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PUBLIC UTILITIES - RATE REGULATION - VALIDITY OF TEMPORARY RATE ORDER

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PUBLIC UTILITIES — RATE REGULATION — VALIDITY OF TEMPORARY RATE ORDER — Of interest to students of public utility rate regulation will be the case of *Driscoll v. Edison Light & Power Co.*[1] in which the United States Supreme Court side-stepped a reconsideration of the fair value rule as announced in *Smyth v. Ames*,[2] and a determination of the constitutionality of temporary rates based on the prudent investment theory.

In 1937 the Pennsylvania legislature passed an act empowering the Public Utility Commission "in any proceeding involving the rates of a public utility . . . if it be the opinion that the public interest so requires [to] immediately fix, determine, and prescribe temporary rates to be charged by such utility, pending the final determination of such rate proceeding."[3] The temporary rates so prescribed were to be

[1] 307 U. S. 104, 59 S. Ct. 715 (1939), rehearing denied May 15, 1939. The writer has had an opportunity to read the briefs submitted by counsel for the Edison Company, the Pennsylvania Public Utility Commission, and the United States as amicus curiae, for which, at this point, he wishes to acknowledge due credit for the use of any material contained therein.

[2] 169 U. S. 466 at 547, 18 S. Ct. 418 (1898). In ascertaining fair value "original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stocks, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case."

[3] Pa. Laws (1937), p. 1053, § 310 (a), 66 Stat. Ann. (Purdon, Supp. 1938), § 1150 (a).

sufficient "to provide a return of not less than five per centum upon the original cost, less accrued depreciation, of the physical property (when first devoted to public use) . . . used and useful in the public service. . . ."[4] A further section of the act provided for recoupment of gross income by the company if upon the determination of the rate proceeding it was found that the final rates were in excess of the temporary rates.[5]

Pursuant to the statute, the commission directed the Edison Light & Power Co. to lower its rates so as to reduce the annual gross operating revenue in the amount of approximately $435,000. The company filed a bill to enjoin the order of the commission. A specially constituted district court permanently enjoined the enforcement of the order on the grounds, inter alia, that the statute was unconstitutional since it did not provide for a weighing of the elements pertinent to determining fair value, and that, even assuming the statute to be constitutional in its procedural aspects, the temporary rate order was invalid because the return permitted was confiscatory.[6]

On appeal the lower court's decision was reversed. Speaking through Justice Reed, the Court found that the rates prescribed by the commission were not confiscatory; and the test of confiscation was that of the fair value rule.[7] In a concurring opinion by Justice Frankfurter, it was pointed out that the Court had quite unnecessarily avoided a consideration of the constitutionality of the Pennsylvania temporary rate statute.[8] As noted later in this discussion, precedents and sound analogies were clearly available for the Court to follow in holding such a statute constitutional.

This comment is concerned with a discussion of temporary rates prescribed on a basis other than that of the fair value rule. The writer will first discuss temporary rates effective during a period of rapid

[4] Ibid.

[5] Ibid., (e).

[6] (D. C. Pa. 1938) 25 F. Supp. 192.

[7] 59 S. Ct. at 720. The Court evaded a consideration of the validity of the temporary rate statute by declaring that the commission had drawn the order in accord with a prior ruling of the Middle District Court which had stated compliance with Smyth v. Ames was necessary in temporary rate making; since the commission, therefore, interpreted the statute as requiring consideration of elements other than original cost in fixing temporary rates, the Court was "reluctant to accept a construction which brings forward" the issue of constitutionality.

[8] "It is one thing to avoid unconstitutionality even at the cost of a tortured statutory construction. It is quite another to recognize the validity of a statute directed expressly to the situation in hand and so employed by the state authorities, when constitutionality of that statute is as incontestably clear as the decision of the New York Court of Appeals has demonstrated it to be in sustaining the sister statute of the Pennsylvania Act. . . ." 59 S. Ct. at 725.

price fluctuation. Following this, attention will be given to temporary rates possible under a statute, of which the Pennsylvania act is an example, together with a discussion of the constitutionality of such a statute. In closing, the possible advantages of temporary rates of the second type will be pointed out.

I.

