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James A. Chance

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The Supreme Law of Utility Rate Hikes

The *Hope* and *Bluefield* Decisions by James A. Chance

The most misunderstood regulatory function is that of ratemaking. Setting rates for the services provided by public utility companies has become an increasingly arduous and exacting task. The Maryland Public Service Commission is the regulatory agency charged with the responsibility of determining rates for public utility services in this state.

During the period from 1948 to 1968 rate hike requests from utility companies were a rarity. The real price of electricity increased only five percent during that twenty year span. But the world is a much different place today. In one year (1973) alone, the price of oil rose 200 percent. From 1971 to 1981 the cost of oil per barrel rose 587 percent while the price of coal per ton increased nearly 385 percent. Increases of this magnitude in the cost of energy have made utility rate hike requests the rule rather than the exception. See Bureau of Labor Statistics, Index of Electricity Rates, 1948-1981.

Baltimore Gas & Electric Company (BG&E) was recently awarded a \$99 million rate increase. Md. Publ. Serv. Comm'n., Case No. 7574, Order No. 65648. They sought, in their original application to the Public Service Commission, a \$199 million increase. More recently under consideration by Maryland's five member Public Service Commission was a request by the Chesapeake and Potomac Telephone Company (C&P) for \$202 million in what they termed "rate relief." The telephone company was awarded \$95 million on March 24, 1982. Md. Publ. Serv. Comm'n., Case No. 7591, Order No. 65714. This 1982 C&P increase exceeds the four previous telephone rate increases combined.

With unemployment in Baltimore at over 12 percent, and state unemployment hovering near 10 percent, and prospects for job security steadily waning, there has been a recent pub-

lic outcry for "ratepayers' relief." During the first few weeks of this election year, the public outcry manifested itself in the form of bills which were introduced before the 1982 General Assembly. S.B. 503, S.B. 542, S.B. 1008, S.B. 1023, Senate of Maryland (1982); H.B. 902, H.B. 1488, H.B. 1764, House of Delegates of Maryland (1982). None of these bills (designed to either change the membership of the commission or place a moratorium on rate increases) has been successful. Legislators undoubtedly realize that the five commissioners who serve on this commission have the unpopular task of balancing the financial interests of a company's shareholders and the adverse interests of a querulous public.

At the core of public utility regulatory law are two key Supreme Court decisions which have arisen repeatedly in rate making proceedings for decades. *Bluefield Water Works Co. v. Publ. Serv. Comm'n.*, 262 U.S. 679 (1923); *Federal Power Comm'n. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). The following discussion is a limited examination of the impact of *Hope* and *Bluefield* upon the regulatory decision-making process in Maryland.

I.

The Public Service Commission Law

The Maryland Public Service Commission Law constitutes a massive legislative deferral to the judgment of a State regulatory entity. MD. ANN. CODE art. 78 (1955). The commission consists of five full-time commissioners appointed by the Governor. The law requires that the Commission be "broadly representative of the public interest, and . . . composed of persons with diverse training or experience." MD. ANN. CODE art. 78 §§3 and 5 (1955). The legislature has empowered the Commission to oversee "all public service companies. . . engaged in oper-

ating a utility business in this State." MD. ANN. CODE art. 78 §1 (1955). The Commission has broad powers specifically conferred by the Article, and also "all implied and incidental powers necessary and proper to carry out the provisions of [the] Article." *Id.*; See also 63 Op. Att'y. Gen. 563 (1978).

Of particular interest, for purposes of this examination of Maryland regulatory law, is the power conferred upon the Commission by Section 68(a) of the Maryland Public Service Commission Law, which reads as follows:

The Commission shall have the power to determine *just and reasonable rates* of public service companies....The rates so determined shall be fixed by order to be served upon each public service company affected thereby. [*Emphasis added.*] MD. ANN. CODE art. 78 §68(a) (1955).

