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Alaska State Legislature

UTILITIES RESTRUCTURING COMMITTEE

State Capitol
Juneau, Alaska
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Bill Hudson Chair
John Cowdery Vice Ch.
Brian Porter
Norman Rokeberg
Pete Kott
John Davies
Ethan Berkowitz
Joe Green Alt.

April 11, 2000

TO: ALL MEMBERS

FROM: REPRESENTATIVE BILL HUDSON
CHAIRMAN

RE: URC MEETING 4/12/00 - **Note Time Change**

Attached please find new back-up material concerning HB 169.

We will meet Wednesday, 4/12/00 at 9 a.m., Capitol 120, to discuss this legislation. The Regulatory Commission of Alaska will be on the teleconference line with us.

Please bring your HB 169 packets with you to the meeting.

Thank you.

HB 169

Sponsor: Rep. Joe Green

An act relating to including the costs of expansion activities and political activities in rates of electric cooperatives.

See attached bill and sponsor statement

Against:

ARECA

Mat-Su Resource Conservation & Development Council

Golden Valley Electric Association (GVEA)

Chugach Electric

For:

Matanuska Electric Assn.

Ed Willis (former legislator)

Has concerns:

Ted Carlson, Eagle River resident

Nan Thompson, Chair of RCA, will be on line to explain RCA's concerns about this bill and to answer questions.



GOLDEN VALLEY ELECTRIC ASSOCIATION INC. PO Box 71249 • Fairbanks, Alaska 99707-1249 • 907-452-1151

March 29, 2000

March 29, 2000

ATTN Sue Plummer

The Honorable Bill Hudson, Chair
House Special Committee on Electric Restructuring
State Capitol, Room 108
Mail Stop 3101
Juneau, Alaska 99801-1182

RE: HB 169

Dear Representative Hudson and Committee Members:

Golden Valley Electric Association (GVEA) is pleased to have this opportunity to present these comments to the Committee. As we understand the issue, HB 169 was introduced in response to the MEA-attempted takeover of Chugach Electric Association last year. While Golden Valley is sympathetic to all of those who were directly affected by this effort, we believe that rate matters are best addressed by the Regulatory Commission of Alaska (RCA).

Cooperative members elect directors to represent their interests in the operation and management of the electric cooperatives. Through the election process and the right to recall directors, cooperative member-owners have a voice in their co-ops.

The RCA is the agency authorized to review utility and cooperative rates and balance the interests of consumers, cooperatives and the public. The RCA already has the authority to determine whether costs such as those identified in HB 169 are legitimately included in the rates charged to the customers of cooperatives. Additionally, customers, citizens or members of a cooperative have the right to have the issue of costs spent to acquire the customers of another cooperative or political activities addressed by the RCA.

Golden Valley respectfully urges the Committee not recommend approval of this bill for the following reasons:

- Rate issues are best addressed by the RCA.
- HB 169 may discourage efforts to attract and retain businesses in Alaska.

Letter to: Representative Bill Hudson
March 29, 2000
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- HB 169 may thwart efforts to develop new and innovative products and services that would be valued by consumers.
- HB 169 may infringe on the shrinking free speech rights granted under the Constitution.
- This committee is also considering legislation that would restructure the electric industry in Alaska. HB 169 might be considered, if at all, along with this legislation. However, HB 169 may indeed deter the formation of a competitive market place as anticipated in the restructuring of the electric marketplace. Competitive electric providers would likely advertise in order to attract or acquire the customers of a cooperative or utility. It may also be safe to assume that competitive electric providers would seek to recover advertising costs through the prices it charges consumers. HB 169, if approved, could potentially prevent the development of a competitive marketplace.

Thank you for considering these remarks.

Sincerely,

A handwritten signature in cursive script that reads "George B. Kitchens". The signature is written in dark ink and is positioned above the printed name and title.

George B. Kitchens
Executive Vice President

cc: GVEA Board



CHUGACH ELECTRIC ASSOCIATION, INC.

EUGENE N. BJORNSTAD, P.E.
General Manager

March 24, 2000

..... 3 7 2000

Representative Bill Hudson, Chair
House Special Committee on Utility Restructuring
State Capitol, Room 108
Mail Stop 3101
Juneau, Alaska 99801-1182

Re: HB 169

Attention: Sioux Plummer

Dear Representative Hudson and Committee Members:

We understand HB 169 as an effort to prevent utilities from spending money on ill-advised takeover and political adventures. As victims of this chicanery, Chugach is very sympathetic to the rationale. However, Chugach cannot support HB 169 as a solution because:

- HB 169 would not have prevented MEA's expenditure of funds on its takeover attempt.
- The problem is not best addressed by legislation curtailing or burdening speech. Rather, the matter is best left to the ratemaking efforts of the RCA.
- HB 169 could have unintended effects which far outweigh any possible benefit.
- HB 169 is likely an unconstitutional restraint on speech.

In short, the measure would do more harm than good and for that reason we urge the Committee not to recommend approval of the bill.