Temporary rate orders may be classified either as an emergency type, issued when the general price level is rapidly rising or falling, or, as proposed by the type of statute of which the Pennsylvania act is an example, as an intermediate step in the normal determination of final rates. With the former the courts are quite familiar. During the World War and in the years immediately following, temporary orders increasing the rates which public utilities might charge were issued by the state commissions upon a showing by the utilities that the sudden increase in prices rendered the existing rates insufficient to meet operating costs.[9] A few states had enacted statutes permitting their commissions, in cases of emergency, temporarily to alter or suspend existing rates.[10] But by far the large majority had no such emergency statutes, with the necessary consequence that their commissions so acted during this period under the general legislative authorization to determine just and reasonable rates.

Though the commissions in issuing these emergency orders did not consider all of the elements necessary to a determination of fair value, as set forth in *Smyth v. Ames*, the courts uniformly upheld the temporary orders. This result followed whether or not the orders were issued pursuant to an emergency statute.[11] To protect consumers in case the temporary rates so fixed were too high, it was provided in

[9] City of La Crosse v. Railroad Commission, 172 Wis. 233, 178 N. W. 867 (1920); Chicago Railways Co. v. Chicago, 292 Ill. 190, 126 N. E. 585 (1920); Kansas City v. Public Service Comm., 276 Mo. 539, 210 S. W. 381 (1918); O'Brien v. Board of Public Utilities Commrs., 92 N. J. L. 587, 106 A. 414 (1919); City of New York v. New York Tel. Co., 115 Misc. 262, 189 N. Y. S. 701 (1920), affd. 202 App. Div. 796, 194 N. Y. S. 924 (1921); Muskogee Gas & Elec. Co. v. State, 81 Okla. 176, 186 P. 730 (1920); Omaha & Council Bluffs St. Ry. v. Nebraska State Railway Comm., 103 Neb. 695, 173 N. W. 690 (1919).

[10] See Wis. Stat. (1937), § 196.70; Ind. Stat. Ann. (Burns, 1933), § 54-712; Ill. Ann. Stat. (Smith-Hurd, 1935), c. 111 2/3, § 36 (4).

[11] Under the Wisconsin emergency statute, see City of La Crosse v. Railroad Commission, 172 Wis. 233, 178 N. W. 867 (1920); Chicago Railways Co. v. Chicago, 292 Ill. 190, 126 N. E. 585 (1920). Not under an emergency statute, see Kansas City v. Public Service Comm., 276 Mo. 539, 210 S. W. 381 (1918); O'Brien v. Board of Public Utilities Commrs., 92 N. J. L. 587, 106 A. 414 (1919).

some of the decisions that this condition was to be rectified in the order fixing the final rates.[12]

That the economic predicament of the consumers in a period of rapidly falling prices demanded emergency decreases in rates was decided in several cases after 1921, where rate reduction orders were upheld in the absence of a clear showing on the part of the utility that the temporary rates were confiscatory.[13]

Sound economic reasons fortify the decisions of these courts. Public utilities must have the increased rates in a rapidly rising price level period, else in many cases they are reduced to insolvency. And likewise, the consumers should be allowed to pay less for the public service rendered during a rapidly falling price level period, else the economic emergency is intensified.[14]

Other measures to cope with the emergency problem have been proposed. Such is the suggestion that in good economic times the utilities should be allowed to charge more than a fair return, the excess to be set aside in an "emergency reserve," so that in times of depression the rates may be reduced below the compensatory level, and the utility allowed to draw on the reserve for such an additional amount as may be necessary to secure a fair return.[15] The use of efficient index numbers

[12] See Omaha & Council Bluffs St. Ry. v. Nebraska State Railway Comm., 103 Neb. 695, 173 N. W. 690 (1919).

[13] Cumberland Tel. & Tel. Co. v. Louisiana Public Service Comm., (D. C. La. 1922) 283 F. 215; Oklahoma Gas & Elec. Co. v. Corporation Comm., 83 Okla. 281, 201 P. 505 (1921). For a discussion of this problem during the last depression, see Swidler, "The Uncertainties in the Legal Status of Temporary Rates," 12 PUB. UTIL. FORT. 136, 202 (1933). On a careful reading of the cases on this point, no provision could be found for recoupment by the company if upon the final rate determination it was discovered that the temporary rates yielded less than a fair return on fair value during the emergency period. That conditions of an economic crisis may affect what return is held to be confiscatory is discussed by Lilienthal, "Regulation of Public Utilities During the Depression," 46 HARV. L. REV. 745 at 768 et seq. (1933). Cf. Block v. Hirsh, 256 U. S. 135, 41 S. Ct. 458 (1921).

