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The Public Utility Regulatory Act Student Symposium - Public Utility Regulation in Texas.

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THE PUBLIC UTILITY REGULATORY ACT

The history of public utility regulation in the United States is immersed in principles of sovereign police power exercised to maintain and protect the public interest.²⁰⁵ The governmental prerogative of regulation has applied to those industries supplying important resources and services in a structure which insulates supplies from the normal risks of competition in the marketplace.²⁰⁶ The regulation of public utilities has a long history, dating as far back as ancient Rome.²⁰⁷ The concept of regulation in economic areas affecting the public interest was also recognized by English courts,²⁰⁸ but was not specifically recognized as a principle of law in the United States until 1877 when the Supreme Court approved the doctrine in *Munn v. Illinois*.²⁰⁹

The extent to which public utilities are monitored and regulated varies greatly from state to state.²¹⁰ Until the passage of the Public Utility

205. See Lovejoy, *Regulation of Business: The Need For A Public Utility Concept*, 3 S. TEX. L.J. 292, 294 (1958).

206. Traditionally the regulation of public utilities has been a substitute for the normal effects of competition.

[T]he goal of rate regulation is to provide a rate of return for public utilities that will equal, over time, the rate of return earned in competitive industry adjusted, if and when necessary, for differences in risk and uncertainty
West & Eubanks, *Automatic Cost of Capital Model*, PUBLIC UTILITIES FORTNIGHTLY, May 22, 1975, at 27-28. There are, however, some types of competition which may exert some influence or impact on a given utility market. Five types of competition to which an electric utility is subjected are:

1. Competition of industrial generating plants. . . .
2. Competition of substitute services. . . .
3. Competition of other electric utilities in cases where a business can be located in any one of a number of utility territories.
4. Competition of government power projects. . . .
5. Competition for the consumer's dollar. . . .

R. CAYWOOD, *ELECTRIC UTILITY RATE ECONOMICS* 5 (1972 ed.); see McKie, *Public Utility Regulation: Structure and Performance*, in PERSPECTIVES IN PUBLIC REGULATION 85, 88-89 (M. Russell ed. 1973).

207. See GLAESER, *PUBLIC UTILITIES IN AMERICAN CAPITALISM 196-97* (1957).

208. During the reign of King James I, the chief justice, Sir Matthew Hall, stated that ferry boats charged with high rates and poor service "ought to be under a public regulation, to wit, that it give attendance at due time, a boat in due order and take but a reasonable toll." L. METCALF & V. REINEMER, *OVERCHARGE* 26 (1967).

209. 94 U.S. 113 (1877); accord, *Railroad Comm'n v. Houston Natural Gas Corp.*, 155 Tex. 502, 505, 289 S.W.2d 559, 561 (1956).

210. The variance of controls is obvious when reviewing the size and funding of the various state regulatory bodies. Commissioners' terms are six years or more in 35 jurisdictions. They are appointed by the governor in most states, appointed by the President of the United States in the District of Columbia, chosen by the legislature in two, and elected in the remaining 12 (including the Texas Railroad Commission). FPC, FEDERAL AND STATE COMMISSION JURISDICTION AND REGULATION OF ELECTRIC, GAS, AND

Regulatory Act (PURA) by the 64th Texas Legislature,²¹¹ utility regulation in Texas was governed by Article 1119 of the Texas Revised Civil Statutes in the case of cities and towns incorporated under the general laws of the state, and by articles 1124 and 1175(12) in the case of special charter and home rule cities.²¹² With the exception of oil and gas utilities which have been relegated to the control of the Texas Railroad Commission,²¹³ rate regulation of public utilities has been, for the most part, under the purview and control of city councils throughout the state, few of which have had the resources and the benefit of the skilled staff required to comprehend the technical nature of regulation and rate determination.²¹⁴ Not all utilities, however, fall within incorporated areas and because of their intrastate character do not fall within the jurisdiction of the Federal Power Commission in the case of electric utilities, or the Federal Communications Commission in the case of intrastate long distance telephone service.²¹⁵ Thus no regulatory body is empowered to test the reasonableness of rate increases in this area. Recently, however, the Supreme Court of Texas held that it was within the constitutional authority of the Attorney General to seek a restraining order prohibiting a privately owned telephone utility from initiating unrea-

TELEPHONE UTILITIES 126-27 (1973) [hereinafter cited as FPC, FEDERAL AND STATE COMMISSION JURISDICTION AND REGULATION].

