the necessary expansion had to be halted, especially during the recession which hit in 1929.

No action was taken on the government divestiture of Commonwealth & Southern Company during World War II. As soon as the war ended, the government made it clear that the Commonwealth & Southern wouldn't be permitted to survive, and in 1949 Consumers Power became an independent entity. One of the immediate and grave monetary concerns for Consumers Power was how the MPSC would treat the wartime excess profits tax for rate making purposes. Between 1936 and 1942, the tax total rose from about \$2.5 million per year to \$16 million, a sum greater than the company's entire annual payroll. In 1942, taxes amounted to about \$37 for every home supplied with electricity, and consequently, practically consumed the entire year's electric revenue.

The excess profits tax created a peculiar situation with respect to customer charges in both 1944 and 1945. By a divided court, in the case of

City of Detroit v MPSC, the Michigan Supreme Court held that the MPSC had the right to exclude in whole or in part "excess profits" of the character defined in the Revenue Act as operating expenses which would place unnecessary burdens on the consumer. As a consequence, the MPSC ordered reductions in revenues for Consumers Power in avoidance of amounts which otherwise would be paid to the federal government in the form of so-called excess profits tax. Similar orders were issued in proceedings against other utilities in the state, including Michigan Bell Telephone Company. These reductions were ordered without any investigation on the part of the MPSC as to whether or not the companies were earning a reasonable return on the value of their properties. The nature of the reduction was a 75% credit on the December, 1944 bill. Similar reasoning was employed in December 1945, when a 20% reduction was ordered. The principal reason for the smaller credit in December, 1945 than in 1944, was the reduction in 1945 in taxable income resulting from expenses relating to redemption of bonds in that year.

Consumers Power experienced significant growth in the 1950s. Population growth and general prosperity kept pace with industrial expansion. The state's census, 5.3 million in 1940, rose to 6.4 million by 1950, and rocketed to nearly 8 million by 1960. Most of this growth took place in Consumers Power's service territory. Consumers Power itself participated in stimulating the state's growth. It was a particular concern of the Company's industrial development department to stimulate economic progress in areas that had not yet benefited from industrialization. Consumers Power brought in Corning Glass to Albion, General Electric to Edmore, Hooker Chemical to Mantague, and U.S. Plywood to Gaylord. In the 1950s, Consumers Power's service territory covered most of the Lower Peninsula.

By 1955, Consumers Power was serving nearly 788,000 electric customers,



an increase of more than 50% since the end of the war, and nearly 427,000 gas customers, up from 253,880. Even more impressive was the increase in the number of gas space-heating purchasers, up from 25,640 to 198,005 in the same period. Moreover, each customer demanded far more service than he had ever before. Kilowatthour sales nearly doubled, and gas sales quadrupled between 1945 and 1955.

The expansion of customers created additional problems. Generating capacity had to be increased to meet demand. Existing plants had to be enlarged, and three new steam generating plants went into construction. Meanwhile the costs of such construction continued to go up due to inflation. Consumers Power now had to face the challenge of raising new capital, a problem that previously had been dealt with by its holding company, Commonwealth & Southern.

Consumers Power raised the additional capital by marketing for the first time its common stock, a significant portion of which was sold to its employees on a payroll deduction plant. The first two Consumers Power common stock offers were made even before the Commonwealth & Southern dissolution was complete. The initial sale in 1946, involved 500,000 shares at \$36 per share. Then in November, 1948 another 400,000 shares of common stock were sold at \$33 per share. Additional shares were brought out in later years.

Nearly one-fifth of the employees of Consumers Power and its subsidiary, Michigan Gas Storage Company, took advantage of the stock purchase opportunity. Stock subscriptions were signed by 1,304 employees, or about 19% of the full time regular employees. The subscriptions covered 21,287 shares. At the price of \$34.25 per share, the total amount subscribed was \$729,080, of which nearly half was paid in cash. In 1951, a similar type of offer was made to the employees. After this offer, nearly one-fourth of the employees

emerged as shareholders of Consumers Power, and of those purchased at the time of the February, 1950 plant, 706 again purchased stock in October of 1951. In January, 1954, some 679,000 shares were offered to stockholders and employees. With this sale, more than 38% of the employees became stockholders.

A major event in the 1950s was the decision of Consumers Power to go into nuclear generation. This decision was based on the fact that it was becoming apparent that coal had become an expensive generating fuel. In 1959, contracts were signed for the \$25 million construction of Consumers Power's Big Rock Point nuclear plant near Charlevoix. Big Rock was the fifth investor owned nuclear reactor in the country and started producing electricity on December 8, 1962.

PART B: REVIEW OF THE REGULATORY ORDERS ISSUED BY THE MICHIGAN
PUBLIC SERVICE COMMISSION DURING THE 1950s WITH REGARD
TO THE CONSUMERS POWER COMPANY.

Although financial tables are presented in this part for both the electric and gas operations of Consumers Power in the 1950s, the gas statistics are provided as a supplement to the electric division data to add further evidentiary support for the observation that Consumers Power experienced substantial growth throughout most of this decade. Thus, the emphasis of this part will be an analysis of the two general rate orders issued by the MPSC in the 1950s relating to Consumers Power's electric service offerings. It will only be noted in passing that there were general rate increases granted to Consumers Power in the 1950s with regard to its gas operations, although the MPSC did also approve gas rate increases in 1949 and in 1961. (See Summary of Major Utility Rate Proceedings in the Appendix).

Before reviewing the orders issued in the 1950s, it is of some interest

to note that on November 12, 1948, the MPSC issued an order permitting Consumers Power to amend its fuel cost clause for certain electric service offerings, so as to increase its annual revenues by approximately \$220,000. The increase granted was only about one-tenth of the \$2,000,000 increase requested by Consumers Power. Mention is made of this case because it involved Consumers Power's fuel cost clause, a subject which has been of great concern in the 1970s and 1980s, particularly with the enactment by the Michigan legislature in 1982 of a new act concerning the procedures to be utilized by the MPSC for approving fuel cost adjustment clauses. A fuel cost clause is important to electric and/or gas utilities because it permits these utilities to automatically pass on to their ratepayers increases or decreases incurred by the utilities in the purchase of generating fuels without the need for awaiting specific MPSC approval in a general rate case, which could involve other complicating issues to be considered simultaneously by the MPSC. A review of the order issued in Case No. D-2916-48.4, indicates that a fuel cost clause was first approved for use by Consumers Power in 1939. However, this automatic fuel cost clause did not apply to electric service provided to residential customers; it applied only to certain classes of industrial and municipal customers. In 1948, Consumers Power sought to have its fuel cost clause applied to residential customers, but the MPSC denied this request.

On January 4, 1950, the MPSC issued an order in Case No. D-2916-50.1, regarding a request by Consumers Power to increase its rates for electric services. This case was decided on the basis of financial data for the years 1948 and 1949. The application was originally filed by Consumers Power on December 30, 1948, and in it Consumers Power requested an increase in electric rates designed to produce additional annual revenues in an amount of approximately \$6,600,000. The final order by the MPSC authorized



increased rates that were designed to produce an annual increase in electric revenues of \$4,180,000, or approximately two-thirds of the amount requested by Consumers Power in its 1948 application.

In this rate order, one can discern the possibility of certain differences in political philosophies between the three commission members, and its effect upon the approach to be taken with regard to utility rate increases. Although the MPSC authorized an electric rate increase of \$4,180,000, such an increase was approved by only two of the three commissioners. The two commissioners who approved the increase were Republicans: Schuyler L. Marshall and Stuart B. White. The Chairman of the MPSC was John H. McCarthy, a Democrat, who wrote a dissenting opinion wherein he stated that the evidence submitted in the hearing demonstrated that Consumers Power did not need an increase in its electric rates.

The written majority opinion in Case No. D-2916-50.1, specifies the economic conditions that Consumers Power was facing in 1948/49:

- (1) a period of unprecedented inflation;
- (2) an unprecedented demand for electric service;
- (3) the general ability for a company to obtain equity funds for new construction was difficult and costly;
- (4) the demand for electricity had increased at a more rapid rate than Consumers Power's construction program, with the result that Consumers Power did not have customary adequate reserve generating, transmission and distribution capacity to assure continuation of uninterrupted service;
- (5) in order to meet present demands and anticipated increased demands for electric service, Consumers Power needed additional monies for new construction of electric facilities.

Other than Consumers Power and the staff of the MPSC, the only other parties to be represented in this proceeding were the Attorney General for



the state of Michigan and 33 municipalities located throughout the Lower Peninsula. Since the municipalities were customers of Consumers Power for their own streetlighting needs, it is apparent that they didn't participate in this proceeding for the purpose of advocating the financial interests of residential users of electrical energy. Although the Attorney General on many occasions attempts to represent the interests of residential customers in rate proceedings, his office apparently didn't do so in this proceeding, inasmuch as he failed to present any witnesses at the hearing. A review of the majority order and the dissenting opinion fails to indicate that the staff of the MPSC presented a position at the hearing on behalf of residential users of Consumers Power's electric energy. Thus, in this proceeding, residential customers were not formally or informally represented by any party participating in the hearing. Another important interest which was unrepresented in this proceeding was that of the industrial users of electrical energy. In the years subsequent to the decade of the 1950s, parties representing the interests of residential and industrial customers of electrical energy would become important participants in rate proceedings.