HB 169 does not prevent expenditures. For this reason, MEA's attempted purchase of Chugach during the Fall of 1998 and most of 1999 would not have been prevented even if HB169 had been law.

The right place to deal with this is before the Regulatory Commission of Alaska. A.S. 43.05.381(a) already prohibits public utilities from including public relations expenditures in their rates¹ and the regulatory commission has traditionally not allowed these and political costs

¹ Although this provision is a questionable burden on commercial speech as outlined in the attached legal opinion, it has apparently never been challenged.

in rates. Electric utility rates are generally set by the RCA. The RCA is already empowered to determine whether costs such as these are legitimately included in customers' rates. The specific question of who will pay for the costs imposed by political activities or unsolicited takeover attempts can be brought before the RCA by any concerned citizen. Indeed, the issue is likely to be an issue in Chugach's upcoming rate cases.

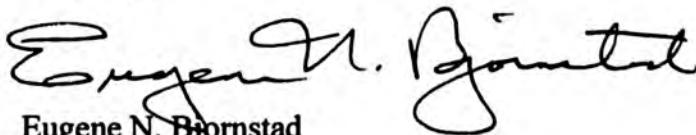
HB 169 could have unintended effects which far outweigh any possible benefit. The following are possible unintended consequences of HB 169:

- Could discourage efforts to attract new businesses or industries to Alaska. For example, efforts to interest a customer of another utility to locate additional operations in the soliciting utility's service territory could be excluded from costs included in rates even though the net effect is to benefit all customers.
- Could discourage utility efforts to develop additional services that could be sold to another utility's customers. This could defeat one of the most effective strategies in enhancing customer value by adding services that can be provided efficiently by the electric utility.
- Could discourage legitimate expenditures to educate the public as to benefits or detriments of a proposed merger or purchase of cooperative assets.

Infringements on free speech deserve careful scrutiny. The attached legal opinion demonstrates the courts' antipathy to limits on speech of the sort proposed by HB 169. The legislators should carefully consider whether the proposal meets the strict standards imposed by our constitutional guarantees of free speech.

For all of the reasons outlined above Chugach has concluded that HB 169 is evidence that bad facts can make for bad law. Chugach urges the committee not to recommend approval of this bill.

Sincerely,



Eugene N. Bjornstad
General Manager

Attachment

ATTORNEYS AT LAW
SIMPSON, TILLINGHAST, SORESENSEN & LORENSEN
A PROFESSIONAL CORPORATION

LESLIE LONGENBAUGH
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E. BUDD SIMPSON
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MAR 23 2000

GENERAL COUNSEL'S OFFICE

March 20, 2000

Mr. Don Edwards, Esq.
General Counsel
Chugach Electric Association, Inc.
P.O. Box 196300
Anchorage, AK. 99519-6300

Re: HB 169 and 1st Amendment Issues
OUR FILE NO: 594.17

Dear Mr. Edwards:

You have asked us to review Section 1 of HB 169 (proposed AS 42.05.381(h)), which would prohibit an electric cooperative from including "expansion activities" in its rates without "first secur[ing] the [coop's existing] customer's consent to the inclusion of a charge for expansion activity." "Expansion activity" includes competitive advertising. In that regard, we believe that the legislation raises serious constitutional issues, in that: (i) advertising is protected commercial speech under both the Alaska and federal constitutions;^{1/} and (ii) no substantial justification for this limitation on protected speech seems apparent. In light of both United States and Alaska Supreme Court decisions that involve facts very similar to those presented by HB 169, it is our view that the legislature may have a difficult time justifying this legislation.^{2/}

^{1/} United States Constitution, Amendment 1; Alaska Constitution, Art. 1, Sec. 5.

^{2/} We appreciate that existing law already prohibits the inclusion of costs for "public relations" in a utility's rates. AS 42.05.381(a). At the outset, that makes the intent of HB 169 even more difficult to understand, since "expansion activity" (the conduct restricted by HB 169) would seem to be subsumed in the existing phrase "public relations."

The rationale for simply reenforcing existing law aside, the fact that there is an existing restriction on "public relations" does not change our opinion on HB 169 for two reasons. First, existing law would be subject to the same rigorous constitutional scrutiny that would face the proposed legislation. Second, HB 169 is, if anything, even broader, and therefore more suspect, than existing law. Currently, utilities can request a case-by-case exemption from the restriction on including "public relations" costs in their rate base (AS 42.05.711(d)), but no such exemption would be possible under HB 169. Sec. 3, HB 169. Moreover, the restriction imposed by HB 169 extends to any activity that is "intended to attract customers..."--a large and vague net that could capture a wide range of speech and conduct, and for that reason be especially vulnerable to a 1st Amendment challenge.