[14] In a period when wages and prices are rapidly falling, if utility rates are not adjusted accordingly a larger proportion of the consumer's dollar is spent for utility services, thereby leaving a smaller proportion for other commodities, the manufacturers of which, having curtailed markets, must cut down their own operations, with the final result of an increase in unemployment. Swidler, "The Uncertainties in the Legal Status of Temporary Rates," 12 PUB. UTIL. FORT. 136 at 139 (1933), gives a discussion of this economic aspect of the problem.

[15] Lilienthal, "Regulation of Public Utilities During the Depression," 46 HARV. L. REV. 745 at 755 (1933). As a matter of practical application this suggestion is not without its difficulties. The absence of "good times," a depression or an emergency, is not so difficult to recognize; but the existence of the positive side of economic conditions offers an opportunity for many differing opinions, with the result of much bickering between the utility and commission as to when the former is entitled to begin to charge more than the legal fair return.

to arrive at present value by adjusting the value at the last rate proceeding is a further possibility.[16] Already in actual practice is the suggested procedure of negotiation between the utility and the commission to effect a temporary rate change without the protracted valuation investigations typical of the normal rate fixing process.[17]

2.

The differences between the emergency statutes and those providing for temporary rates pending the final determination in normal rate proceeding are several and patent. In the former the commission must find an emergency to exist, and such an "emergency" has been interpreted to mean an economic depression or a period in which prices are rising rapidly.[18] In the latter the commission need only be of the opinion that "the public interest so requires." A reasonable construction of this qualifying clause can mean no more than that the commission has grounds for believing that the existing rates are not just and reasonable. Secondly, the emergency statutes provide no standard upon which the rate is to be determined,[19] whereas original cost less accrued depreciation of the property useful in the public service is expressly stated as the valuation basis in the second type of statute. Thirdly, no recoupment provision is found in the emergency statutes, whereas recoupment is expressly provided for in the temporary rate statutes.[20]

In considering the question of the constitutionality of statutes providing for temporary rates pending the normal rate proceeding, we should bear in mind that such statutes provide but a convenient step in the rate establishment. The rates so fixed are interim rates, effective until the final rates are set. Further, there is no attempt by these statutes to change the basis upon which final rates are established.

In the case of *Prendergast v. New York Telephone Co.*[21] a reduc-

[16] The adjective "efficient" is advisedly used, for in West v. Chesapeake & Potomac Telephone Co. of Baltimore, 295 U. S. 661, 55 S. Ct. 894 (1935), the Court struck down a commission's proposed rates because the separate price indices used in arriving at the present property valuation were found to be unreliable, giving a variety of different results. It is believed that if reliable price indices are developed, the Court will not find the use of them, per se, to be a procedural denial of due process. Cf. 51 HARV. L. REV. 885 at 891 (1938).

[17] See excerpt from report of Utility Consumers National Policy Committee, quoted in Spurr, "Has Utility Regulation Been Reduced to Negotiation and Wheedling?" 20 PUB. UTIL. FORT. 259 (1937), and discussion therein on this point.

[18] See statutes cited in note 10, supra, and cases cited in note 9, supra.

[19] See statutes cited in note 10, supra.

[20] Pa. Laws (1937), p. 1053, § 310 (e), 66 Stat. Ann. (Purdon, Supp. 1938), § 1150 (e); N. Y. Laws (1934), c. 287, 47 Consol. Laws (McKinney, Supp. 1938), "Public Service Law," § 114.

[21] 262 U. S. 43, 43 S. Ct. 466 (1923).

tion of the rates charged by the company had been ordered during the pendency of a rate case against the company. This order was issued under a New York statute containing no provision for recoupment by the company if the final rates were found to be greater than those prescribed under the temporary order. An injunction was issued against the enforcement of the rates. On appeal to the United States Supreme Court, the lower court's order was upheld. The Court said in the course of its opinion:

> "Nor did the fact that the orders of the Commission merely prescribed temporary rates to be effective until its final determination, deprive the Company of its right to relief at the hands of the court. The orders required the new reduced rates to be put into effect on a given date. *They were final legislative acts as to the period during which they should remain in effect pending the final determination;* and if the rates prescribed were confiscatory the Company would be deprived of a reasonable return upon its property during such period, *without remedy*, unless their enforcement should be enjoined." [22]