The majority opinion in Case No. D-2916-50.1, discussed at some length the rates charged by Consumers Power for its services in the past. Starting in 1915, the average rates paid by customers of Consumers Power declined until 1918; subsequently increases were incurred, reaching a peak in 1921, followed by a period of declining rates which extended to 1950. The period of increase between 1918 and 1921 was due to World War I which caused inflationary pressures and Consumers Power sought increases in its general rates until 1921. During the period from 1921 to 1924, there was a reduction in the average rate paid by residential customers due principally to the increased use of energy. Since 1924 there were 47 separate reductions in general rate schedules; and of this number, 8 separate reductions were

made in residential service. These reductions were brought about by Consumers Power either voluntarily or as a result of conferences with the MPSC or its predecessors.

The majority opinion also noted that Consumers Power had continued its policy of charging uniform rates throughout its entire territory except in two areas. In one area, the City of Bay City, it had municipal competition, while in the other area, the City of Pontiac, rates were by agreement with the city.

Evidence introduced in this proceeding indicated that for the years 1920 through 1948, the average annual use of electricity per customer increased, and that these increases had an impact upon the reduction of the average rate paid for the same corresponding period of time:

TABLE 16

<u>Year</u>	<u>Annual Revenue per customer</u>	<u>Annual Kwh per customer</u>	<u>Average Electric Rate Billed</u>
1920	\$21.31	281	7.65¢
1925	22.40	334	7.00
1930	28.65	578	5.10
1935	28.52	726	4.10
1940	36.35	1238	3.36
1945	43.49*	1640	3.03
1948	50.90	2080	2.45

* Disregarding 20% rebate in December 1945 bills.

The biggest factor relating to the MPSC granting a rate increase of \$4,180,000 instead of the \$6,600,000 sought by Consumers Power, was the approach adopted with regard to the proper valuation for the rate base of Consumers Power. There was a difference of opinion between the majority

opinion and the written dissent as to the approach to utilize; and each side interpreted the legal precedents in a different fashion to support their position. The competing philosophies regarding the proper value to be placed on the rate base were three: (1) original cost; (2) reproduction cost; or (3) fair value. Under the original cost method, the rate base would be valued at the dollar amount actually expended on the utility plant, less depreciation. The reproduction cost method would value the rate base at the current dollar amount it would take to rebuild the utility plant if it were destroyed. The fair value approach would reach a value for the utility plant somewhere between the low extreme of the original cost method and the high extreme of the reproduction cost approach. The fair value method would consider such items as original investment, reproduction cost, depreciation, and the value of the service to the customer as exemplified by a comparison of rates with other electric utilities in the state and throughout the nation.

All members of the MPSC rejected the reproduction cost approach, even though the evidence submitted by Consumers Power utilized this concept to reach a valuation of its electric utility plant of \$412,721,000. The staff of the MPSC took the position that the proper approach to rate base valuation would be to use original cost, less depreciation, plus reasonable working capital requirements. Using the original cost approach, the staff concluded that a proper rate base would be \$247,955,000, based on a weighted average rate base for the year 1949. Chairman McCarthy adopted the staff's approach, and in his dissenting opinion noted that if the staff's original cost rate base were adopted, and a 6 1/4% rate of return were applied to it, Consumers Power would only be entitled to total net annual revenues in the amount of \$15,500,000. Since Consumers Power had a net revenue from electric operations in 1949 of \$16,222,000, it clearly wasn't entitled to any rate

increase. Chairman McCarthy was of the opinion that prior decisions of the Michigan Supreme Court or the recent decision of the U.S. Supreme Court in Hope Natural Gas Company, 320 US 591 (1944), did not require the rejection of the original cost rate base in this proceeding.

The majority opinion was of the belief that legal precedent, both at state and federal levels, precluded the utilization of an original cost rate base. Consequently, they used a fair value approach, and determined that the value of the Consumers Power's rate base should be \$330,000,000. Applying a 5.7% rate of return to this rate base, the majority opinion noted this would yield net earnings of approximately \$18,810,000, or the need of additional increased net revenues in the amount of \$2,588,000. So as to produce these additional net revenues, the majority authorized a rate increase which would produce additional annual gross revenues in the amount of \$4,180,000.

One can speculate that the Republican majority adopted a fair value rate base approach so as to justify providing Consumers Power increased electric rates. Consumers Power always had a close identification with the Republican Party in the recent past as evidenced by the fact that its previous Chairman of the Board, Wendel Wilkie, had previously been that party's presidential nominee against Franklin D. Roosevelt. Moreover, this was a period of inflation, coupled with growth in customers for Consumers Power, and the Republicans on the MPSC sought to justify a rate increase to Consumers Power on the basis of providing attractive returns on utility plant investments so as to enable Consumers Power to obtain additional funds from investors for the construction of new utility facilities. The MPSC stated the following in its order:

The Commission is cognizant of the need for expansion and takes into consideration the fact that there is a backlog of approximately 9,000 customers awaiting service; that the stand-by margin of generating capacity of this company serves a very important territory in Michigan,



comprising 53 counties with a population in excess of 2,250,000 people and includes such industrial centers as Pontiac, Flint, Saginaw, Bay City, Muskegon, Grand Rapids, Kalamazoo, Battle Creek and Jackson and scores of smaller cities which have, in recent years, become industrialized because of a decentralization policy . . .⁴³

Again, it should be borne in mind that no party to this Consumers Power electric rate increase proceeding claimed to be representing the direct interests of residential rate payers. The Republican members of the MPSC appeared to be exclusively concerned with the financial needs of Consumers Power and expressed no concern in their written majority opinion as to the impact the increased rates would have on residential rate payers. Although, Chairman McCarthy in his dissent expressed the opinion that Consumers Power was not entitled to any increase in rates, his dissent was based solely on the legal issue of the proper methodology to be used in determining the value of the rate base and gave no consideration to what the interests of the residential rate payers might be in this proceeding.

Before proceeding to an analysis of the second major electric rate case of Consumers Power in the 1950s, it should be noted that the MPSC did issue an order on July 17, 1950 in Case No. D-2916-50.6, which evidences the policy of Consumers Power to expand its operations not only within its authorized service area, but by the process of acquisition of other electric utility companies. In 1950, Consumers Power purchased the electric utility assets of the Michigan Public Service Company, and requested approval from the MPSC to lower the rates charged to customers in the service area acquired from the Michigan Public Service Company so as to bring them into closer conformity with the electric rates charged by Consumers Power within its own service territory.

On May 22, 1959, the MPSC issued an order in Case No. D-2916-59.2,

authorizing Consumers Power to again increase its annual revenues from the sale of electric energy by \$6,788,485. The majority opinion in this case was written by two members of the MPSC: Otis M. Smith, Chairman of the MPSC, a Democrat; and Thomas M. Burns, a Republican. The third member of the MPSC, Democrat James H. Lee, wrote a dissenting opinion wherein he expressed the view that Consumers Power was not entitled to any rate increase. This particular case is significant because one of the parties to this proceeding, the Michigan Rate Payers Association, was a voluntary coalition representing the specific interests of residential users of electric energy. In addition, it should be noted that Commissioner Lee in his dissent attempted to assess the impact of this rate increase on residential rate payers. No party was present in this proceeding to represent the interests of any industrial users of electric energy.

The primary area of dispute between Lee and the other two commissioners revolved around the proper methodology to determine the value of the electric rate base. This was the same issue of contention a decade earlier in Case No. D-2916-50.1, between Chairman McCarthy and the remaining two members of the MPSC. Another major area of controversy in Case No. D-2916.59.2, was how to treat for rate making purposes the tax effect of accelerated depreciation. In addition to the issues of rate base value and the proper treatment of accelerated depreciation, Commissioner Lee disagreed with his colleagues on the MPSC on a number of other issues which involved relatively small amounts of money: (1) how to treat employee discounts; (2) the proper treatment of money contributions to industrial development groups; (3) the proper allocation of management salaries and expenses to merchandise operations; (4) the proper treatment of the advertising program; and (5) how to treat the 1959 wage increase.

The application in Case No. D-2916-59.2, was filed by Consumers Power



on January 28, 1958, and was amended on April 7, 1958 to reflect a request for increased electric rates in the amount of \$15,300,000. Parties to this proceeding, in addition to Consumers Power, were the staff of the MPSC, the Attorney General, and the Michigan Rate Payers Association. Unlike the earlier rate case in 1950, in this case the Michigan Rate Payers Association represented the interests of the residential users of electric energy.

In its Opinion and Order, the MPSC made note of the substantial growth of Consumers Power in the 1950s. The electric service area of Consumers Power included almost 27,000 people. Within this area, Consumers Power served some 828,000 customers in 1,498 communities. In 1957, approximately 67% of Consumers Power's operating revenues were derived from sales of electricity; most of the remaining 33% came from sales of natural gas. Growth in both population and business activity had been very substantial in the electric service area. The record showed that kilowatthour sales had increased from 3.85 billion in 1949 to 8.02 billion in 1957, and over this same period the number of electric customers increased from 623,000 to 828,000. In meeting these substantial additional demands for electric service, Consumers Power invested about \$402,000,000 in capital additions to its electric plant and applicable common plant in the years 1950 through 1957.