Mr. Don Edwards, Esq.
March 20, 2000
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In undertaking this analysis, we appreciate that the legislation does not expressly prohibit expansion advertising. It is, however, our understanding that forcing a utility to pay for otherwise-legitimate business activity out of its margin (or, alternatively, obtain consumer-by-consumer consent) significantly affects the practicality of engaging in "expansion activity." And, any significant constraint on the exercise of protected commercial speech would be tested under the same standards as an outright prohibition on that speech. See *Alaska Transportation Commission v. AIRPAC, Inc.*, 685 P.2nd 1248, 1254 (Alaska 1984)

Commercial advertising is protected commercial speech. *Central Hudson Gas & Electric Corporation v. Public Service Commission of New York*, 447 U.S. 557 (1980). In *Central Hudson*, the United States Supreme Court considered a case very similar to that presented by HB 169. *Central Hudson* invalidated a public utility commission regulation that banned promotional advertising by electric utilities. The ban had been justified on energy conservation grounds, but the court held that the state's justification was too tenuous and speculative to justify the ban. *Central Hudson* established a four-part analysis to test the validity of government regulation of commercial speech:

At the outset, we must determine whether the expression is protected by the First Amendment. For commercial speech to come within that provision, it at least must concern lawful activity and not be misleading. Next, we ask whether the asserted governmental interest is substantial. If both inquiries yield positive answers, we must determine whether the regulation directly advances the governmental interest asserted, and whether it is not more extensive than is necessary to serve that interest.

447 U.S. at 566.

The Supreme Court recently reaffirmed the *Central Hudson* test in *Greater New Orleans Broadcasting Association v. United States*, 527 U.S. 173, 174-5 (1999) (overbroad federal ban on private casino gambling advertisements broadcast by radio or television stations violated the First Amendment).

In applying the *Central Hudson* test, the government bears the burden of justifying the challenged restriction. *Greater New Orleans*, 527 U.S. at 174.

In *Alaska Transportation Commission v. AIRPAC, Inc.*, 685 P.2d 1248, the Alaska Supreme Court adopted the *Central Hudson* test--again, applying it in a context that was

Mr. Don Edwards, Esq.

March 20, 2000

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quite similar to HB 169. In *AIRPAC*, the Alaska Transportation Commission had attempted, *inter alia*, to "limit[] AIRPAC's right to solicit customers for its back-haul trip from Anchorage to Dutch Harbor." The Alaska Supreme Court ruled that the ATC's order violated AIRPAC's right to free speech because, under the *Central Hudson* test, the restrictions on AIRPAC's marketing efforts were unnecessary to further any substantial state interest. For example, the ATC's order did not relate to air safety, and "restricting an air taxi operator's right to solicit business for the flight back to its base of operations inhibits economical and efficient service." 685 P.2d 1253-54.

We have like difficulty conforming HB 169 to the *Central Hudson* test. First, expansion advertising is protected speech, in that it "concern[s] a lawful activity and...[is] not...misleading." Second, there is no "substantial state interest" apparent from the bill itself. The inclusion of promotional costs in rates to customers does not raise the involuntary participation issue that exists with respect to political activities by utilities, and therefore we doubt that the bill is motivated by any desire to protect ratepayers' rights of free speech. Compare *Homer Electric Association v. Alaska Public Utilities Commission*, 756 P.2d 874, 878 n.8 (Alaska 1988) (potential constitutional problems with requiring ratepayers to subsidize political or religious activities with which they do not agree); see also proposed AS 42.05.381(i) in Section 1 of HB 169.

Indeed, the only apparent motivation for the bill is to protect other public utilities from competition. If the sole purpose of Alaska's public utilities statutes was to preserve monopolies, an argument for the legislation might be more plausible. However, competition is not prohibited, nor even necessarily discouraged, under our public utility laws. See *Chugach Electric Association v. City of Anchorage*, 426 P.2nd 1001 (Alaska 1967).

Moreover, the final question asked by the *Central Hudson* test is whether the restriction on speech is "not more extensive than necessary" to further the statute's interest. Even to the extent that Alaska's public utility statutes are concerned with potentially unhealthy competition, AS 42.05.221(d) creates a tailored, balanced process for addressing that issue in a specific service area. With this less-intrusive means of controlling damaging competition (whenever it is, in fact, damaging), a sweeping restriction on *all* competitive speech seems especially overbroad.

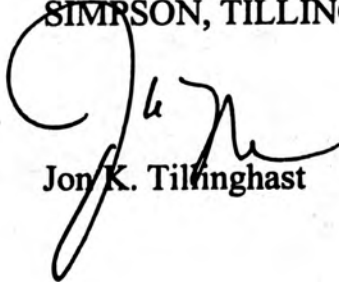
In summary, though we can't warrant that there is no conceivable justification for HB 169's constraints on protected commercial speech, none that meets the governing federal and Alaska test seems evident to us.

Mr. Don Edwards, Esq.
March 20, 2000
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If you have any further questions on this matter, please don't hesitate to ask.

Sincerely,

SIMPSON, TILLINGHAST, SORENSEN & LORENSEN



Jon K. Tillinghast



GOLDEN VALLEY ELECTRIC ASSOCIATION INC. PO Box 71249 • Fairbanks, Alaska 99707-1249 • 907-452-1151

March 29, 2000

MAR 31 2000

ATTN Sue Plummer

The Honorable Bill Hudson, Chair
House Special Committee on Electric Restructuring
State Capitol, Room 108
Mail Stop 3101
Juneau, Alaska 99801-1182

RE: HB 169

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Thank you for considering these remarks.