In 1973 the total budget of the various state regulatory commissions ranged from \$292,000 in South Dakota to \$12,175,000 in California. *Id.* at 138. In 1967, the staff size of the various regulatory bodies ranged from seven to 795 and total expenditures ranged from \$102,000 to \$10,277,915. FPC, FEDERAL AND STATE COMMISSION JURISDICTION AND REGULATION 44-46 (1967); *see* FPC, FEDERAL AND STATE COMMISSION JURISDICTION AND REGULATION 131-34, 138-40 (1973).

211. TEX. LAWS 1975, ch. 721, at 2327, introduced as H.B. 819 which was altered considerably in House committee and in the Conference Committee which debated and compromised the "consumer oriented" House version with a weaker Senate version.

212. TEX. LAWS 1937, ch. 144, § 1, at 274, and TEX. LAWS 1921, ch. 48, at 152, repealed in TEX. LAWS 1975, ch. 721, at 2327. Rural electrical cooperatives in Texas are governed by the provisions of the Electric Co-operative Corporation Act, TEX. REV. CIV. STAT. ANN. art. 1528b (1962) and subject to regulation by the Rural Electrification Administration in Washington, D.C.

213. TEX. REV. CIV. STAT. ANN. art. 6053, § 1 (1962).

214. The Supreme Court of Texas in *Railroad Comm'n v. Houston Natural Gas Corp.*, 155 Tex. 502, 289 S.W.2d 559 (1956) recognized the inherent complexity in the regulation of public utilities:

The vast quantity of legal writing on the judicial effort to evolve formulas for evaluating the property of utility companies would indicate that the courts may not have had much more success than the professional economists.

Id. at 511, 289 S.W.2d at 564.

215. In setting local rates for telephone utilities, municipal home rule governing bodies have not been permitted to consider profits of the utility made through intrastate long distance rate returns, nor have they been able to control long distance rates charged within their municipal boundaries. *City of Athens v. Gulf States Tel. Co.*, 380 S.W.2d 687, 689 (Tex. Civ. App.—Tyler 1964, writ ref'd n.r.e.); *accord*, *City of Carrollton v. Southwestern States Tel. Co.*, 381 S.W.2d 401, 405 (Tex. Civ. App.—Eastland 1964, writ ref'd n.r.e.); *City of Weslaco v. General Tel. Co.*, 359 S.W.2d 260 (Tex. Civ. App.—San Antonio 1962, writ ref'd n.r.e.).

sonably high rates in statutorily unregulated areas of the state.²¹⁶ The limitation of prescribing reasonable rates in such areas is a legal obligation of such a utility and a district court may determine the reasonableness of such rate increase without exercising a legislative function which is prohibited by the constitution.²¹⁷

As a result of the piecemeal scheme of utility regulation and the lack of resources and expertise in most areas where regulation has been possible, rate determination has varied substantially from one area of the state to another.²¹⁸ Such disparity may also be observed when the profits of privately owned telephone and electric utilities are weighted and compared with the national average.²¹⁹ In examining the rate of return on rate base determinations²²⁰ from 1969 to 1973, on only five occasions did a Texas electric utility fall below the national average.²²¹ Even during those years

216. *State v. Southwestern Bell Tel. Co.*, 526 S.W.2d 526 (Tex. 1975).

217. *Id.* at 530-31.

218. Fulda, *Telephone Regulation in Texas: Should Regulation by Cities Be Replaced by a State Commission?*, 45 TEXAS L. REV. 611, 647-49 (1967). The lack of expertise available to the vast majority of municipal governments in dealing with the complex area of utility regulation and rate determination is a serious defect in the concept of local control. The excessive cost of consultants, economists, investigators and lawyers has placed utilities beyond effective regulation by municipalities. TEXPIRG, REGULATION OF TELEPHONE & ELECTRIC UTILITIES 26-28 (1975); see D. Marshall, A Proposal for the Regulation of Utilities in the State of Texas, 28-30, August, 1961 (unpublished thesis in University of Texas Library).

219. TEXPIRG, REGULATION OF TELEPHONE & ELECTRIC UTILITIES 4-6, 12-13 (1975).

220. A rate of return on rate base is that amount determined to be a reasonable return on a regulated company's investments.