A major component of this rate case was how to treat, for rate making purposes, the tax effect of accelerated depreciation. On this issue the positions of Consumers Power and the staff of the MPSC were the same, while the Michigan Rate Payers Association took a stand in substantial opposition to Consumers Power and the staff. The position of the Michigan Rate Payers Association was that even though the federal tax law permitted Consumers Power to utilize an accelerated method of depreciation, and thus, receive a more liberal tax benefit in the early years of the operating life of its



electric utility plant, that for rate making purposes Consumers Power should be required to use straight line depreciation. The position of Consumers Power and the staff was that the difference between income taxes calculated by the use of straight line depreciation and the income taxes calculated by the use of an accelerated method of depreciation is a legitimate part of the cost of electric service and should be reimbursed by the rate payers. Since straight line depreciation, if used as the sole basis of rate making, would result in a lower rate increase than originally sought by Consumers Power, the Michigan Rate Payers Association was of the opinion that the use of accelerated depreciation resulted in a permanent tax saving rather than a deferral of taxes. Commissioner Lee agreed with the position taken by the Michigan Rate Payers Association, and in his dissent characterized the rate increase justified by the use of accelerated depreciation as a "phantom" tax charge:

The use of accelerated depreciation provisions of the tax code results in a tax saving rather than in a tax deferral. Utility property generally has a long life, and for this reason the claiming of depreciation for tax purposes extends over a lengthy period. It has been demonstrated conclusively in testimony before this Commission that the accumulated tax saving for a growing utility continues to rise over a long period and, once it has reached a peak, very probably will remain at that high level permanently. The gross amount of this accumulation therefore becomes a permanent windfall to the utility at the expense of the utility's customers. The permanence of this amount indicates clearly that the utility experiences a tax saving rather than a tax deferral.

Capital for the use in utility operations should, without question, be provided by investors. By permitting the phantom income tax, the Commission forces the customers of the utility to contribute to its capital funds. It was pointed out in the previous paragraph that the accumulated funds generated through provisions for "future" taxes are a permanent windfall to the utility. Therefore the amount of this fund is clearly a permanent, involuntary contribution of capital by customer.⁴⁴



Chairman Smith and Commissioner Burns agreed with Consumers Power and the staff that the difference between income taxes calculated by the use of straight line depreciation and income taxes calculated by the use of accelerated depreciation should be included in the cost of service in this case. Whereas Commissioner Lee was of the opinion that the use of accelerated depreciation resulted in an over-all tax saving, Smith and Burns stated that accelerated depreciation merely resulted in a deferral of tax liability. More importantly, whereas Commissioner Lee believed the use of accelerated depreciation resulted in the rate payers of Consumers Power making a contribution to the capital of Consumers Power, Chairman Smith and Commissioner Burns reached exactly the opposite conclusion.

The other major issue in this proceeding that needed resolution was the valuation of the electric rate base. This issue, as in the prior rate case, revolved around the concept of the original cost valuation versus the fair value concept. Whereas in the earlier rate case, Consumers Power had submitted a rate base valuation based on reproduction cost, in this proceeding Consumers Power offered a rate base which it identified as a fair value rate base. The rate base was determined in large part through the use of a procedure generally referred to as the trending of original cost. Consumers Power's calculations, which also included working capital requirement, resulted in a fair value rate base of \$650,000,000. Chairman Smith and Commissioner Burns in their majority opinion adopted for purposes of this case a fair value rate base. Their fair value rate base varied from that of Consumers Power in some small particulars, and consequently, they determined a rate base value of \$516,500,000. These two members of the MPSC, as did their predecessors who wrote the majority opinion a decade earlier in Case No. D-2916-50.1, felt that a reading of prior state law precedents



together with the applicable federal law contained in the Hope Natural Gas case, required the use of a fair value rate base and not an original cost rate base.

The staff presented evidence as to an original cost rate base, with certain minor modifications. The Michigan Rate Payers Association developed a net original cost depreciated rate base, which was also an average base for the year 1958. Commissioner Lee felt that state and federal legal precedents required that the rate base be determined on original cost, less depreciation, with no inclusion of any amount for working capital. Under this approach, his rate base valuation was \$495,162,000. Commissioner Lee then applied a rate of return of 6% to his rate base calculation to arrive at an annual revenue requirement of \$29,710,000 for Consumers Power. Other evidence introduced at the hearing had demonstrated that Consumers Power's adjusted electric operating revenues for 1958 were \$27,731,475. Under Lee's calculations, Consumers Power's actual adjusted revenues for 1958 exceeded its required income requirements by some \$470,000. Therefore, Consumers Power did not need a rate increase, and for other reasons stated in his dissenting opinion, Lee believed that the evidence indicated the need for a substantial rate reduction.

Another reason given by Commissioner Lee for concluding that Consumers Power did not need an increase in its electric rates was that throughout the 1950s Consumers Power's net earnings per share of common stock had steadily increased.

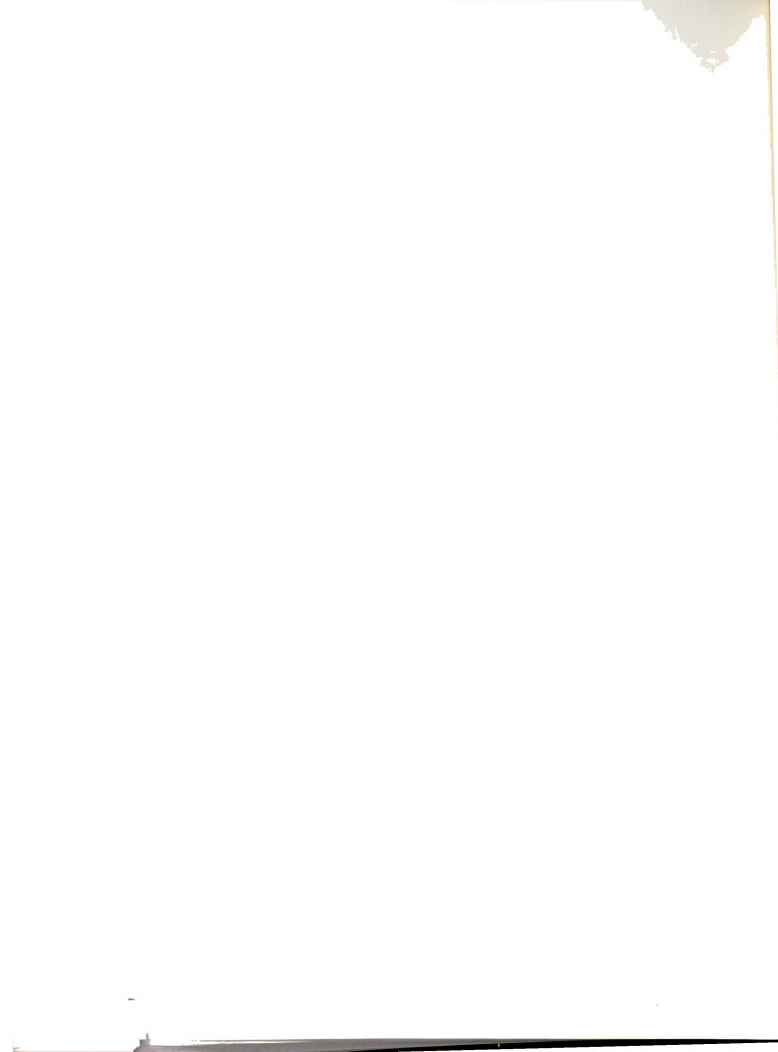
TABLE 17

<u>Year</u>	<u>Net Earnings</u>	<u>Per Share</u>
1950	\$19,000,000	\$2.78
1951	19,500,000	2.61
1952	20,700,000	2.80
1953	24,900,000	3.17
1954	26,600,000	3.12
1955	29,200,000	3.11
1956	31,200,000	3.33
1957	32,760,000	3.30

Thus, Commissioner Lee was able to conclude: "Despite the so-called higher costs and the constant addition to the number of shares outstanding, the earnings per share show an upward trend with slight occasional interruptions. This refutes the claim of the company that it needs higher rates."⁴⁵

In Commission Lee's dissenting opinion, one can discern the first expression of concern about the effect that the approved rate increases would have on the residential users of electrical energy. Lee's concluding remark on this subject was expressed as follows: "even if the increase would amount to 'only three or four cents per day for the typical household customer', the total amounts to a huge and unwarranted raid on the collective pocketbook of the company's customers."