Sincerely,

A handwritten signature in cursive script that reads "George B. Kitchens". The signature is written in dark ink and is positioned above the printed name and title.

George B. Kitchens
Executive Vice President

cc: GVEA Board

approval a New York Public Service Commission decision²⁶ in which the commission had held that expenditures for institutional advertising were a proper expense for ratemaking purposes, the court noted that the decision stated that what was of concern there were advertisements which were obviously designed to project a favorable image of the company to its customers, its existing stockholders, and potential investors; that to the extent that such advertising fostered sound consumer relations or encouraged people to invest in the company, it was clear that the consumers, as well as the stockholders, were ultimately benefited through the lessening of the expense of doing business; that the trend in modern regulatory decisions was to allow such charges as proper for rate-making purposes. The commission had concluded that in view of the fact that management should be permitted to control advertising expenditures as long as they are within the limits of reason, and so long as these expenses do not exceed what is reasonably necessary and proper in the particular case, there was no ground to distinguish the advertising costs in question from other necessary and proper expenses. The court determined that the department's disallowance of some of the expenditures for advertising on the grounds stated by it was an unwarranted interference with the function and prerogative of the company's business managers and that it was therefore beyond the power and authority of the department. On remand the test year computations were to be made without deduction of such advertising costs, the court directed.

26. *Re Consolidated Edison Co.* (1961, NY) 41 PUR3d 305.

27. Institutional advertising was defined
978

The court in *State ex rel. Dyer v Public Service Com.* (1960, Mo) 341 SW2d 795, cert den 366 US 924, 6 L Ed 2d 384, 81 S Ct 1351, declined to overturn a decision of the commission to allow, as an administrative expense, a contribution by an electric utility to a private utility power group for several advertisements. In this appeal from a judgment affirming orders of the public service commission made in a utility rate proceeding, the court explained (1) that the commission had found that it was a recognized fact that the principal purpose of advertising is to create good public relations and stimulate a demand for the service or product being advertised, and (2) that the commission was unable to find from the evidence offered that this particular form of advertising would do neither. The court went on to point out that the commission had further stated that in view of the fact that it was of the opinion that management should be permitted to control such advertising expenditures as long as they are within the limits of reason, and in view of the fact that the commission was unable to find that such advertising would not result in benefit to the rate payers, the expenses incurred therefor would be allowed.

See *State v Oklahoma Gas & Electric Co.* (1975, Okla) 536 P2d 887, an appeal from an order of the corporation commission prohibiting public utilities from making expenditures for institutional advertising,²⁷ in which the court declared that the prohibition on expenditures for institutional advertising was an unreasonable means of protecting rate payers from these expenditures. Noting that this

as advertising designed to promote the corporate image of the utility and to present it in a favorable light to the public and to potential investors.

did not mean that the commission must allow all institutional advertising expenses as operating expenses for rate-making purposes, the court concluded that the commission might disallow any institutional advertising expenditures from operating expenses for rate-making purposes unless the utility established that such expenditures benefited all rate payers.

Refusing to disturb the commission's allowance of the power company's expenses incurred for trade ally advertising, the court in *Commonwealth v Virginia Electric & Power Co.* (1971) 211 Va 758, 180 SE2d 675, an appeal from the corporation commission's authorization of electric rate increases, pointed out that although the commission had recently disapproved further use of such advertising in the form engaged in by the company, the commission had refused to eliminate those expenses, finding it reasonable to assume that the company would substitute some other form of promotional activity at an equal or greater cost.

§ 8. Advertising supporting rate increase

In the following cases involving the propriety of allowing advertising expenses incurred by a public utility to be included in operating expenses for rate-making purposes, the courts held that advertising expenses incurred in support of attempts to obtain rate increases should be disallowed.

In *Ft. Smith v Southwestern Bell Tel. Co.* (1952) 220 Ark 70, 247

SW2d 474, wherein the Arkansas Public Service Commission's condemnation of the company's practice of using the ratepayers' money to conduct an advertising campaign to increase the rates proposed to be charged the ratepayers by the company was approved,²⁸ the court explained that the commission's language indicated that in hearings for rate increases by any utility, the commission would carefully examine to see how much was being paid for overhead and staff work directed, in whole or in part, at trying to get rate increases from the public. Making no specific reduction in the amount of advertising expenditures claimed by the company as operating expenses, the court did declare that the utility must use all its receipts as though they were a public trust, and that receipts must not be dissipated in an effort to get further increases from the public.