"Just and reasonable rates" are defined in Section 69(a) of the Law as "rates which are not in violation of any of the provisions of this article, which fully consider and are consistent with the public good, and which result in an operating income to the public service company, . . . yielding, after reasonable deduction for depreciation and other necessary and proper expenses and reserves, a *reasonable return* upon the *fair value* of the company's property used and useful in rendering service to the public." [*Emphasis added.*] MD. ANN. CODE art. 78 §69(a) (1955).

The innocuous language employed by the Maryland Legislature takes on its true meaning only when held in the light of *Hope* and *Bluefield*. Terms such as "fair value" and "fair rate of return" are ascribed with constitutional definition as a result of these two Supreme Court decisions. The figures attached to "fair value" and "rate of return" will be the topic of heated discussion at any Commission proceeding, as they constitute multi-million dollar questions. See *Potomac Edison Co. v. Public Serv. Comm'n.* 279 Md. 573, 369 A.2d 1035 (1977). Someone, either the utility company's shareholders or the ratepaying public, will have to pay the bill.

II.

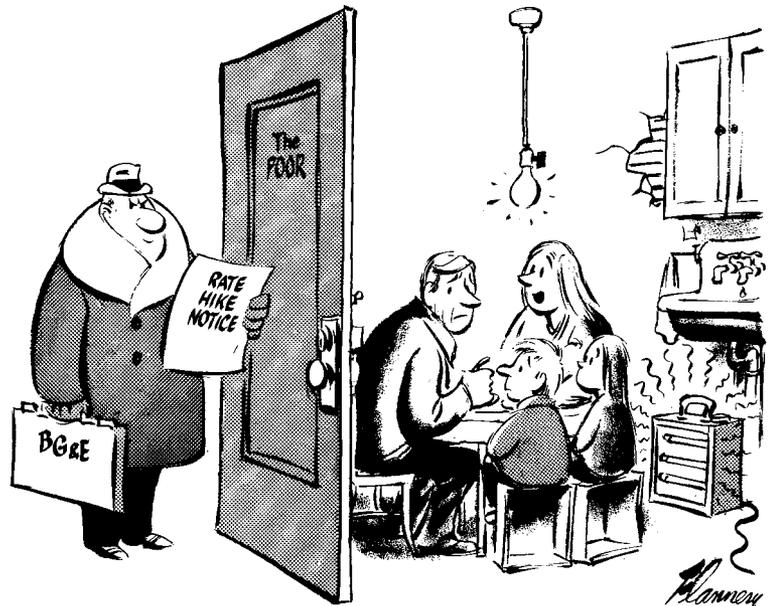
The Lesson of *Bluefield*

In 1920, the Bluefield Water Works Company went before the West Virginia Public Service Commission seeking an upward adjustment in the rates they were permitted to charge in furnishing water to the citizens of Bluefield. The increase which was awarded was far below that which was sought. On appeal, the ultimate question raised by the company was, "What are 'just and reasonable' rates?"

The West Virginia Legislature enacted a statute authorizing the Public Service Commission to fix "just and reasonable" rates. W. VA. CODE ch. 15-0 §16 (1920); See also W. VA. CODE ch. 24 art. 2 and 3 (1982). The plaintiff, Bluefield Water Works Company, argued that the rates prescribed by the Commission were confiscatory, as they deprived the company of its property without due process of law. The company's petition to set aside the order of the Commission was rejected by West Virginia's highest court. It was from the decision that the utility company appealed. *Bluefield*, 262 U.S. at 683.

The Supreme Court, recognizing the federal question, found that the Public Service Commission prescribed rates by virtue of powers delegated by the State. The Court further found that if, as alleged, the prescribed rates were confiscatory, the order would be contrary to the Fourteenth Amendment and the rates would be void. The alleged unconstitutionality of this state action served as the basis for the utility company's invocation of the jurisdiction of the Supreme Court. *Id.*

In order for rates to be constitutional, the Court held, they must be "sufficient to yield a reasonable return on the value of property used, at the time it is being used to render the service. . . ." *Bluefield*, 262 U.S. at 690. Rates which are not sufficient to yield such a return are "unjust, unreasonable, and confiscatory, and their enforcement deprives the public utility company of its property in violation of the 14th Amendment." *Id.* It was necessary to further explicate. What was



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meant by "reasonable return"? How must a Commission determine "value of property used, at the time it is being used to render service"?