[I]t is designed to permit the regulated company to set a rate schedule which will produce the minimal revenues necessary to cover operating expenses, including taxes, and a rate of return on the invested capital necessary to attract and retain this invested capital.

Commonly the revenue requirement is expressed in the following way:

$$R = C(I-d)r$$

where R = revenue requirement,

C = cost of providing the service of the company, including depreciation expenses and taxes,

I = total investment in plant and equipment,

d = accrued depreciation, and

r = rate of return allowed by the regulatory commission.

Murry, *Practical Economics of Public Utility Regulation*, in PERSPECTIVES IN PUBLIC UTILITY REGULATION 35 (M. Russell ed. 1973).

221. PRIVATELY OWNED TEXAS ELECTRIC UTILITIES
RATE OF RETURN ON RATE BASE—1969-1973^a

COMPANY	1969 ^b	1970 ^c	1971 ^d	1972 ^e	1973 ^f
Central Power & Light	9.72	9.29	9.74	9.20	8.88
Community Public Service	7.66	8.22	8.39	7.22	9.19
Dallas Power & Light	7.57	7.78	6.90	7.56	7.04
El Paso Electric	9.55	9.51	9.68	9.24	8.52
Gulf States Utilities ^g	7.98	7.88	7.60	7.92	7.10
Houston Lighting & Power	9.52	9.31	9.88	9.97	9.41
Southwestern Electric Power	7.47	9.74	9.32	10.30	10.70
Southwestern Electric Service	7.64	8.09	8.25	8.37	8.81

when a Texas electric utility rate of return on rate base was lower than the national average, an examination of the rate of return on common stock equity for those same years illustrates that the return was always above the national average.²²²

Southwestern Public Service	7.65	8.53	8.57	8.39	9.91
Texas Electric Service	9.28	9.66	9.17	9.45	9.05
Texas Power and Light	9.26	9.64	9.40	9.72	9.36
West Texas Utilities	9.11	9.75	9.47	9.42	10.65
State Average ^h	8.93	9.06	9.23	9.38	9.23
National Average ^l	7.30	7.30	7.40	7.60	7.80

- a. *TEXPIRG, REGULATION OF TELEPHONE & ELECTRIC UTILITIES* 4 (1975).
- b. *FPC, STATISTICS OF PRIVATELY OWNED ELECTRIC UTILITIES IN THE UNITED STATES* 752-53 (1970).
- c. *Id.*
- d. *FPC, STATISTICS OF PRIVATELY OWNED ELECTRIC UTILITIES IN THE UNITED STATES* 732-33 (1971).
- e. *FPC, STATISTICS OF PRIVATELY OWNED ELECTRIC UTILITIES IN THE UNITED STATES* 732-33 (1972).
- f. The 1973 statistics are derived from the following formula. The page and line number indicate figures taken from the individual reports (Annual Report) for 1973. Formula: 1973 Annual Report, p. 114, l. 21, col. c or e

$$a = \frac{a + b + c + d}{2} - \frac{[p. 403, l. 1 (col. c + d) + 1. 17 c + d]}{2} - \frac{(p. 405, l. 48/avg.) - (p. 226, l. 51 . . . 1. 57, col. b + f)}{2} - \frac{(p. 227, l. 12, col. b+f) + (p. 351/avg.)}{2}$$

b = 0
c = (p. 110, l. 26 c+d)

d = (p. 110, l. 28 c+d)

e = [1/8 (p. 448, col. f) (p. 419, l. 159, col. b) - p. 418, l. 75, b)] - .06 (p. 114, l. 12, col. e)

- g. Gulf States Utilities figures are for Texas operations for these years.
- h. State averages for rate of return for the 12 companies are weighted averages based on the total kilowatt-hour output for each company.
- i. *FPC, STATISTICS OF PRIVATELY OWNED ELECTRIC UTILITIES IN THE UNITED STATES* 732-33 (1972).

222. PRIVATELY OWNED TEXAS ELECTRIC UTILITIES
RATE OF RETURN ON COMMON STOCK EQUITY—1969-1973^a

COMPANY	1969 ^b	1970 ^c	1971 ^d	1972 ^e	1973 ^f
Central Power & Light	18.0	16.0	16.2	16.0	15.2
Community Public Service	13.9	14.1	14.4	16.1	15.7
Dallas Power & Light	13.2	13.2	12.8	12.7	14.6
El Paso Electric	17.2	17.0	17.1	17.1	15.7
Gulf States Utilities ^g	14.0	14.4	12.1	12.5	12.9
Houston Lighting & Power	14.5	15.1	15.5	15.5	13.9
Southwestern Electric Power	15.6	16.1	15.5	17.0	17.3

The fact that the profits of privately owned electric utilities in Texas have consistently been higher than the national average does not necessarily justify the conclusion that the national average is a fair or reasonable return, but because the returns are exorbitantly higher than the national average it is logical to recognize that most companies have returns substantially lower and yet have maintained their financial integrity.