A review of the two Consumers Power electric rate cases decided by the MPSC in the 1950s, Case No. D-2916-50.1 and Case No. D-2916-59.2, reveals certain divergences of political philosophy and opinion among the members of the MPSC. In each case, one member of the MPSC dissented from the majority members of the MPSC and wrote opinions stating that Consumers Power was not entitled to any rate increase. In each instance, the dissenting member of the MPSC was a Democrat. In the first electric rate case, the majority opinion approving an increase in electric rates for Consumers Power was written by two Republicans. In the second rate case, the increase was approved by a Democrat and a Republican. Thus, one cannot



simply state that Democrats opposed the rate increases sponsored by the utility companies, and the Republicans supported the rate increases. Rather one can speculate that Democrats who were liberally orientated in their politics opposed the rate increases, and the more moderate to conservative Republicans and Democrats approved substantial increases in rates. Although Chairman Otis M. Smith was both a Democrat and a black, he was basically conservative in his political philosophy as evidenced by the fact that eventually he became a Vice President and General Legal Counsel for General Motors. Thus, Chairman Smith supported a significant increase in electric rates for Consumers Power in 1958.

It is of some interest to note that the more moderate or conservative members of the MPSC who approved the rate increase for Consumers Power did so by applying liberal accounting and financial concepts to the financial data introduced into evidence at the hearings. They utilized such concepts as fair value rate base and accelerated depreciation to approve rate increases that were designed essentially to provide additional monies to Consumers Power to construct new electric utility plant for an expanding customer base. Their primary concern was to protect the financial integrity of the utility company, rather than examine the impact of the increased rates on residential customers. The more politically liberal members of the MPSC utilized more conservative financial concepts to conclude that Consumers Power should not be granted any rate increases. Their opinion was that if Consumers Power wanted to construct new facilities to meet new demand, such monies should come from investors rather than rate payers.

Finally, at the conclusion of the 1950s, one can discern the emergence of a political concern as to how the rate increases granted to Consumers Power would impact on the financial condition of the residential customers of Consumers Power. This consumer concern is evidenced in the dissenting

opinion of Commissioner James Lee and the participation of the Michigan Rate Payers Association.



TABLE 18

SUMMARY OF OPERATING INCOME AND EXPENSES -
ELECTRIC AND GAS SERVICES OF THE CONSUMERS POWER COMPANY

	1950	1951	1952	1953
<u>ELECTRIC OPERATIONS</u>				
Operating Revenues:	\$85,573,278	\$93,565,285	\$99,084,135	\$109,288,514
Operating Expenses:	(\$41,549,094)	(\$45,456,357)	(\$48,600,445)	(\$ 52,478,232)
Depreciation:	(9,321,000)	(8,929,600)	(9,304,800)	(10,726,570)
Amortization:	(320,000)	(369,519)	(367,066)	(367,620)
Taxes:	(15,612,133)	(19,782,807)	(19,748,237)	(21,192,700)
Deferred Income Tax:	(-0-)	-0-	(263,817)	(1,037,747)
Total Deductions from Electric Operating Revenues:	(\$66,802,227)	(\$74,538,283)	(\$78,284,365)	(\$ 85,802,869)
Net Electric Operating Income:	\$18,771,051	\$19,027,002	\$20,799,770	\$ 23,485,645
<u>GAS OPERATIONS</u>				
Operating Revenues:	\$26,291,578	\$34,003,968	\$37,804,030	\$ 47,327,758
Operating Expenses:	(\$18,970,869)	(\$24,005,030)	(\$29,789,916)	(\$ 33,043,729)
Depreciation:	(1,605,000)	(1,581,400)	(1,903,200)	(2,211,000)
Amortization:	(-0-)	-0-	-0-	-0-
Taxes:	(2,769,806)	(4,271,652)	(2,986,384)	(6,085,511)
Total Deductions from Gas Operating Revenues	(\$23,345,675)	(\$29,858,682)	(\$34,679,500)	(\$ 41,340,260)
Net Gas Operating Income:	\$ 2,945,903	\$ 4,145,886	\$ 2,624,530	\$ 5,987,498

Source: Moody's Public Utility Manuals, 1950-1960.

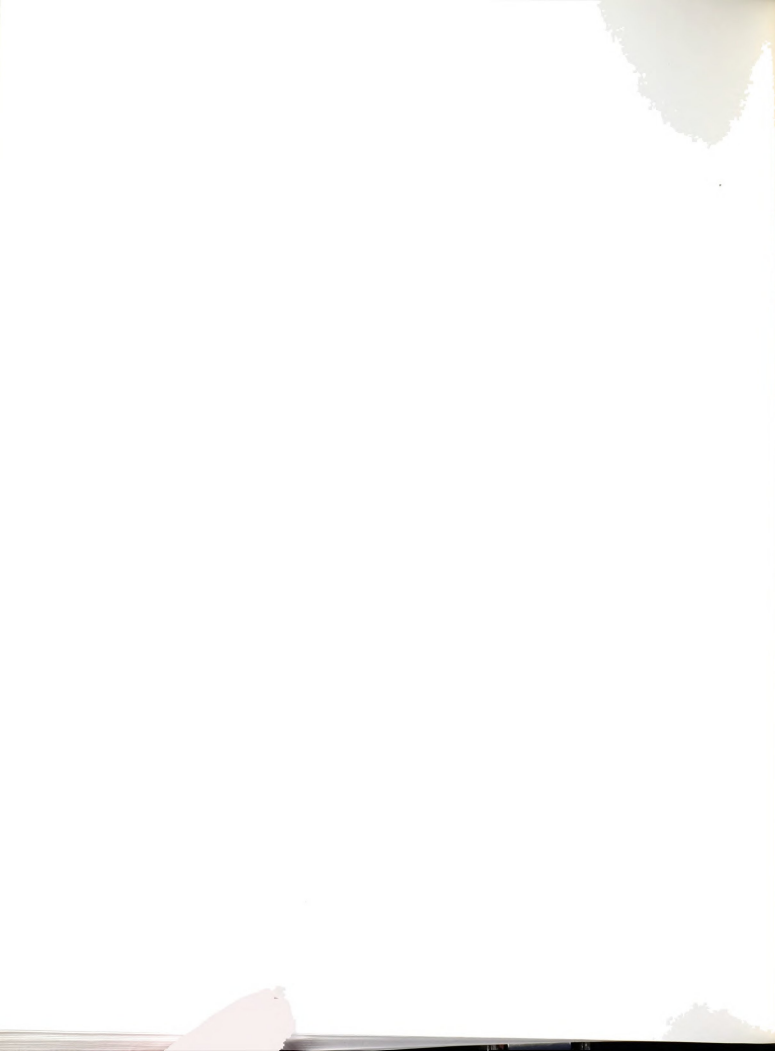


TABLE 18
SUMMARY OF OPERATING INCOME AND EXPENSES -
ELECTRIC AND GAS SERVICES OF THE CONSUMERS POWER COMPANY

	1954	1955	1956	1957
<u>ELECTRIC OPERATIONS</u>				
Operating Revenues:	\$114,941,968	\$128,669,005	\$138,430,282	\$147,787,714
Operating Expenses:	(\$ 56,852,858)	(\$ 61,151,839)	(\$ 67,696,628)	(\$ 72,010,083)
Depreciation:	(11,323,799)	(12,835,800)	(14,282,400)	(15,507,600)
Amortization:	(367,620)	(367,620)	(367,620)	(140,613)
Taxes:	(20,162,536)	(24,520,443)	(25,826,291)	(26,265,154)
Deferred Income Tax:	(1,657,101)	(2,930,564)	(3,721,219)	(4,900,950)
Charges Equivalent to Income Tax Reduction:	(589,104)	-0-	-0-	-0-
Total Deductions from Electric Operating Revenues:	(\$ 90,953,018)	(\$101,806,266)	(\$111,894,158)	(\$118,824,400)
Net Electric Operating Income:	\$ 23,988,950	\$ 26,862,739	\$ 26,536,124	\$ 28,963,314

TABLE 18

SUMMARY OF OPERATING INCOME AND EXPENSES -
ELECTRIC AND GAS SERVICES OF THE CONSUMERS POWER COMPANY

	1954	1955	1956	1957
<u>GAS OPERATIONS</u>				
Operating Revenues:	\$ 52,799,132	\$ 59,804,543	\$ 68,914,298	\$ 72,594,400
Operating Expenses:	(\$ 35,648,084)	(\$ 39,786,339)	(\$ 43,770,319)	(\$ 45,643,287)
Depreciation:	(2,450,400)	(3,556,449)	(3,942,360)	(4,443,600)
Taxes:	(6,800,927)	(8,378,247)	(10,436,384)	(10,865,282)
Deferred Income Tax:	(89,650)	(285,771)	(487,589)	(671,433)
Charges Equivalent to Income Tax Reduction:	(131,285)	(-0-)	-0-	-0-
Total Deductions from Gas Operating Revenues	(\$ 45,120,346)	(\$ 52,006,806)	(\$ 58,636,652)	(\$ 61,623,602)
Net Gas Operating Income:	\$ 7,678,786	\$ 7,797,737	\$ 10,277,646	\$ 10,970,798



TABLE 18
SUMMARY OF OPERATING INCOME AND EXPENSES -
ELECTRIC AND GAS SERVICES OF THE CONSUMERS POWER COMPANY

	1958	1959
ELECTRIC OPERATIONS		
Operating Revenues:	\$150,162,911	\$168,485,422
Operating Expenses:	(\$ 71,287,841)	(\$ 77,827,862)
Depreciation:	(16,761,600)	(18,187,800)
Amortization:	(60,840)	(60,840)
Taxes:	(26,194,385)	(31,541,569)
Deferred Income Tax:	(5,346,250)	(5,404,406)
Charges Equivalent to Income Tax Reduction:	-0-	-0-
Total Deductions from Electric Operating Revenues:	(\$119,650,916)	(\$133,022,477)
Net Electric Operating Income:	\$ 30,511,995	\$ 35,022,477