Affirming the commission's disallowance of expenditures during the test year for advertising purposes, including costs of advertising by means of newspaper, radio, and television, ostensibly as a means of informing the public as to the company's situation in connection with the instant application for a rate increase, the court in *Southern Bell Tel. & Tel. Co. v Louisiana Public Service Com.* (1960) 239 La 175, 118 So 2d 372, noted that proper allowance should be made for ordinary advertising expenses. The court, referring to the commission's statement, explained that after re-

28. The commission, in *Re Southwestern Bell Tel. Co.* (1951, Ark) 87 PUR NS 97, from which the above appeal was taken, had noted that during the course of the hearing, the propriety of this practice was questioned and that the company had discontinued the practice after the issue had been raised in the hearing. The com-

mission voiced the hope and assumption that the company would not engage in such practice in the future, but apparently took no further action on the matter, stating in its order that the operating revenues and expenses, as discussed in this opinion, were thereby approved.

viewing the rulings of the courts of other states which condemn the practice of utilities in using the rate payer's money to conduct an advertising campaign to increase the rates proposed to be charged to the rate payer, the commission disallowed this item, not on the grounds of impropriety, but because the record clearly showed that these expenditures were abnormal and nonrecurring in character and that their inclusion in the operating expense accounts would distort the test year earnings.

§ 9. Promotion

[a] Expenses allowed or allowable

Under the circumstances of the following cases involving the propriety of allowing promotional expenses incurred by a public utility to be included in operating expenses for rate-making purposes, the courts held that promotional expenditures made by the utility were allowable.

Within the limits of reason, advertising or development expenses to foster normal growth are legitimate charges upon income for rate purposes, the court declared in *West Ohio Gas Co. v Public Utilities Com.* (1935) 294 US 63, 79 L Ed 761, 55 S Ct 316, reversing on appeal the decree of a state Supreme Court affirming a rate order of the state public utilities commission. The commission had more than halved the expenses claimed by the gas company for procuring new business or endeavoring to procure it, on the ground that anything more than what was allowed by the commission was unnecessary and wasteful. The court responded that the criticism had no basis in evidence, either direct or circumstantial. Noting that good faith was to be presumed on the part of the managers of a business, the court stated that in the absence of a showing of ineffi-

ciency or improvidence, a court would not substitute its judgment for theirs as to the measure of a prudent outlay.

In *El Dorado v Arkansas Public Service Com.* (1962) 235 Ark 812, 362 SW2d 680, a minimum gas service charge case, the court, responding to the contention that expenses incidental to merchandising, such as advertising, should not be allowed as a utility expense, declared that the commission had correctly allowed the expense of company advertising to be charged to utilities expense. The court pointed out that the record reflected that the company engaged in merchandising only such items as were related to its utility business and would tend to increase the sale of gas. The court held, therefore, that the commission had authority to permit the company to charge to utilities expense items of merchandise advertising, and that it did not act arbitrarily in doing so on the reasonable theory that increased gas sales would tend to lower the price paid by consumers.

On appeal from a rate base determination by the public utility commission, the court in *Re Honolulu Gas Co.* (1935) 33 Hawaii 487, determined that the commission's division of the gas company's expenses, incurred in carrying on a merchandise business devoted to the sale locally of gas stoves, gas heaters, gas refrigerators, and other gas appliances, between utility and nonutility activities, was unwarranted, and that such expenses, including advertising, should have been considered and included in the rate base. The court, pointing out that the commission was correct in its conclusions that the merchandise activities of the company were nonutility, it followed that the same had no proper place in the rate base, and the

division of expenses on the above basis was justified, explained that the uncontroverted evidence showed that the merchandise business of the company constituted but a small percentage of the company's total operations, and that it returned slight, if any, profit to the company and was carried on solely for the purpose of promoting or increasing the demand for manufactured gas throughout the territory in which the company was supplying that product. Noting that there was ample authority to sustain the principle that a company will not be permitted to charge as an operating expense of its public utility activities separate merchandising or other non-utility enterprises, the court stated that it was well settled that where a gas manufacturing company engages in the sale of gas appliances not as an independent or profit-making vocation but to encourage and stimulate the sale of gas, the merchandising thus carried on is a business activity beneficial to the consuming public because the increased use of gas necessarily tends to lower the rate to the consumers, and the assets and capital thus devoted should be included within the property to be appraised in determining the rate base. Recognizing that here, as in other cases, it was the practice of the gas company to conduct such business partly to aid consumers in securing gas appliances manufactured under standard specifications that would thus render most efficient service to the consumers, and partly, by thus promoting the sale of appliances to be used for additional purposes, to increase the sale of gas, the court concluded that the reasonable expenses incurred in promoting new business or in the endeavor to procure it should be incorporated into the rate base.