[O]f the twelve largest electric companies (in terms of total revenue required in 1971) in the United States, only three had above average rates of return. None of them had a rate of return on its rate base as high as 9%. Since the nation's largest companies must be requiring relatively large amounts of capital, investors apparently do not feel that rates of return in the 6-7% range are unreasonable or risky.²²³

Southwestern Electric Service	12.9	13.7	14.1	14.2	14.9
Southwestern Public Service	15.8	17.9	16.8	15.7	16.1
Texas Electric Service	16.8	17.3	16.1	16.4	15.6
Texas Power and Light	16.6	16.8	16.3	16.7	15.3
West Texas Utilities	15.5	16.4	15.8	15.4	16.3
State Average ^h	15.6	15.9	15.6	15.8	15.1
National Average ⁱ	12.2	11.8	11.7	11.8	11.5

- a. *TEXPIRG, REGULATION OF TELEPHONE & ELECTRIC UTILITIES 5 (1975).*
- b. *FPC, STATISTICS OF PRIVATELY OWNED ELECTRIC UTILITIES IN THE UNITED STATES 756-57 (1970).*
- c. *Id.*
- d. *FPC, STATISTICS OF PRIVATELY OWNED ELECTRIC UTILITIES IN THE UNITED STATES 735-36 (1971).*
- e. *FPC, STATISTICS OF PRIVATELY OWNED ELECTRIC UTILITIES IN THE UNITED STATES 735-36 (1972).*
- f. The percent rate of return on common stock equity in 1973 is determined according to the following formula:

$$\frac{\text{earnings available for equity} \times 100}{\text{common equity}}$$
- Definitions:
 earnings available for equity: *FPC ANN. REP. 116A, 1. 63 - 117, 1. 29 (1973).*
 common equity: *Id.* at 111, 1. 13 - 1. 2.
- g. Gulf States Utilities is not included in the state averages. All figures for GSU are based on Texas operations only.
- h. State averages are weighted averages determined by the following formula:

$$\% \text{ rate of return on common equity} \times \frac{\text{KWH output for company}}{\text{total KWH state output}}$$
- i. National averages for 1969-1972: *FPC, STATISTICS OF PRIVATELY OWNED ELECTRIC UTILITIES IN THE UNITED STATES 734 (1972).* The 1973 average was determined by weighting the 1972 national average with the 1973 averages for Texas.

223. *TEXPIRG, REGULATION OF TELEPHONE & ELECTRIC UTILITIES 6-7 (1975).* A regulatory agency must be able to recognize that the public interest can be protected only through the maintenance of a careful analysis of all factors relevant in rate base determinations.

The legal atmosphere within which regulatory agencies operate has tended to emphasize their role as arbiters between conflicting interests, while the concern of the regulated companies for the state of their earnings and their stance vis-à-vis the regulatory agencies has tended to cause them to pay relatively little attention to any efficiency-promoting innovations that would not yield them a fairly immediate financial gain.

Vickrey, *Economic Efficiency and Pricing*, in *PUBLIC PRICES FOR PUBLIC PRODUCTS 53 (S. Mushkin ed. 1972).*

Texas is the last state to create a public utility regulatory commission.²²⁴ It is debatable, however, whether such a commission can forestall the rising utility rates within the state. What it can establish is a statewide depository of experts capable of digesting the complexities of regulation and rate structure and determination previously absent in Texas.

STRUCTURE OF THE PUBLIC UTILITY COMMISSION

The Public Utility Regulatory Act introduces Texas' first agency established to regulate most public utilities through a commission composed of three individuals appointed by the governor and confirmed by a two-thirds vote of the state senate.²²⁵ This process of selection through gubernatorial appointment is utilized by a majority of the states.²²⁶ Thus, the process of selection under the Texas Act is not atypical, yet it is not without its imperfections.