TABLE 18
SUMMARY OF OPERATING INCOME AND EXPENSES -
ELECTRIC AND GAS SERVICES OF THE CONSUMERS POWER COMPANY

	1958	1959
<u>GAS OPERATIONS</u>		
Operating Revenues:	\$ 76,389,065	\$ 87,936,995
Operating Expenses:	(\$ 50,160,029)	(\$ 57,249,936)
Depreciation:	(5,019,200)	(5,965,800)
Taxes:	(9,477,282)	(10,926,136)
Deferred Income Tax:	(890,121)	(1,194,853)
Charges Equivalent to Income Tax Reduction:	-0-	-0-
Total Deductions from Gas Operating Revenues	(\$ 65,546,632)	(\$ 75,336,725)
Net Gas Operating Income:	(\$ 10,842,433)	(\$ 12,600,270)

TABLE 19

OPERATING STATISTICS OF THE ELECTRIC AND
GAS DIVISIONS OF THE CONSUMERS POWER COMPANY

	1950	1951	1952	1953	1954
<u>ELECTRIC DIVISION</u>					
Customers:					
Residential	565,214	602,509	619,640	638,104	660,303
Commercial & Industrial	79,667	84,810	86,201	88,540	89,446
Other	447	507	520	533	543
TOTAL	645,328	687,826	706,361	727,177	750,292
Sales (M k.w.h.):					
Residential	1,334,655	1,501,660	1,647,921	1,816,104	2,033,078
Commercial	663,811	740,719	791,717	861,775	929,997
Industrial	2,367,789	2,454,344	2,522,270	2,992,279	2,976,137
Other	140,551	138,859	154,557	160,416	155,765
TOTAL	4,506,807	4,835,582	5,116,465	5,830,574	6,094,977
<u>GAS DIVISION</u>					
Total Customers:					
	316,272	332,441	351,315	373,458	395,509
Sales (M cu. ft.):					
Domestic	19,711,517	27,670,152	29,973,521	32,414,136	39,310,117
Commercial & Industrial	9,072,223	10,342,065	12,289,297	15,978,808	17,344,253
Other	52,368	68,822	100,690	144,208	130,672
TOTAL	28,836,108	38,081,039	42,363,508	48,537,152	56,784,442

Source: Moody's Public Utility Manuals, 1950-1960.

TABLE 19
OPERATING STATISTICS OF THE ELECTRIC AND
GAS DIVISIONS OF THE CONSUMERS POWER COMPANY

	1955	1956	1957	1958	1959
<u>ELECTRIC DIVISION</u>					
Customers:					
Residential	683,890	707,308	725,774	740,054	755,513
Commercial & Industrial	91,121	93,043	94,693	95,719	96,352
Other	551	560	572	580	589
TOTAL	775,562	800,911	821,039	836,353	852,454
Sales (M k.w.h.):					
Residential	2,244,271	2,501,144	2,729,873	2,890,249	3,094,393
Commercial	1,047,657	1,139,903	1,238,406	1,409,658	1,599,315
Industrial	3,783,935	3,749,452	3,803,532	3,373,978	4,012,905
Other	169,283	192,381	246,730	274,189	325,647
TOTAL	7,245,146	7,582,880	8,018,541	7,948,074	9,032,260
<u>GAS DIVISION</u>					
Total Customers:	426,714	443,730	462,922	483,682	509,462
Sales (M cu. ft.):					
Domestic	44,228,544	53,417,479	55,645,786	59,560,937	70,061,031
Commercial & Industrial	22,294,178	22,569,109	24,866,893	24,007,655	28,169,532
Other	164,424	184,081	193,380	244,638	304,448
TOTAL	66,687,146	76,170,669	80,706,059	83,813,230	98,535,013

TABLE 20

SUMMARY OF UTILITY PLANT INVESTMENT OF THE CONSUMERS POWER COMPANY

	1950	1951	1952	1953	1954
Electric Plant	\$349,095,527	\$382,508,073	\$419,383,875	\$456,906,077	\$ 499,175,682
Gas Plant	56,438,663	65,773,049	77,678,452	89,113,390	99,825,695
Common Utility Plant	7,766,227	9,042,812	9,361,657	9,836,278	10,954,909
Other Utility Plant	3,556,982	3,593,562	3,611,781	3,620,601	3,624,953
Total Utility Plant	\$416,857,399	\$460,917,496	\$510,035,765	\$559,476,346	\$ 613,581,239
Less Depreciation	\$ 63,210,493	\$ 68,855,718	\$ 73,980,983	\$ 80,795,675	\$ 86,797,557
Less Amortization	11,071,356	10,595,216	10,609,860	11,805,405	12,282,002
Net Utility Plant	\$345,575,550	\$381,466,562	\$425,444,922	\$446,875,268	\$ 514,501,680
	1955	1956	1957	1958	1959
Electric Plant	\$549,332,779	\$608,318,036	\$659,996,397	\$711,323,723	\$ 761,457,785
Gas Plant	114,282,905	131,712,903	168,538,110	190,460,033	241,703,508
Common Utility Plant	11,974,283	14,645,002	21,161,225	26,175,307	25,710,482
Other Utility Plant	3,638,053	3,684,635	3,718,311	3,758,839	3,732,768
Total Utility Plant	\$679,228,020	\$758,360,576	\$853,414,043	\$931,717,902	\$1,032,604,543
Less Depreciation	\$ 94,927,129	\$103,726,616	\$112,586,142	\$123,720,176	\$ 137,879,211
Less Amortization	14,400,946	16,663,716	20,386,593	26,101,058	34,990,953
Net Utility Plant	\$569,899,945	\$637,970,244	\$720,441,308	\$781,896,668	\$ 859,734,379

Source: Moody's Public Utility Manuals, 1950-1960.

TABLE 21

SUMMARY OF STOCK ISSUES AND LONG-TERM DEBT OF THE CONSUMERS POWER COMPANY

	1950	1951	1952	1953	1954
Common Stock	\$113,821,962	\$131,790,506	\$131,790,506	\$153,421,383	\$178,391,723
\$4.50 Preferred Stock	54,778,800	54,778,800	54,778,800	54,778,800	54,778,800
\$4.52 Preferred Stock	20,000,000	19,979,000	19,979,000	19,955,000	19,955,000
Premium on Preferred	37,982	37,942	37,942	37,896	37,896
TOTAL CAPITAL STOCK	\$188,638,744	\$206,586,248	\$206,586,248	\$228,193,079	\$253,163,419
Earned Surplus	\$ 19,717,906	\$ 24,177,808	\$ 24,809,366	\$ 30,956,783	\$ 37,698,983
Appropriated Surplus	-0-	-0-	263,817	1,301,564	2,727,735
TOTAL CAPITAL STOCK & SURPLUS	\$208,356,650	\$230,764,056	\$231,659,431	\$260,451,426	\$293,590,137
Bonds	\$144,125,000	\$178,825,000	\$203,825,000	\$228,825,000	\$228,825,000
Misc. Long-Term Debt	5,775,000	4,300,000	2,825,000	1,350,000	-0-
TOTAL LONG-TERM DEBT	\$149,900,000	\$183,125,000	\$206,650,000	\$230,175,000	\$228,825,000

Sources: Moody's Public Utility Manuals, 1950-1960.

TABLE 21

SUMMARY OF STOCK ISSUES AND LONG-TERM DEBT OF THE CONSUMERS POWER COMPANY

	1955	1956	1957	1958	1959
Common Stock	\$213,056,073	\$213,056,073	\$236,539,674	\$238,004,523	\$247,899,769
\$4.50 Preferred Stock	54,778,800	54,778,800	54,778,800	54,778,800	54,778,800
\$4.52 Preferred Stock	19,955,000	19,555,000	19,155,000	18,755,000	18,355,000
\$4.16 Preferred Stock	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000
Premium on Preferred	37,897	37,348	36,377	35,618	34,858
TOTAL CAPITAL STOCK	\$297,827,770	\$297,427,221	\$320,509,851	\$321,573,941	\$331,068,427
Earned Surplus	\$ 29,634,206	\$ 38,503,249	\$ 46,415,650	\$ 53,064,641	\$ 63,983,158
TOTAL CAPITAL STOCK & SURPLUS	\$327,461,976	\$335,930,470	\$336,925,501	\$374,638,582	\$395,051,585
Mortgage Bonds	\$256,237,000	\$293,249,000	\$324,194,000	\$361,194,000	\$392,128,000
Misc. Long-Term Debt	-0-	-0-	35,156,700	33,668,700	23,807,000
TOTAL LONG-TERM DEBT	\$256,237,000	\$293,249,000	\$360,067,700	\$394,862,700	\$415,935,000