Before the Commission could determine reasonable rates, the Court first required that the Commissioners ascertain the current value of property used by the company to provide utility service. In the 1898 case of *Smyth v. Ames*, 169 U.S. 466 (1898), the Supreme Court had established that the calculation of reasonable rates was to be based on the fair value of utility property used and useful in the public interest. *Accord C&P Teleph. Co. v. Public Serv. Comm'n*, 230 Md. 395, 187 A.2d 475 (1962); *Hagerstown v. Public Serv. Comm'n*, 217 Md. 101, 141 A.2d 699 (1958). In *Bluefield* the Court adopted the rule of *Smyth v. Ames* by reference, and enumerated three factors to be considered in estimating fair value of utility property: (1) the original cost of construction; (2) the present cost of construction; and (3) other matters including, but not limited to, the expense of permanent improvements, the property's probable earning capacity, and the monies required to meet operating expenses. *Smyth v. Ames*, 169 U.S. 466, 546-548 (1898);

Bluefield, 262 U.S. 679, 691 (1923).

Once the "value of utility property used and useful in the public interest" was determined, the Commission was charged with the task of fixing a "reasonable return" on that value. In defining what constituted a "reasonable return," the Court said that a public utility was entitled to a return on its investments equal to that generally being made on investments in other businesses where there are corresponding risks. *Bluefield*, 262 U.S. at 692. For a return on shareholders' investments to be "reasonable" it should be "sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." *Bluefield* 262 U.S. at 693; See also *Potomac Edison Co. v. Public Serv. Comm'n*, 279 Md. 573, 369 A.2d 1035 (1977).

In disposing of the petition of Bluefield Water Works Company, the Supreme Court found that the Public Service Commission of West Virginia had acted unconstitutionally and beyond its authority in prescribing rates

which did not afford the company a reasonable return on the fair value of its investment. *Bluefield*, 262 U.S. at 695. Rates set by the Commission were not "reasonable" according to the test enumerated in *Bluefield*.

III.

The Lesson of *Hope*

Twenty years after the nation's highest court handed down the *Bluefield* mandate, they tackled similar questions in *Hope. FPC v. Hope Nat. Gas Co.*, 320 U.S. 591 (1944). In 1938, the Congress enacted the Natural Gas Act. Under the provisions of this Act, the Federal Power Commission (FPC) was empowered to review and determine the reasonableness of interstate rates. The controversy in *Hope* arose out of an FPC order compelling the Hope Natural Gas Company to decrease its rates. *Hope*, 320 U.S. at 594.

Hope Natural Gas was a West Virginia company and a wholly owned subsidiary of Standard Oil Company of New Jersey. An affiliate of Hope Natural Gas distributed gas to several locations in Ohio. In 1938, the FPC received complaints from two Ohio cities charging that the rates collected by Hope through its affiliate were excessive and unreasonable. Later that year the FPC, on its own motion, instituted an investigation to determine the reasonableness of Hope's interstate rates. *Id.* Another complaint was received in 1939 from the Public Utility Commission of Pennsylvania. The cases were consolidated and hearings were held. *Hope*, 320 U.S. at 595.

In 1942, the FPC ordered Hope to decrease its interstate rates to a level established by the Commission as "just and reasonable." Rates must provide a reasonable return to investors on the "fair value" of the property. By inflating their estimates of the "fair value" of their property the company stood to gain. As a result, when the "fair value" increases so does the return to investors. Hope Natural Gas Company put on evidence of reproduction costs (the cost of reproducing the property at current costs) and "trended original costs" (to account for inflation), arguing

that the Commission must consider those as well as the original cost of the property in computing fair value.