Ideally gubernatorial appointment will remove the commissioners from the maze of political considerations characteristic of elective offices and will better enable each commissioner to make his or her decision without a searching eye on the next election or the next public opinion poll. The disadvantage is the elimination of direct electoral accountability. The element of election cannot be entirely disregarded since the gubernatorial election will determine the orientation of the appointed commissioners.²²⁷ The advantage of a small commission over a large one is a positive feature in that accountability of the body to the public will be facilitated by the fact that the electorate can better pursue the voting records of commission members. Such accountability is, however, also indirect in that it will be only through the governor or the senate that the public is able to exercise control over the composition of the commission.

The effectiveness of the commission was seriously jeopardized between the first House passage of PURA and the bill as it was finally passed by both houses of the legislature by the inclusion of an "opt-in" and "opt-out"

224. FPC, FEDERAL AND STATE COMMISSION JURISDICTION AND REGULATION 3-15 (1973); see PUBLIC UTILITIES FORTNIGHTLY, December 5, 1974, at 50.

225. TEX. LAWS 1975, ch. 721, § 5, at 2331.

226. Commissioners are appointed by the governor in 35 states, selected by the legislature in two, appointed by the President of the United States in the District of Columbia, and elected by citizens in the remaining 12 (including the Texas Railroad Commission). FPC, FEDERAL AND STATE COMMISSION JURISDICTION AND REGULATION 126-27 (1973).

227. One source states:

The governor appoints the utility commissions in two thirds of the states, thus the gubernatorial election often decides the orientation of a majority of the commission. With an unparalleled apparatus for getting their message into community organizations and media, utilities can swing elections. And they do.

L. METCALF & V. REINEMER, OVERCHARGE 230 (1967).

procedure for municipalities.²²⁸ Municipalities under the Act include cities and incorporated villages or towns existing, created, or organized under the general, home-rule, or special laws of the state.²²⁹ With the exception of intrastate telephone regulation,²³⁰ it is possible that the jurisdiction, and thus the effectiveness, of the commission may be hampered. The Conference Committee version, which finally passed both houses of the legislature on June 2, 1975, permits a municipality to elect to surrender its "exclusive original jurisdiction" over electric, water and sewer utilities within its political boundaries to the commission any time after September 1, 1977 by ordinance or by a vote of the electorate.²³¹ A municipality may reinstate its exclusive original jurisdiction by a vote of the electorate at any time except when a case involving that municipality is pending before the commission.²³² When the exclusive original jurisdiction of a municipal governing body is reinstated it must be retained for a minimum of five years, thus precluding regulation by the commission under such circumstances.²³³

Areas outside the incorporated limits of a municipality are without the option to exercise jurisdiction over electric, water and sewer utility rates.²³⁴ Thus, all rural and extra-municipal rate determinations will automatically fall under the control of the commission on September 1, 1976.²³⁵ Likewise all telecommunications will automatically come within the exclusive original jurisdiction of the commission after the same date.²³⁶

228. Compare H.B. 819, 64th Legislature (1975) as originally passed by the House of Representatives on May 18, 1975 with the Public Utilities Regulatory Act, TEX. LAWS 1975, ch. 721, at 2337, as finally passed and signed by the governor on June 2, 1975. Exclusive original jurisdiction over utility regulation remains with municipalities. They must take action, through ordinance or vote of the electorate, to "opt-in" to commission jurisdiction. They also have the prerogative to "opt-out" and reinstate their jurisdiction. TEX. LAWS 1975, ch. 721, § 17(b), (c), at 2335.

229. TEX. LAWS 1975, ch. 721, § 3(b), at 2328.

230. The exclusive original jurisdiction over all telephone utilities in Texas is vested in the new commission. TEX. LAWS 1975, ch. 721, § 18, at 2335.

231. The exclusive original jurisdiction over electric, water and sewer utilities remains with municipal governing bodies in Texas unless their jurisdiction is surrendered. TEX. LAWS 1975, ch. 721, § 17(a), (b), at 2334-35. Most states have not allotted to municipalities the authority to control utilities or rates within their boundaries. FPC, FEDERAL AND STATE COMMISSION JURISDICTION 16 (1973).

232. TEX. LAWS 1975, ch. 721, § 17(c).

233. *Id.*

234. *Id.* § 17(e), at 2335.

235. *Id.* § 87(b), at 2352.