TABLE 22

SUMMARY OF CAPITAL STRUCTURE OF THE CONSUMERS POWER COMPANY

<u>CAPITAL STRUCTURE: 12/31/50:</u>	<u>Rating</u>	<u>Amount Outstanding</u>
<u>LONG TERM DEBT</u>		
<u>Issue</u>		
1. First 2 7/8s, due 1975	Aa	\$113,825,000
2. First 2 7/8s, due 1977	Aa	25,000,000
	<u>Par Value</u>	<u>Amount Outstanding</u>
<u>CAPITAL STOCK</u>		
1. \$4.50 Cumulative Preferred	No Par	547,788 shares
2. \$4.52 Cumulative Preferred	No Par	199,790 shares
3. Common	No Par	6,794,362 shares
<u>CAPITAL STRUCTURE: 12/31/55:</u>	<u>Rating</u>	<u>Amount Outstanding</u>
<u>LONG TERM DEBT</u>		
<u>Issue</u>		
1. First 2 7/8s, due 1975	Aa	\$113,825,000
2. First 2 7/8s, due 1977	Aa	25,000,000
3. First 3 1/8s, due 1981	Aa	40,000,000
4. First 3 1/4s, due 1987	Aa	25,000,000
5. First 3s , due 1984	Aa	25,000,000
6. First 3 1/4s, due 1990	Aa	30,000,000
	<u>Par Value</u>	<u>Amount Outstanding</u>
<u>CAPITAL STOCK</u>		
1. \$4.50 Cumulative Preferred	No Par	547,788 shares
2. \$4.52 Cumulative Preferred	No Par	199,550 shares
3. \$4.16 Cumulative Preferred	No Par	100,000 shares
4. Common	No Par	7,473,798 shares

Source: Moody's Public Utility Manuals, 1950-1960.

TABLE 22

SUMMARY OF CAPITAL STRUCTURE OF THE CONSUMERS POWER COMPANY

<u>CAPITAL STRUCTURE: 12/31/59:</u>	<u>Rating</u>	<u>Amount Outstanding</u>
<u>LONG TERM DEBT</u>		
Issue		
1. First 2 7/8s, due 1975	Aaa	\$109,024,000
2. First 2 7/8s, due 1977	Aaa	24,775,000
3. First 3 1/8s, due 1981	Aaa	39,700,000
4. First 3 1/4s, due 1987	Aaa	25,000,000
5. First 3s, due 1984	Aaa	24,750,000
6. First 3 1/4s, due 1990	Aaa	30,000,000
7. First 4s, due 1986	Aaa	40,000,000
8. First 4 3/4s, due 1987	Aaa	27,967,000
9. First 4 1/2s, due 1988	Aaa	40,000,000
10. First 4 5/8s, due 1989	Aaa	35,000,000
<u>CAPITAL STOCK</u>	<u>Par Value</u>	<u>Amount Outstanding</u>
1. \$4.50 Cumulative Preferred	No Par	547,788 shares
2. \$4.52 Cumulative Preferred	No Par	180,570 shares
3. \$4.16 Cumulative Preferred	No Par	100,000 shares
4. Common	No Par	9,525,406 shares

SECTION V CONCLUSIONS

The primary purpose of this study is to ascertain the regulatory policies pursued by the MPSC in the 1950s with regard to Michigan Bell and Consumers Power. A review of the rate orders issued in the 1950s with regard to these particular utility companies indicates that substantial rate increases were provided to these utilities so as to promote their economic growth in terms of earnings and customers.

The 1950s were a decade of initial inflationary pressures in the state of Michigan, followed by a brief two year period of recessionary trends in 1957-1958. Throughout the 1950s, both Michigan Bell and Consumers Power experienced substantial economic growth, while the budget allocations made by the Michigan legislature to the MPSC to perform its regulatory functions remained relatively stable. Thus, although the number of rate cases increased in the 1950s, and correspondingly the responsibilities of the MPSC in this area grew in importance, the budget of the MPSC did not increase in a commensurate degree. That the staff of the MPSC was beginning to need to be enlarged in order to properly perform audits of the major utilities in rate cases is evidenced by the comments made in the state budgetary reports the latter half of the 1950s. In addition, the need for increased sums of money to be expended on expert witnesses in rate cases indicates that rate cases for public utilities were becoming a regular part of the yearly activities of the MPSC. Rate cases were no longer a relatively infrequent occurrence as in prior decades.

The rate increases granted to Michigan Bell and Consumers Power in the late 1940s and the early 1950s were supported by the Republican members of the MPSC. Any proposal for the refusal of the rate increases requested by these utilities was submitted by the Democratic members of the MPSC,



principally Chairman James H. McCarthy. A review of the written orders issued by the MPSC in the late 1940s and the early 1950s approving rate increases for these utilities indicates that neither the Republicans in the majority or the Democrats that dissented from the rate increases were concerned principally with the effect that the rate increases would have on the financial interest of the residential users of their utility services. Both the Republicans and the Democrats confined their analysis to the protection of the financial position of the utility company.

With regard to an analysis of the rate orders issued by the MPSC in the late 1950s, one discerns the development of rate increases supported by both Republican and Democrats. The Democrat who supported rate increases for Michigan Bell and Consumers Power in the late 1950s was Chairman Otis M. Smith. In essence, Smith was a moderate, black Democrat, who sided with Republicans in approving rate increases so as to promote the financial integrity and growth of utility companies. The Democrat who opposed rate increases for Michigan Bell and Consumers Power was James Lee. Lee's dissenting opinions with regard to the rate increases granted to these utility companies in the late 1950s are very important since they evidence for the first time a concern by a commissioner on the MPSC with the impact these rate increases would have on the financial interests of the residential rate payers of these utilities. That the late 1950s were the initial period of consumer concern with increasing utility rates is evidenced by the fact that the Michigan Rate Payers Association was a participating party in the hearings concerning the last rate case of Consumers Power in the 1950s.

In the late 1950s, the analysis of which members of the MPSC supported rate increases for utility companies cannot simply be done on the basis of party affiliation. A more relevant criteria is the political philosophy of the various members of the MPSC. It appears that liberal Democrats, namely,

Commissioner Lee, were inclined to argue that Michigan Bell and Consumers Power were entitled to no rate increases and perhaps should have their rates reduced by the MPSC, while moderate to conservative Republicans and Democrats (Chairman Otis M. Smith) approved substantial rate increases for these utilities. It is important to note that those moderate to conservative members of the MPSC who approved rate increases for the utility companies did so by employing liberal accounting and financial concepts such as fair value rate base, accelerated depreciation and the actual booked cost of the capital structure. The liberal members of the MPSC who disapproved the rate increases for the utilities and sought to protect the financial interests of the residential rate payers, did so by employing conservative accounting and financial concepts such as original cost rate base, straight line depreciation and hypothetical capital structures.

The members of the MPSC who supported substantial rate increases for Michigan Bell and Consumers Power were of the opinion that such increases were necessary if these utility companies were to experience growth in gross and net revenues and were to be able to induce persons to invest in the construction of new facilities to provide service to new customers. The regulatory policy underlying the rate increases to Michigan Bell and Consumers Power was the promotion of expanding utility services which would generate additional revenues for these utility companies.

Although Michigan Bell and Consumers Power were granted substantial rate increases in the 1950s, at no time did the MPSC approve the full amount of the rate increase requested by the utility company. Quite often, the rate increase approved for the utility company was less than fifty percent of the amount sought by that company. The documentary evidence examined with regard to the rate increases approved by the MPSC in the 1950s provides little, if any, support to a theory that the MPSC may have been a captive



of the utility companies regulated by the MPSC. Moreover, the employment histories of the members of the MPSC, both before and after their tenure on this commission, does not lend support to the "captive" idea.



FOOTNOTES

1. James Willard Hurst, Law and Economic Growth: The Legend History of the Lumber Industry in Wisconsin, 1836-1915, (Cambridge: Harvard University Press, 1964).
2. Gabriel Kolko, Railroads and Regulation, 1877-1916, (Princeton: Princeton University Press, 1965), and The Triumph of Conservation: A Reinterpretation of American History, 1900-1916, (New York: Free Press of Glencoe, 1963).
3. The material for this particular part of the Master's Thesis was obtained from 20 Callaghan's Michigan Civil Jurisprudence, Public Utilities, (Mundelein, Illinois: Callaghan & Company, 1961), Section 16-22, pp. 405-413).
4. Munn v Illinois, 94 US 113, 24 LE 77 (1877); Chicago, B & Q R Co. v Iowa, 94 US 1555, 24 LE 94 (1877); and Peik v Chicago & N R Co., 94 US 164, 24 LE 97 (1877).
5. Pingree v Michigan Central R Co., 118 Mich 314, 76 NW 635 (1898); and Wellman v Chicago & Grand Trunk R Co., 83 Mich 592, 47 NW 489 (1890), aff'd 143 US 339, 36 LE 176, 12 S Ct 400 (1892).
6. State v Chicago, M & St P R Co., 38 Minn 281, 298.
7. See Michigan Central R Co v Michigan Railroad Commission, 160 Mich 355, 361, 125 NW 549 (1910).
8. Morgan v United States, 298 US 468, 80 LE 1288, 56 S Ct 906 (1935).
9. Act No. 106 of the Public Acts of 1909.
10. Act No. 138 of the Public Acts of 1911, reenacted and superceded in Act No. 206 of the Public Acts of 1913.
11. Annual Report of the Michigan Public Service Commission - 1963, p. 10 (Published by the State of Michigan).
12. Ibid., p. 32.
13. Ibid., p. 33.
14. Ibid., pp. 13 & 14.
15. The Budget Report for the State of Michigan for the Fiscal Year Ended June 30, 1951, Vol. 1, p. 122.
16. The financial data for this table was obtained from the various Budget Reports for the State of Michigan for the Fiscal Years Ended June 30, 1951 through June 30, 1960.
17. Ibid.