In 1934 the New York Legislature amended its Public Service Law and established the temporary rate order provision from which the Pennsylvania act was derived.[23] An express proviso for recoupment by the company was omitted; however, the amended law included the following:

> "The commission is hereby authorized in any proceeding in which temporary rates are fixed, determined and prescribed under this section, to consider the effect of such rates in fixing, determining and prescribing rates to be thereafter charged and collected by said public utility company on final determination of the rate proceeding." [24]

The quoted provision was expressly held by the New York Court of Appeals to have satisfied the deficiencies pointed out by the Court in the *Prendergast* case: [25]

> "This section . . . forces the Public Service Commission to consider the returns from the temporary rate and to establish the

[22] Ibid., 262 U. S. at 49 (italics supplied).

[23] N. Y. Laws (1934), c. 287, 47 Consol. Laws (McKinney, Supp. 1938), § 114. The interpretation rendered by the New York Court of Appeals of the clause in the statute quoted at note 24, infra, was spelled out in the recoupment provision of the Pennsylvania act.

[24] N. Y. Laws (1934), c. 287, 47 Consol. Laws (McKinney, Supp. 1938), § 114.

[25] Bronx Gas & Elec. Co. v. Maltbie, 271 N. Y. 364, 3 N. E. (2d) 512 (1936).

permanent rate, or the final rate, accordingly; that is, if the temporary rate has proved to be too low the final rate must make it up to the company."[26]

The Supreme Court of the United States may turn from state decisions to its own for further analogies and precedents. In *The New England Divisions Case*,[27] the Interstate Commerce Commission had issued a temporary rate order which prescribed a division of joint rates among certain railroads. The commission acted before a complete analysis of all available evidence was made, and it did not consider each division, road, and rate separately. The order was to be effective until further action by the commission, and was left open for correction. The Court sustained this provisional act by the commission, stating that:

"A hearing may be a full one, although the evidence introduced does not enable the tribunal to dispose of the issues completely or permanently; and although the tribunal is convinced, when entering the order thereon, that, upon further investigation, some changes in it will have to be made. . . . That the order is not obnoxious to the due process clause, because provisional, is clear. If this were not so, most temporary injunctions would violate the Constitution."[28]

A further analogy for sustaining the temporary rate statute may be found in the common practice of the courts in requiring public utility companies to put up a bond to pay back overcharges to the consumers which were exacted while litigation over a rate order was in progress. Logic would dictate no change in constitutionality if the remedy be reversed, requiring that the customers should make good the loss which the company sustains when temporary rates are fixed at too low a level.[29]

An objection advanced against the validity of the temporary rate statute is that the commission has no right to require recoupment from a new consumer. But we can be confident that the number of new customers so affected will be small.

"A few consumers may be new customers paying what the old consumer should have paid. . . . We can never work our institu-

[26] Ibid., 271 N. Y. at 375.

[27] 261 U. S. 184, 43 S. Ct. 270 (1923).

[28] Ibid., 261 U. S. at 201.

[29] This argument was advanced in Bronx Gas & Elec. Co. v. Maltbie, 271 N. Y. 364 at 373-374, 3 N. E. (2d) 512 (1936), and cited with approval by the district court when the Driscoll case was first before it, Edison Light & Power Co. v. Driscoll, (D. C. Pa. 1937) 21 F. Supp. 1 at 4.

tions of government if we refine matters to such an extent that we have to consider all these little details. . . . Besides, when we speak of the consumer—the customer—we mean the public, not individuals." [80]

It would seem, then, that when the issue of constitutionality of temporary rate statutes is considered by the Court to be squarely before it, no difficulty should be encountered in sustaining them. *Smyth v. Ames* says nothing of temporary rates. Its fair value rule applies to the end result of the rate proceeding. Realizing that the temporary rates based on original cost, less accrued depreciation, are only initial steps in the final rate establishment, and remembering that any loss sustained because of the temporary rates may be recouped by the company, the Court, it is submitted, should approve these temporary rate statutes.[81]

3.