236. *Id.* § 18, at 2335. Telecommunication utilities have been governed by TEX. LAWS 1937, ch. 144, § 1, at 274 (formerly article 1119 of the Texas Revised Civil Statutes). The weakness of the former law has been discussed by the late Professor Carl Fulda in *Telephone Regulation in Texas: Should Regulation by Cities Be Replaced by a State Commission?*, 45 TEXAS L. REV. 611 (1967):

Under Texas law the statewide method of fixing telephone rates, extolled by the New York and Utah commissions, is impossible because each Texas city represents a separate sovereignty and there exists no coordinating agency with authority to order [telephone] exchanges of approximately equal size to adopt the same rates.
Id. at 617.

While the weakness of the "opt-in" provision may startle the wary urban consumer, it should be noted that no single governmental body has necessarily been the safe refuge of the rate payer. While there are those who have contended that the courts are best suited to "legislate" in the area of public utility regulation and the determination of the proper exercise of such police power,²³⁷ the courts in Texas have repeatedly recognized rate-making and regulation of utilities as a legislative function.²³⁸

Two factors appear to be essential in utility regulation by any governmental body: expertise²³⁹ and the public interest.²⁴⁰ The new commission will employ an experienced director of public utilities, a chief engineer who is

237. Lovejoy, *Regulation of Business: The Need For a Public Utility Concept*, 3 S. TEX. L.J. 292, 295 (1958).

238. See, e.g., *Lone Star Gas Co. v. State*, 137 Tex. 279, 306, 153 S.W.2d 681, 696 (1941); *Texas Gas Utilities Co. v. City of Uvalde*, 77 S.W.2d 750, 751 (Tex. Civ. App.—San Antonio 1934, no writ). In *Railroad Comm'n v. Houston Natural Gas Corp.*, 155 Tex. 502, 289 S.W.2d 559 (1956), the supreme court questioned the judicial success of rate determination, and held that "[i]t is fundamental that in Texas the fixing of domestic utility rates is a legislative function of the state government. . . ." *Id.* at 506, 289 S.W.2d at 562; accord, *City of Houston v. Southwestern Bell Tel. Co.*, 263 S.W.2d 169, 171-72 (Tex. Civ. App.—Galveston 1953, writ ref'd). The constitutionality of particular statutes giving the district courts certain appellate functions in utility rate determinations has been questioned. Newcomb, *Some Aspects of Regulation of Public Utilities Operating in Texas*, 5 BAYLOR L. REV. 335, 337-38 (1953). The Supreme Court of Texas recently held that,

the determination of whether rates fixed by the utility are unreasonably high is a judicial function. . . .

It is one thing to inquire whether the rates which have been charged and collected are reasonable—that is a judicial act; but an entirely different thing to prescribe rates which shall be charged in the future—that is a legislative act.

State v. Southwestern Bell Tel. Co., 526 S.W.2d 526, 529-30 (Tex. 1975).

239. The Supreme Court of Texas recently noted the extensive assets of the American Telephone and Telegraph Company and the magnitude of the regulatory task as a consequence. Quoting a report of the FCC, the court observed that the

lack of resources is an even more serious problem for State and municipal regulatory bodies. And the splintering of jurisdiction between the Federal Government and the States undoubtedly contributes further to the deterioration of effective, coordinated regulation. A.T.&T. is so much bigger, and better financed, than any government agency it confronts that even the process of selecting which information it will offer the regulator gives the whole operation a substantial aura of self-evaluation.

In the *Matter of American Telephone & Telegraph Co. and The Associated Bell System Companies, etc.*, 9 F.C.C.2d 30 (1967), quoted in *State v. Southwestern Bell Tel. Co.*, 526 S.W.2d 526, 532 (Tex. 1975).

240. The fact that the public interest is represented by regulatory bodies unable to cope with the specialized aspects of utility regulation is commonly observed. Ideally, a commission should be "consumer oriented," if for no other reason than to balance the effects of power and organization characteristic of utility companies.

The commission must represent the public in order that the interests of the unorganized many are not compromised by the organized few. The idea—sometimes voiced—that the interests of the utility and the interests of the public are one and the same seems to me a Reader's Digest view of the universe and largely without foundation. They are not the same in important respects, and the commission must be "on the side" of the consumer.