Notwithstanding the contention

that the commission had erred in allowing excessive amounts expended for advertising by the telephone company to be treated as operating expenses for rate-making purposes, the court in *Illinois Bell Tel. Co. v Illinois Commerce Com.* (1973) 55 Ill 2d 461, 303 NE2d 364, affirmed the commission's finding that the expenditures had not been excessive or improper. Noting that there was no quarrel with the company's expenditures for "informative" as distinguished from "promotional" advertising, the court stated that the telephone company's position was that a reduction in advertising would injure service and reduce its net earnings. The court referred to the commission's statement relative to the company's advertising and public relations programs, in which the commission had declared that the company's expense in relation thereto had not been excessive nor should it be deemed improper. The commission had gone on to add that in an economic climate involving inflationary spiraling of costs which the utilities cannot avoid and still provide adequate service to the public, it becomes apparent to the regulatory agencies that a company's operating expenses should be closely scrutinized and that those which do not specifically relate to business operations should be excluded for ratemaking purposes in the determination of the company's operating income. The commission had pointed out that this observation had also been made in a recent expression of policy on advertising by the New York Public Service Commission wherein it was stated that since management could control its advertising expenditures, it was not in the interest of anyone to have unnecessary institutional advertising

exacerbate customer resentments at a time when large rate increases were made necessary by increases in the various classes of costs beyond the control of utility management. The commission had concluded that sound business judgment indicated that the belt tightening process should begin in those areas not directly and totally related to the providing of the utility service to the public. The court explained that after the admonition that such expenditures would be carefully scrutinized in the future, the commission had then found that the telephone company's expenditures had not been excessive or improper, and the court stated that from its review of the record, it could not say that the commission's findings were without sufficient support in the evidence.

Denying the exceptions by the commission as to the gas company's advertising expenses to be included in operation costs for ratemaking purposes, the court in *Wichita Gas Co. v Public Service Com.* (1930, DC Kan) 3 F Supp 722, pointed out that the propriety of spending money for advertising the wares of a utility was for the owners to determine, and concluded that the method used by the gas company to increase its business was appropriate, the amount expended was reasonable, and the results justified the expenditure.

The court in *Central Maine Power Co. v Public Utilities Com.* (1957) 153 Me 228, 136 A2d 726, sustained the company's exception to the commission's exclusion, as operating expenses, of a large portion of the expenditures made by the company for sales promotions, with the court pointing out that the good faith of the management of the company was not challenged in the slightest degree and that the question resolved itself

into whether it clearly appeared that the expenses were excessive or unwarranted, or, stated differently, whether expenses in excess of the allowance by the commission were within the limits of reason. The court, criticizing the commission for unreasonably substituting its judgment for that of the company's management, explained that the items had not been considered by the commission to be as a whole improper or unlawful charges against the ratepayers, and that placing a more than 50 percent reduction on the amounts shown to be required to meet the company's needs in the promotional field, basing such reduction on the ground that an expanding utility such as the electric company should severely reduce expense of this type, was clearly a substitution of the commission for the company in the management of the utility.

Promotion expenses, including those of advertising, for gas appliances and gas utilization, were allowed in *Consolidated Gas Co. v Newton* (1920, DC NY) 267 F 231, mod on other grounds, 258 US 165, 66 L Ed 538, 42 S Ct 264, a suit in equity brought to enjoin the defendant commission and state officials from imposing confiscatory rates on the plaintiff gas company. The propriety of the expenses was challenged largely because the sale of gas and of machines to burn gas had not increased much. The court pointed out that the truth appeared to be that the constantly increasing use of electricity for illumination had driven out gas more and more, until, to hold its sales, the plaintiff gas company had to promote the use of gas for heating and cooking. The court noted that the company had succeeded in achieving a slight increase in sales, and its officers attributed their ability

to do even this well to such promotions. Pointing out that their decision was not now open to question since they were under a duty to keep up their sales so far as they could, and to push the use of gas in any new ways in which the public would use it, the court determined that even under municipal management, advertising, when not pushed to the useless extreme which competition too often engenders, is a necessary function.

The commission's refusal to allow the gas company's promotional expenditures as operational costs had been found by the trial court to be in error of law, and the court in *State ex rel. North Carolina Utilities Com. v Piedmont Natural Gas Co.* (1961) 254 NC 536, 119 SE2d 469, an appeal from the commission's order canceling a proposed new rate, affirmed such finding. The commission had disallowed the amount in excess of the national average of promotional expenditures for companies retailing natural gas, but the court determined that the gas company's expenditures should have been compared to those of companies in the defendant company's class instead of to the national average. Pointing out that the gas company had, within recent years, changed over from manufactured to natural gas, that all its customers had to be "sold" on natural gas, that new customers had to be won, and that competition with electricity and oil had to be met, the court added that the company was faced with promotion in a new field at a time when promotional expenditures throughout the nation (on which the national average was figured) included those of many older companies which had been in the field for years with a well-

known product and an established market. The court, noting that the commission had recognized the high quality of the company's management and that the company was rapidly expanding its facility by a heavy promotional program, remanded the proceeding to enable the commission, *inter alia*, to ascertain the company's true operating expenses.