The Commission refused to place any reliance on these prospective estimates in determining fair value, saying that these computations were "not predicated upon facts" and were "illusory" and "irrational." *Hope*, 320 U.S. at 597. The FPC based its decision of fair value upon the "actual legitimate cost" of the company's property, i.e., original cost less depreciation. *Hope*, 320 U.S. at 597-598. Accordingly, Hope's rates were adjusted downward by the Commission. Hope appealed.

The Court of Appeals for the Fourth Circuit set aside the order of the Commission holding that the rate base should reflect the "fair value" and that "actual legitimate cost" was not the proper measure of fair value. The Commission petitioned on writs of certiorari for review in the Supreme Court. The writs were granted because of the public importance of the questions presented.

In reversing the Court of Appeals, The Supreme Court (Douglas, J.) held that it is "the result reached and not the method employed" which is controlling in determining "just and reasonable" rates. *Hope*, 320 U.S. at 603. The Court examined certain factors to be considered in arriving at just and reasonable rates. Among those considerations enumerated by the Court were the following: (1) rates should be sufficient to assure confidence in and financial security of the company's enterprise, (2) rates should be sufficient to allow the company to maintain its credit and attract capital, and (3) rates should be sufficient to provide the corporate equity holders with a reasonable return on their investment. *Id.* General economic conditions were also deemed a legitimate consideration in determining where to set rates. The Court made clear that the fixing of just and reasonable rates unquestionably involved "a balancing of investor and consumer interests." *Hope*, 320 U.S. at 604.

The Court also addressed the matter of scope of review in appeals from

regulatory ratemaking decisions. They held that "... the Commission's order does not become a suspect by reason of the fact that it is challenged. It is the product of expert judgment which carries a presumption of validity." *Id.* The final disposition of *Hope* rested upon a finding by the Supreme Court that the Circuit Court of Appeals had erred in setting aside the FPC order. In order to reverse the decision of the regulatory commission, the Supreme Court held, there must have been a showing that the order was invalid because of its unjust and unreasonable consequences. *Hope*, 320 U.S. at 602. Under the Natural Gas Act that was the burden of the Appellant (*Hope*). Finally the Court held that the use of "actual legitimate cost" was neither unjust nor unreasonable, and that Hope had failed to make a convincing showing that it was. The Court of Appeals was reversed. The FPC's use of "actual legitimate cost" (original cost less depletion and depreciation) in determining fair value of the company's property was held reasonable, and the Commission order was reinstated.

IV.

Hope and Bluefield Today

In two recent rate hike proceedings before the Maryland Public Service Commission, *See BG&E and C&P cases, supra*, the Maryland Commission relied heavily upon the principles enumerated in *Hope and Bluefield*. Most recently, in *Re Chesapeake & Potomac Telephone Co. Md. P.S.C. No. 7591, Order No. 65714 (1982)*, the commissioners used the language in the *Hope* decision to eliminate an inflation allowance from the "fair value" of the company's property. They adopted language from this 1943 case to make new regulatory policy some 39 years later. This adjustment, made possible by the language of Justice Douglas in *Hope*, will save Maryland telephone customers \$3 million annually.

The Maryland Public Service Commission Law, reflecting the mandate of the Supreme Court, contains sections which require the commission to consider "interests of the public"

and the "economy of the State" in fixing rates. Furthermore, the principles of *Hope* and *Bluefield* have been adopted by the Maryland Court of Appeals in their handling of appeals involving decisions of the Public Service Commission.