D. JONES, *NEW CONCEPTS AND CURRENT ISSUES IN PUBLIC UTILITY REGULATION* 62-63 (1963), quoted in L. METCALF & V. REINEMER, *OVERCHARGE* 90-91 (1967).

registered and experienced in public utility engineering and rate determination, a chief accountant, and a director of research experienced in the area of industrial economics and analysis.²⁴¹ No longer will utility companies present their facts and figures before persons unskilled in dealing with such criteria utilized in rate structure and the determination of reasonable returns.²⁴² By stipulating the requirement of expertise in the various functionaries of the commission, it would be reasonable to expect an improvement in the manner in which data is synthesized and translated into equitable rate determinations.

In addition to the expert personnel who will deal primarily with the technical aspects of utility regulation, a general counsel and staff are specifically charged with the "protection and representation of the public interest before the commission,"²⁴³ it is this division of the new commission that will be responsible for conducting investigations of the utilities under the jurisdiction of the regulatory body.²⁴⁴ Article five of the new Act prescribes the manner in which such information is to be obtained, in addition to prescribing uniform methods of depreciation, amortization, or depletion²⁴⁵ and the type and manner in which data is to be kept by the utilities and ultimately rendered to the commission.²⁴⁶

The conflict of interest provisions, if enforced, will minimize the threat of an industry-controlled or dominated agency.²⁴⁷ The Conference Committee compromises to the bill which was first passed by the House of Representatives resulted in stronger conflict of interest provisions which prohibit any commissioner or any staff member from having any pecuniary interest in any public utility, including ownership or control of any securities therein, for a period of two years prior or subsequent to an individual's tenure on the commission.²⁴⁸ The enforcement of these provisions is left with the Attorney

241. TEX. LAWS 1975, ch. 721, §§ 8(b)(1)-(4), at 2333.

242. Acquiring qualified staff personnel to deal effectively with proposed rate increases is a costly and complex matter for municipalities in Texas. TEXAS MUNICIPAL LEAGUE, TELEPHONE RATES IN TEXAS CITIES 3 (1974).

243. TEX. LAWS 1975, ch. 721, § 8(c)(7), at 2333.

244. In TEX. LAWS 1975, ch. 721, § 8(c)(3), at 2333, the general counsel and staff are given the authority to conduct investigations of public utilities under commission jurisdiction. When a municipality retains or recaptures its jurisdiction over utility regulation it is vested with the right to exercise the same regulatory powers as the commission. *Id.* § 22, at 2336. A municipal governing body may also conduct its own investigations in the same manner as the general counsel, had jurisdiction been surrendered by the municipality to the commission. *Id.* § 24, at 2336-37. The commission, upon request, is permitted to assist municipalities in proceedings involving regulation and rate determination, including the production of testimony by members of the commission. *Id.* § 25, at 2337, and § 28(b), at 2339.

245. *Id.* § 17(b), (e), at 2338. See also *Id.* § 28(a)(2), at 2338.

246. *Id.* § 27(a), at 2337-38.

247. *Id.* § 6, at 2331-32.

248. *Id.* § 6(a), (b), at 2331.

General²⁴⁹ who would be permitted to seek a civil penalty of \$1,000 for each *knowing* violation of section six²⁵⁰ in addition to a criminal penalty for the *willful and knowing* violation of the conflict of interest provisions.²⁵¹

RATE DETERMINATION BY THE PUBLIC UTILITY COMMISSION

The implementation of commission review of rates alleged to be unreasonable, departs from prior Texas law which limited such review to the district courts but only after the city council first sought such judicial determination.²⁵² The commission may act *sua sponte* or upon the complaint of any affected person to review rates that are alleged to be unreasonable.²⁵³ Citizens of a municipality as well as public utilities may appeal to the commission or to the Railroad Commission, whichever is appropriate, for review of rates which have been set by the municipal governing body.²⁵⁴ A citizen appeal must conform with the prescription of a petition for review which is to be signed by 20,000 qualified voters or 10 percent of the qualified voters, whichever is less.²⁵⁵ Petitions must be filed with the appropriate commission within 30 days of the final rate determination made by the municipal governing body.²⁵⁶ The matter is then required to be heard *de novo* and rates set according to the findings made by the commission.²⁵⁷

In order to determine the rates to be set, the commission is governed by a formula which sets a percentage for the adjusted value of the utility's property.²⁵⁸ This represents a departure by Texas from the concept of "fair

249. *Id.* § 72(c), at 2349.

250. *Id.* § 73(a), at 2349.