See *State v Oklahoma Gas & Electric Co.* (1975, Okla) 536 P2d 887, an appeal from commission order prohibiting public utilities from making expenditures for promotional advertisements,²⁹ wherein the court declared that such prohibitions were invalid. The commission had argued that if such expenditures did not sell energy, they were wasteful, and rate payers should not be required to pay them, but the court responded that this argument did not justify prohibiting such expenditures, because the same result could be obtained by excluding such expenditures from operating expenses for rate-making purposes. To the opposite argument, that if such practices sold energy, they increased the use of fossil fuels and should be prohibited, the court replied that many promotional expenditures are designed to achieve conversion to competing utilities, and to instill preferences for one form of energy over another, rather than to increase overall consumption of energy, and that since the commission did not have jurisdiction over appliance manufacturers and distributors, and since the proposed prohibitions did not prohibit appliance manufacturers and distributors from advertising their products, the prohibited practices and expenditures had little, if any, effect upon overall consump-

29. Promotional advertising was defined as advertising designed to increase usage,

obtain new customers, or encourage use of one form of energy over another.

tion of energy. As long as appliance manufacturers and distributors were allowed to advertise their products, it was arbitrary to deny utilities the right to counteract this advertising at the expense of the stockholders on the ground that promotional advertising and practices by utilities increased overall consumption of fossil fuels, the court explained. Turning then to testimony that if peak load demand for electricity exceeded peak capacity, a brownout would occur, the court declared that if a particular utility faced a foreseeable danger of being unable to meet peak demand, the commission might have authority to prohibit it from engaging in any promotional activities which would further increase its peak demand, but the court pointed out that this did not justify a rule prohibiting all utilities from engaging in such activities. Noting that attempts to disallow promotional expenditures as operating expenses for ratemaking purposes had been held to constitute an invasion of a discretion reserved to corporate management if the expenditures were designed to produce ultimate benefits to every customer and were not excessive or unwarranted, the court concluded that promotional practices which were reasonably calculated to improve the utility's load factor and benefit all consumers by reducing the average unit cost of energy were not unjustly discriminatory, and prohibitions against such practices constituted an invasion of the discretion reserved to corporate management.

[b] Expenses reduced or disallowed

Under the circumstances of the following cases involving the propriety of allowing promotional expenses incurred by a public utility to be included in operating expenses for rate-

making purposes, the courts held that promotional expenditures made by the utility should be reduced or disallowed.

See *Trans World Airlines, Inc. v Civil Aeronautics Board* (1967) 128 App DC 126, 385 F2d 648, cert den 390 US 944, 19 L Ed 2d 1133, 88 S Ct 1029, a case involving a government subsidy mail rate determination rather than a determination of consumer rates, in which the court upheld the Civil Aeronautics Board's disallowance of a specified amount of selling expense as in excess of the amount appropriate under the honest, economical, and efficient management criterion, over the airline's contention that the disallowance was an unwarranted interference with the airline's managerial discretion. The court explained that once the principle of setting a ceiling on selling expenses was established, it was plain that the Board had acted reasonably and that its action had support in the record. In response to the airline's charges of interference with managerial discretion, the court pointed out that a company which sought and pocketed the boon of subsidy or protective contracts could not assail the restraint inherent in accountability to government officials as a tyrannical burden. The government officials were themselves accountable in court for compliance with the rule of law applicable to administrative agencies, the court explained, concluding that the petitioner had not established the agency's action in this case to be arbitrary or capricious.

In reversing that part of the public utility commission's ratemaking order which had allowed a sizable sum for promotional expenses, the court in *Application of Hawaiian Electric Co.* (1975) 56 Hawaii 260, 535 P2d 1102, 83 ALR3d 951, noted that the bur-

den was always on the applicant to prove justification for a requested rate increase, and that the electric company had the burden of showing the propriety of its request for these promotional expenditures. The court held that the electric company had not carried its burden. Part of the expenditures claimed were for allowances or payments to owners and developers who built all-electric homes and apartments and advertised them for sale as such, the court pointed out, declaring that in the context of present times, these promotional expenditures on the part of a regulated public service company were wasteful and unreasonable, and their allowance by the commission was an abuse of its discretion. The disturbing aspect of the public utility commission's decision to allow expenditures for these programs was the rationale behind it, the court observed, noting that the basis of the allowance seemed to be the circuitous reasoning by which an earlier allowance of promotional expenditures to the applicant's competitor, on the ground that the expenditures were necessary to attract away customers from the applicant, now necessitated a like allowance to the applicant. Disapproving the public utility commission's consistent failure to meet squarely the issue of the reasonableness of competitive advertising expenditures, the court explained that one of the primary factors which the public utility commission must take into consideration when it fixes rates is fairness to the ratepayer, and that it was obvious that the particular type of advertising competition involved here did not benefit the ratepayer. Turning then to the propriety of allowing a sizable sum for promotion programs designed to increase the use of electricity and purportedly to

improve the company's load factor, the court indicated that these programs consisted essentially of direct advertising and contributions to dealer and distributor advertising of certain electric appliances. The electric company was, in effect, subsidizing the promotional activities of dealers and distributors whose commercial transactions formed no part of the electric company's own business venture, the court remarked, distinguishing such expenses from those of the gas company competitor, which sold gas appliances as an essential component of its commercial operations. The electric company failed to satisfactorily show how much of an improvement in its load factor these expenses could reasonably be said to make, the court observed, adding that since the appliances being promoted by the electric company were those generally in use during peak load periods, it was difficult to see how the electric company could argue that these expenses encouraged the increase of off-peak utility loads. In conclusion, the court spoke of the stark reality of energy problems and environmental concerns, and insisted that in the face of dwindling oil supplies and spiraling costs, promotional practices which were wasteful or which only served to aggravate the energy crisis should be viewed by a regulatory agency with extreme caution.