The Maryland courts have ruled that "fair value of property used and useful in rendering service to the public" does not require the inclusion of reproduction cost or trended original cost in arriving at an appropriate rate structure. See *Chesapeake & Potomac Telephone Co. v. Publ. Serv. Comm'n.*, 201 Md. 170, 93 A.2d 249 (1952). The Court of Appeals has held that the Commission may base its decision upon those consumer interests which it has examined. See *Potomac Ed. Co. v. Publ. Serv. Comm'n.*, 279 Md. 573, 369 A.2d 1035 (1977). It has also been decided that an order of the Commission fixing rates will not be disturbed except under a clear showing that it is unjust, unreasonable, or unlawful. See *Publ. Serv. Comm'n v. Byron*, 153 Md. 464, 138 A. 404 (1927); *Publ. Serv. Comm'n. v. Balt. Gas & Elec.*, 273 Md. 357, 329 A.2d 691 (1974); *Potomac Ed. Co. v. Publ. Serv. Comm'n.*, 279 Md. 573, 369 A.2d 1035 (1977). All of these views initially were put forth by the Supreme Court in 1923 and 1943.

The Maryland regulatory process has been forever colored by the decisions of the United States Supreme Court in *Hope* and *Bluefield*. This year, as in years past, principles enumerated in those decisions became the focal points of the Maryland Public Service Commission as it engaged in the intricate process of ratemaking. It is only reasonable to believe that in the future *Hope* and *Bluefield* will remain as cornerstones in the complex structure of regulatory law.

(Author wishes to thank Commissioner William A. Badger and Mrs. Mary Maggio of the Maryland Public Service Commission for their cooperation and assistance.)

A Primer on Consumer Debt Collection

by R.M. Dapkunas

Experience in the credit and collection field has revealed two important points. First, collection work need not be looked upon as some sort of clandestine, back-room business. Second, collection work can be very profitable and predictable in terms of income.

Debt Collection Defined

Collections is a very mechanical process for resolving delinquency. It is not necessarily getting people to pay all that they owe on a debt. It is encouraging the delinquent to become a paying customer once again. Many times people don't have *today* what they owe from *yesterday*. With the proper inducement, they may set aside money from future earnings to cover these debts.

In Maryland, consumer debt collection is covered by the Consumer Protection Act. MD. COM. LAW CODE ANN. §14-201(1975). Debt collection under this Act involves collections on consumer transactions; that is, those transactions involving a person seeking or acquiring real or personal property, services, money or credit for personal, family or household purposes.

Consumer debt collection is also governed by a federal statute, popularly known as the FAIR DEBT COLLECTION PRACTICES ACT §1692, 15 U.S.C. §1692 (Supp. 1975 to 1980). The Act took effect in 1968 as a result of evidence indicating the use of, "... abusive, deceptive and unfair debt collection practices by many debt collectors." The Federal Act is more comprehensive than the state act, but it provides exemptions for State Regulations under §1692(n) and §1692(o), where the state requirements are substantially the same as the federal regulations. Even where the debt collection is purely intrastate, the Federal Act has determined that there is a direct effect on interstate commerce.

A "Collectable" Account

Once a person is determined to be delinquent, a decision must be made as to whether he is "collectable." "Collectable" as usually defined by the industry, refers to someone who has something to lose, either money, reputation or another asset that this debt could jeopardize. Often in the process of trying to effect a collection, it is necessary to inform the debtor of the potential affect of his delinquency on his future credit.

In explaining the consequences of the failure to resolve delinquency, both the Maryland and federal law prohibit certain actions. Section 14-202 of Maryland's Commercial Law lists nine specific acts which are prohibited. They include: threatening force or violence; threatening criminal prosecution, except for violation of a criminal statute; threatening or disclosing false credit information; contacting the debtor's employer prior to final judgment, except as permitted by statute; threatening or disclosing information on the debtor's credit to one who does not have a legitimate business need; communicating with the debtor in such a way as to harass or abuse; using obscene or abusive language; knowingly threatening or attempting to enforce a right which does not exist; using communications which simulate legal or judicial processes. Section 1692(d) of the Federal Statute prohibits many of the same acts prohibited by the Maryland Act; that is, "[a] debt collector may not engage in any conduct the natural consequences of which is to harass, oppress or abuse any person in connection with the collection of a debt."

The credit and collection industry has made the following demographic observations concerning collection potential;

— Collection is more effective with those who are older, principally