The advantages of this new technique in rate regulation may be briefly suggested. In the first place, it obviates the old procedure by which a utility secured a restraining order against a commission's proposed decrease in rates upon posting a bond for the protection of consumers. This procedure is subject to criticism. Certain consumers did not receive their refunds when the decreased rates were finally sustained by the courts.[82] The expenses of refunding have been extremely high in many cases,[83] and this distribution cost is eventually borne by the consumers. Though no direct causal relation between the refund procedure and the delays incident to appeals to the courts can dogmatically be proven, it is at least pertinent to point out the general indifference of the utilities to the inordinate delays common in rate

[80] Bronx Gas & Elec. Co. v. Maltbie, 271 N. Y. 364 at 374-375, 3 N. E. (2d) 512 (1936). Cf. San Diego Land & Town Co. v. Jasper, 189 U. S. 439, 23 S. Ct. 571 (1903).

[81] It may be noted that if the temporary rate statutes providing a return of not less than a given percentage upon original cost are declared unconstitutional, the effect will be the impossibility of establishing any kind of temporary rates. If in fixing a temporary rate all the elements constituting fair value must be considered, then it really is no temporary rate at all.

[82] Lilienthal, "Regulation of Public Utilities During the Depression," 46 HARV. L. REV. 745 at 768, note 45 (1933). Cf. Louisville & N. R. R. v. Railroad Comm., (D. C. Ala. 1913) 208 F. 35 at 60.

[83] Justice Brandeis pointed out in a concurring opinion in St. Joseph Stock Yards Co. v. United States, 298 U. S. 38 at 89, 56 S. Ct. 720 (1936), that the cost of making refunds on excessive charges in the Chicago telephone rate cases had amounted to $2,575,412.89 (to November 30, 1935), with over $2,100,000 remaining to be disposed of.

litigation.[34] It is submitted that adoption by the states of a similar temporary rate statute will help to eliminate this unfortunate aspect of the rate problem.

But what is probably the outstanding advantage of the temporary rate order is to be found in the use the commissions may make of the experience gained under such orders in their final determination of rates. The Court on more than one occasion has pointed out the predominant place actual experience should take, if available, in the determination of rates.[35] Here is an effective means whereby estimates of returns from rates can be checked on the basis of experience. Furthermore, the way is opened for a pragmatic examination of the adequacy of a rate schedule; if under a temporary order the utility continued to prosper and had enough income to pay its current expenses, including a depreciation allowance, and also pay interest on its bonds and a liberal dividend on its stock, it could hardly be argued that a final order confirming the temporary order was confiscatory.[36] Moreover, in such a case the commission could continue to adhere to the *Smyth v. Ames* formula by giving to the elements of value there enunciated such weight as would result in a legal rate base approximating the one established by experience.

A further, though indirect, advantage may be the abandonment of emergency rate statutes and the substitution therefor, or the enactment in states without such emergency statutes, of a statute embracing the salient features of the New York and Pennsylvania statutes, which include, of course, inter alia, the emergency situation. A standard will then be available even in the case of emergency rates. The public utilities should welcome this possible action by the states, especially in times of rapidly falling prices, for under the old emergency procedure no provision for recoupment is found.

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[34] "On September 13, 1921, the Illinois Commerce Commission . . . issued an order that the Company show cause why its rates should not be reduced. . . . On August 16, 1923, the Commission entered an order reducing the rates, to become effective October 1, 1923. . . . On April 30, 1934, this Court sustained the validity of the rate order entered August 16, 1923." Brandeis, J., in St. Joseph Stock Yards Co. v. United States, 298 U. S. 38 at 88, 56 S. Ct. 720 (1936), in speaking of the time factor in the case of Lindheimer v. Illinois Bell Tel. Co., 292 U. S. 151, 54 S. Ct. 658 (1934).

[35] West Ohio Gas Co. v. Public Utility Comm., 294 U. S. 79, 55 S. Ct. 324 (1935); Northern Pac. Ry. v. North Dakota, 216 U. S. 579, 30 S. Ct. 423 (1910); City of Louisville v. Cumberland Tel. & Tel. Co., 225 U. S. 430, 32 S. Ct. 741 (1912); Lindheimer v. Illinois Bell Tel. Co., 292 U. S. 151, 54 S. Ct. 658 (1934).

[36] Cf. Lindheimer v. Illinois Bell Tel. Co., 292 U. S. 151, 54 S. Ct. 658 (1934).