The commission, in setting new gas rates, had disallowed as operating expense one-third of the amount claimed by the appellant gas company as new business expense, and in *Peoples Gas Light & Coke Co. v Slattery* (1939) 373 Ill 31, 25 NE2d 482, app dismd 309 US 634, 84 L Ed 991, 60 S Ct 724, the court affirmed the commission's action in this regard, viewing the company's promotional prac-

tice of rental purchase plans for putting gas appliances on the premises of customers as creating an unduly large expenditure for business promotion to be charged as an operating account. The court explained that since gas appliances were sold by many other dealers, and since those sales made by the gas company, if conducted as a separate business, would not be subject to regulation, the advisability of such a method of promoting sales of gas and the propriety of the amount thus expended became matters entirely for the commission. Concluding that the action of the commission in disallowing part of the claimed promotional expenses was not unjustified, the court pointed out that in the very nature of things, a sale of outside articles to promote the sales of a commodity regulated by a utility must be controlled by the commission, since otherwise it would be possible to either raise the operating expenses to unreasonable heights or convert the utility into a mere medium for the sale of appliances and merchandise not regulated by the commission.

In *Boston Consol. Gas Co. v Department of Public Utilities* (1951) 327 Mass 103, 97 NE2d 521, a suit in equity to determine whether rates permitted by the department were confiscatory, it was determined that costs involved in the sale of gas appliances, including the cost of advertising appliances for sale, stood on a different footing than did expenses of sending repairmen to customers in response to complaints of leaks, faulty operation of appliances, etc., which were considered proper charges to the operating expenses of a gas business. The court noted that the gas

company had treated the appliance business as a separate entity for most purposes, but had sought to treat the expenses of the appliance business, including the advertising expenditures, as a part of the company's business of supplying gas. The company had argued that gas could not be bought by the consumer like ordinary merchandise, but could be bought only by having it flow through appliances of one kind or another; that apart from these appliances it could not be advertised effectively; and that whatever promoted the flow of gas through appliances promoted the sale of gas. The court observed that the difficulty with the argument seemed to be that it either fell short of proving the point or it proved too much: if the appliance business was really a part of the gas business, the gas customers were entitled to have the profits from appliances included in the earnings of the gas business, but if it was really a separate business, its expenses ought not to be charged against the gas customers. The court cited an earlier case³⁰ in which it had been stated that the sale and servicing of gas appliances constituted a separate business from the supplying of gas, so that it would not be fair, on the one hand, to charge all customers with higher rates so that some might buy appliances and have them serviced at less than cost, or, on the other hand, to lower the cost of gas service because of a profit on those items. The court recommitted the case for purposes of having the company's earnings determined by correct legal standards.

While the public utility commission had determined that in the absence of evidence of bad faith or imprudence,

30. *Lowell Gas Co. v Department of Public Utilities* (1949) 324 Mass 80, 84

NE2d 811, cert den 338 US 825, 94 L Ed 501, 70 S Ct 71.

the advertising and promotional expenditures by an electric company were within the limits of the discretion of the management, the court in *Public Service Co. v State* (1973) 113 NH 497, 311 A2d 513, upheld the contention that all promotional advertising expense should be disallowed because the company and the industry was encountering increased unit costs and decremental profits. The court noted that it was not disputed that increased demand had caused the purchase of power from outside sources so that increased costs would result, and further observed that the parties making the contention disclaimed any concern with past advertising and promotion, seeking only to preclude further such expense. Pointing out that the merchandise and promotional advertising aggregated a comparatively insignificant figure, the court nevertheless held that under present conditions, promotional advertising might well be disallowed, and distinguished the holding of *Pub-*

lic Service Co. v State (1959) 102 NH 150, 153 A2d 801,³¹ which, the court explained, was decided under circumstances quite different from those of this case and could not stand in the way of disallowance of proposed expenses where appropriate under current conditions.

The commission's disallowance, for rate-making purposes, of certain claimed advertising or new business expenses, was upheld in *State v Lone Star Gas Co.* (1935, Tex Civ App) 86 SW2d 484, error ref, revd on other grounds 304 US 224, 82 L Ed 134, 58 S Ct 883, reh den 304 US 590, 82 L Ed 1549, 58 S Ct 1051, a suit by the state to restrain the defendant gas company from violating a rate setting order of the commission. The court explained that only a small amount of advertising was proved, nothing in proportion to the charges made for it, and concluded that the high annual expense claimed for advertising was not supported by the quantum and character of evidence required.

31. In the above-cited case, wherein the commission's action in making no reduction in the questioned accounts was upheld, the court voiced its unwillingness to question the judgment of the commission

in its treatment of the amounts claimed by the company for sales and new business, of which promotional expenses were a part.

Consult POCKET PART in this volume for later cases