18. The Budget Report for the State of Michigan for the Fiscal Year Ended June 30, 1951, Vol. 1, P. 122.

19. Ibid.

20. The Budget Report for the State of Michigan for the Fiscal Year Ended June 30, 1954, Vol. 1, pp. H-32 and H-33.

21. The Budget Report for the State of Michigan for the Fiscal Year Ended June 30, 1960, Vol. 1, p. H-26.

22. The data for this table was obtained from the Budget Report for the State of Michigan for the Fiscal Year Ended June 30, 1954, Vol. 1, p. H-59.

23. Ibid., p. H-60.

24. The Budget Report for the State of Michigan for the Fiscal Year Ended June 30, 1962, Vol. 1, p. H-36.

25. A.J.G. Priest, "The Public Utility Rate Base", 51 Iowa Law Review, p. 283 (1966).

26. See 64 American Jurisprudence 2d, Public Utilities, (Rochester, New York: The Lawyers Co-Operative Publishing Co., 1972), Section 138, p. 665.

27. For an extensive analysis of the "cost of capital" concept as the basic standard of a fair rate of return see James C. Bonbright, Principles of Public Utility Rates, (New York: Columbia University Press, 1961), pp. 240-256.

28. Ibid., pp. 153-158.

29. Data regarding the employment status of the members of the MPSC in the 1950s was obtained in a personal interview with Albert J. Thorburn on August 21, 1984. Mr. Thorburn is an attorney engaged in the private practice of law, who has practiced before the MPSC since 1948. Mr. Thorburn did provide some evidence of "influence" by the utility companies with MPSC members and the staff of the MPSC when he indicated that it was not unusual in the 1950s for the utilities to buy drinks for various MPSC members and the staff during social hours at various bars and restaurants in the Lansing area. It is doubtful, however, that from this type of evidence, it could be conclusively determined that the MPSC was "captured" by the utility companies.

30. The material for this particular part of the master's thesis was obtained from Willis Frederick Dunbar, Michigan Through the Centuries, (New York: Lewis Historical Publishing Company, Inc., 1955), Vol. II, pp. 103 & 104.

31. Opinion and Order of the Michigan Public Service Commission issued on April 1, 1948, Case No. T-252-48.7, p. 4.

32. Majority Opinion of Commissioners Stuart B. White and Schuyler L. Marshall, issued on June 19, 1950, Case No. T-252-50.7, pp. 18 & 19.

33. Dissenting Opinion of James H. McCarthy, Chairman, issued on June 19, 1950, Case No. T-252-50.7, p. 17.



34. Ibid., p. 27.
35. Opinion and Order of the Michigan Public Service Commission issued on July 16, 1951, Case No. T-252-51.19, p. 16.
36. Ibid., p. 17.
37. 1957 Annual Report of the Michigan Bell Telephone Company, p. 4.
38. Opinion and Order of the Michigan Public Service Commission issued on June 5, 1952, Case No. T-252-52.13, p. 18.
39. 1957 Annual Report of the Michigan Bell Telephone Company pp. 5 & 6.
40. Ibid., pp. 14-16 and 1958 Annual Report of the Michigan Bell Telephone Company.
41. 1958 Annual Report of the Michigan Bell Telephone Company, pp. 5 & 6.
42. The material for this particular part of the Master's Thesis was obtained from George Bush, Future Builders: The Story of Michigan's Consumers Power Company, (New York: McGraw-Hill Book Company, 1973).
43. Opinion and Order of the Michigan Public Service Commission issued on January 4, 1950, Case No. D-2916-50.1, p. 23.
44. Dissenting Opinion of James H. Lee, Commissioner, issued on May 22, 1959, Case No. D-2916-59.2, pp. 5 & 6.
45. Ibid., pp. 12 & 13.
46. Ibid., p. 13.



APPENDIX MATERIALS

TABLE 23

Makeup of Michigan Public Service
Commission 1947 - 1960
(Number of members was reduced to 3
by Act 377 of Public Acts of 1947)

	<u>Chairman</u>	<u>Commissioner</u>	<u>Commissioner</u>
July, 1947 to July, 1949	R - White	R - Woofenden	R - Marshall
July, 1949 to November, 1950	D - McCarthy	R - White	R - Marshall
November, 1950 to January, 1951	D - McCarthy	-	R - Marshall
January, 1951 to July, 1951	D - McCarthy	D - Veale	R - Marshall
July, 1951 to October, 1951	D - McCarthy	D - Veale	-
October, 1951 to May, 1954	D - McCarthy	D - Veale	R - Hunt
May, 1954 to September, 1954	D - McCarthy	-	R - Hunt
September, 1954 to August, 1956	D - McCarthy	D - Elmer	R - Hunt
August, 1956 to January, 1957	D - McCarthy	D - Lee	R - Hunt
January, 1957 to March, 1957	D - Hart	D - Lee	R - Hunt
March, 1957 to July, 1957	-	D - Lee	R - Hunt
July, 1957 to August, 1957	D - Smith	D - Lee	R - Hunt
August, 1957 to October, 1959	D - Smith	D - Lee	R - Burns
October, 1959 to November, 1959	-	D - Lee	R - Burns
November, 1959 to January, 1961	D - Hill	D - Lee	R - Burns

Source: Records Maintained at the Michigan Public
Service Commission



TABLE 24

LAWS CONTROLLING THE JURISDICTION
OF THE MICHIGAN PUBLIC SERVICE COMMISSION

ELECTRIC, GAS, TELEPHONE, OIL PIPELINES, AND WATER

Act 232 of 1863	Act 238 of 1923
Act 129 of 1883	Act 3 of 1929
Act 102 of 1887	Act 9 of 1929
Act 171 of 1893	Act 16 of 1929
Act 106 of 1909	Act 69 of 1929
Act 144 of 1909	Act 3 of 1939
Act 300 of 1909	Act 240 of 1952
Act 206 of 1913	Act 244 of 1952
Act 419 of 1919	Act 272 of 1952
Act 47 of 1921	Act 44 of 1960

CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY
(Authority to construct and operate)

Electric utilities	Act 69 of 1929
Gas Utilities	Act 69 of 1929; Act 9 of 1929
Telephone Utilities	Act 206 of 1913
Oil Pipeline Utilities	Act 16 of 1929
Water Utilities	Act 44 of 1960

AUTHORIZATION TO ISSUE STOCKS, BONDS, NOTES OR OTHER EVIDENCE OF INDEBTEDNESS

Electric Utilities	Act 419 of 1919; Act 144 of 1909; Act 232 of 1863
Gas Utilities	Act 419 of 1919; Act 144 of 1909
Oil Pipeline Utilities	Act 419 of 1919; Act 144 of 1909
Steam Utilities	Act 419 of 1919; Act 144 of 1909
Telephone Utilities	Act 419 of 1919; Act 144 of 1909; Act 129 of 1883
Telegraph Utilities	Act 419 of 1919; Act 144 of 1909
Water Utilities	Act 232 of 1863; Act 202 of 1887; Act 419 of 1919

TABLE 24LAWS CONTROLLING THE JURISDICTION
OF THE MICHIGAN PUBLIC SERVICE COMMISSIONCONTROL AND REGULATION OF RATES AND CHARGES

Electric Utilities	Act 106 of 1909; Act 238 of 1923; Act 3 of 1939; Act 419 of 1919; Act 47 of 1921; Act 243 of 1952
Gas Utilities	Act 419 of 1919; Act 3 of 1939; Act 9 of 1929; Act 47 of 1921; Act 238 of 1923; Act 272 of 1952; Act 243 of 1952
Steam Utilities	Act 419 of 1919; Act 3 of 1929; Act 47 of 1921
Telephone Utilities	Act 206 of 1913; Act 300 of 1929; Act 47 of 1921; Act 3 of 1939; Act 173 of 1952; Act 243 of 1952
Water Utilities	Act 44 of 1960

REGULATION OF CONDITIONS OF SERVICE

Electric Utilities	Act 419 of 1919; Act 106 of 1909
Gas Utilities	Act 419 of 1919
Oil Pipeline Utilities	Act 16 of 1929
Steam Utilities	Act 419 of 1919
Telephone Utilities	Act 206 of 1913; Act 300 of 1909
Water Utilities	Act 44 of 1960

REGULATIONS AS TO PUBLIC SAFETY (pertains to construction)

Electric Utilities	Act 3 of 1939; Act 419 of 1919; Act 106 of 1909; Act 171 of 1893
Gas Utilities	Act 3 of 1939; Act 419 of 1919; Act 9 of 1929; Act 240 of 1952
Steam Utilities	Act 3 of 1939
Oil Pipelines Utilities	Act 3 of 1939; Act 16 of 1929
Telephone Utilities	Act 3 of 1939; Act 300 of 1909; Act 206 of 1913; Act 171 of 1893
Water Utilities	Act 3 of 1939

Source: Annual Report of the Michigan Public Service Commission

TABLE 25

SUMMARY OF MAJOR UTILITY RATE
PROCEEDINGS 1947 - 1960

MICHIGAN BELL TELEPHONE COMPANY

Date of Commission Order	Annual Operating Revenue before Relief	Requested Increase	Increase granted by Commission	Rate Base (Type)	Rate of Return Allowed
9-28-48	\$ 96,694,000	\$ 10,500,000	\$ 8,217,000	G (Yr. end 8-31-48)	6.0
6-30-49	101,990,000	20,445,000 (9,845,000 - partial) (10,600,000 - additional final)	4,861,000 (partial)	---	---
6-19-50			9,000,000 (final)	H (Yr. 1949)	6.0
11-20-51	129,589,000	22,000,000	-0-	D	6.3 - 6.5
6-05-52	129,589,000	(Rehearing of - 11-20-51 order)	7,221,882	G	6.3 - 6.5
5-11-54	170,904,907	22,283,481	-0-	D (Yr. end 9-30-53)	6.5

Rate Base (Type) A - Average net plant plus working capital

D - Average capital invested

C - Average net plant investment

H - Between net plant investment (original cost) and current cost

Source: Annual Report of the Michigan Public Service Commission - 1963.



TABLE 25

SUMMARY OF MAJOR UTILITY RATE
PROCEEDINGS 1947 - 1960

MICHIGAN BELL TELEPHONE COMPANY (continued)

Date of Commission Order	Annual Operating Revenue Before Relief	Requested Increase	Increase granted By Commission	Rate Base (Type)	Rate of Return Allowed
7-28-55	\$177,860,000	(Rehearing of - 5-11-54 order)	\$ 2,802,000	D (Yr. end 5-31-54)	6.95
8-06-57	223,857,495	12,542,000	2,835,000	G (Yr. 1956)	6.60
6-26-58	240,450,900	(Rehearing of - 8-6-57 order)	2,212,000	G (Yr. 1957)	6.60
2-18-60	249,067,000	Minimum of 25,000,000	4,014,223	A (Yr. end 7-31-59)	6.62
CONSUMERS POWER COMPANY (Electric)					
1-04-50	67,193,300	6,600,000	4,180,000	B	5.70
5-22-59	147,787,714	15,300,000	6,788,485	A (Yr. 1957 Actual)	6.0

Rate Base (Type) A - Average net plant plus working capital

B - Current cost (between original cost and reproduction cost - Yr. 1949 Est.-)



TABLE 25

SUMMARY OF MAJOR UTILITY RATE
PROCEEDINGS 1947 - 1960

CONSUMERS POWER COMPANY (Gas)

Date of Commission Order	Annual Operating Revenue Before Relief	Requested Increase	Increase granted By Commission	Rate Base (Type)	Rate of Return Allowed
3-25-49	\$ 16,399,775	\$ 4,800,000	\$ 1,800,000	A (Yr. 1948 Actual)	6.51
7-01-49	16,339,775	(Rehearing of 3-25-49 order)	1,161,000	A (Yr. 1949 Est.)	6.50
12-18-52	35,592,798	6,500,000	5,328,840	Total capital at 6-30-52 plus \$3,528,000 authorized 12-05-52	6.34
4-30-54 (1)			(2,909,583)		
5-04-61	98,756,325	13,541,929	7,925,307	A (Yr. 1959; 10 Mos. Actual, 2 Mos. Est.)	6.34
7-26-62 (2)			(2,000,000)		

(1) Commission ordered decrease in rates due to reduction in cost of purchased gas.

(2) Commission ordered decrease in rates due to reduction in cost of purchased gas.

() - Denotes decrease

TABLE 25
SUMMARY OF MAJOR UTILITY RATE
PROCEEDINGS 1947 - 1960

MICHIGAN CONSOLIDATED GAS COMPANY					
Date of Commission Order	Annual Operating Revenue Before Relief	Requested Increase	Increase granted By Commission	Rate Base (Type)	Rate of Return Allowed
1-17-49	\$ 39,289,856	\$ 12,920,000	\$ 7,287,000	A (Yr. 1949 Est.)	6.00
6-15-49 (1)			(2,512,000)		
11-30-49 (1)			(2,400,000)		
11-19-52	72,996,157	10,178,261	7,213,694	D (Yr. ending 9-30-52 plus \$8,000,000 incremental capital)	6.65
1-13-53	72,996,157	1,896,055	1,896,055	(2)	(2)
4-09-54	82,797,389	245,244 (3)	245,244 (3)	D (Yr. ending 6-30-53)	6.30
4-03-54 (4)			(2,517,076)		
8-17-55	87,112,252	9,900,000	4,400,000	D (Yr. 1954)	6.10
2-01-58	119,999,499	15,500,000	5,997,761	A (Yr. end 6-30-57)	6.50

Rate Base (Type): A - Average net plant plus working capital
D - Average invested capital

- (1) Commission ex parte ordered decreases in surcharge authorized 1-17-49.
- (2) Same as order of 11-19-52; increase granted ex parte.
- (3) Increase applicable only in the city of Mt. Pleasant.
- (4) Commission ex parte ordered decrease in rates due to reduction in cost of purchased gas.

TABLE 25

SUMMARY OF MAJOR UTILITY RATE
PROCEEDINGS 1947 - 1960UNION TELEPHONE COMPANY
(Tri-County Tel. Co. merged into
Union Tel. Co. in Dec. 1949)

Date of Commission Order	Annual Operating Revenue Before Relief	Requested Increase	Increase granted By Commission	Rate Base (Type)	Rate of Return Allowed
2-01-49	\$ 1,432,893	\$ 375,000	\$ 196,938	D	6.19
5-31-51	4,277,903	713,920	546,000	A (Yr. 1952 Est.)	8.05
1-25-56	6,483,973	815,242	492,955	D (12-31-54 Adj.)	7.35

GENERAL TELEPHONE COMPANY OF MICHIGAN
(Name changed from Michigan Associated
Telephone Company on 8-01-52)

8-11-48	2,990,133	644,277	342,000 (Interim Increase)		
12-28-48			302,277 (Final Increase)	D (Yr. 1949 Est.)	6.69
1-08-51	4,279,059	965,616	870,000	A (Yr. 1951 Est.)	5.79
12-05-52	6,049,518	1,070,412	660,000 (1)	D (Yr. 1951)	6.61

Rate Base (Type) A - Average net plant plus working capital
D - Average capital invested
E - Total capitalization

(1) Company appealed 12-5-52 order. On 10-21-55, Commission authorized company to increase rates \$1,070,412, the amount originally requested in 1-22-52 application.

TABLE 25

SUMMARY OF MAJOR UTILITY RATE
PROCEEDINGS 1947 - 1960

THE DETROIT EDISON COMPANY

Date of Commission Order	Annual Operating Revenue Before Relief	Requested Increase	Increase granted By Commission	Rate Base (Type)	Rate of Return Permitted Allowed
7-07-48	\$108,181,000	\$ 13,080,000	\$ 5,000,000 (Interim Increase)	-	-
1-06-49			13,080,000 (Includes Interim)	C (Yr. end 6-30-48)	5.25
<u>MICHIGAN GAS UTILITIES COMPANY</u>					
12-05-52	918,640	53,587	53,587 (1)	A	4.0
8-10-56	1,465,027	(109,877)	(109,877) (2)	-	-
<u>MICHIGAN GAS & ELECTRIC COMPANY</u>					
6-19-58 (3)	2,819,743	797,343	-0-	A (Yr. 1958)	6.7
<u>UPPER PENINSULA POWER COMPANY</u>					
12-13-48	1,604,542	340,500	302,500 (4) (Interim)	-	-
12-22-49	1,604,542	340,500	(32,800) (5)	(6)	(6)
8-06-53	1,849,562	240,000	236,500	A	6.98

Rate Base (Type) A - Average net plant plus working capital

C - Net plant at end of period adjusted, plus working capital

- (1) Effects Monroe service area only.
- (2) Commission issued ex parte order approving reduction in Western Division.
- (3) On 5-31-57, Commission issued order requiring company to show cause why its rates should not be decreased.
- (4) On 10-18-57, company countered with application to increase rates. Matters were combined.
- (5) Order authorized interim increase for period of six months; increase expired 6-13-49.
- (6) Commission denied application of 10-21-48 and ordered reduction of \$32,800 in Iron Range Div.
- (6) Commission made no specific finding as to rate base or rate of return. The Commission did find that after the reduction of \$32,800 in the Iron Range Div., the utility's rates would be just and reasonable.

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Interview with Albert J. Thorburn on August 21, 1984. Mr. Thorburn is engaged in the private practice of law and has represented the legal interests of numerous utility companies before the Michigan Public Service Commission since the late 1940s.

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