251. *Id.* § 74(a), at 2349. A violation of the provisions of section six carries a criminal penalty of third degree felony. The punishment prescribed for conviction of this class of offense is imprisonment of not less than two nor more than 10 years and a discretionary fine not to exceed \$5,000. TEX. PENAL CODE ANN. § 12.34 (1974).

252. TEX. LAWS 1975, ch. 145, at 348 (formerly Article 1125 of the Texas Revised Civil Statutes). See Reschenthaler, *The Legal Background of Electric Utility Regulation in Texas—An Economist's View*, 21 BAYLOR L. REV. 295, 297 (1969).

253. TEX. LAWS 1975, ch. 721, § 42, at 2342. See also *Id.* § 83, at 2351. "'Affected person' means . . . any person or corporation whose utility service or rates are affected by any proceeding before the regulatory authority. . . ." *Id.* § 3(h), at 2329. This provision regarding standing before the commission for review or complaint is typical of other states' requirements. FPC, FEDERAL AND STATE COMMISSION JURISDICTION AND REGULATION 17 (1973).

254. TEX. LAWS 1975, ch. 721, § 26(a), (b), at 2337.

255. *Id.* § 26(c), at 2337.

256. *Id.* § 26(d), at 2337.

257. *Id.* § 26(e), at 2337.

258. The Act establishes certain guidelines within which the commission may exercise its discretion in setting value on utility properties:

Utility rates shall be based upon the adjusted value of property The adjusted value of such property shall be a reasonable balance between original cost less depreciation and current cost less an adjustment for both present age and condition. The regulatory authority shall have the discretion to determine a reasonable balance that reflects not less than 60% nor more than 75% original cost . . . and not less than 25% nor more than 40% current cost

Id. § 41(a), at 2341-42.

value"²⁵⁹ which has tended to result in comparatively higher value bases than the concept of "depreciated original cost," utilized by a majority of state regulatory commissions,²⁶⁰ because the replacement cost of property will ordinarily be much greater than its original cost.²⁶¹ Potential difficulty could result, however, if the new commission is unable to act efficiently in making rate adjustments which are responsive to a fluctuating and unstable economy. If privately owned utilities are unable to attract investors and maintain their confidence as a result of losses to investors, such utilities will be hindered and services will deteriorate.²⁶²

Since 1964 the risk return status of utility investment in the nation has fallen off considerably, and regulatory bodies have been the target of criticism for their failure to develop techniques and methods which would permit the regulatory process to be more responsive to capital market conditions.²⁶³ Section 39 of the Act expressly charges the commission to fix

259. See *Railroad Comm'n v. Houston Natural Gas Corp.*, 155 Tex. 502, 289 S.W.2d 559 (1956). Fair value represents one of various value bases utilized in rate determination, others being the trended original cost and the reproduction cost. Fair value has been defined as "[a]n amount which might lie somewhere between book cost and reproduction cost" R. CAYWOOD, *ELECTRIC UTILITY RATE ECONOMICS* 176 (1972). In *Smyth v. Ames*, 169 U.S. 466, 546-47 (1897) the Supreme Court listed six elements to be taken into consideration for fair value determination: (1) original cost of construction; (2) amount spent for permanent improvements; (3) number and market value of stocks and bonds; (4) present value of the property as compared with the original cost of construction; (5) probable earning capacity under various rates; and (6) the amount required to meet operating expenses.

260. Twenty-nine states utilize the original cost valuation standard, or variations thereof, in determining rate base. FPC, *FEDERAL AND STATE COMMISSION JURISDICTION AND REGULATION* 50 (1973).

261. L. METCALF & V. REINEMER, *OVERCHARGE* 61 (1967). An abandonment of the entire concept of property rate valuation is advocated in Dunlap, *It Is Time For A Change*, *PUBLIC UTILITIES FORTNIGHTLY*, March 27, 1975, at 25-26.

262. See Brophy, *The Utility Problem of Regulatory Lag*, *PUBLIC UTILITIES FORTNIGHTLY*, January 30, 1975, at 21.

263. The regulatory lag of utility commissions in failing to respond to capital market changes has been cited as a cause of declining earnings:

Over this last decade, the utilities' risk return status has so deteriorated that investors have lost much of the confidence they once had in utilities because utilities' stocks have performed so poorly compared to investor expectations. Currently, the utilities find it much more difficult and expensive to attract investors' capital

The risk differential which formerly existed (prior to and up through the mid-1960's) in favor of utilities as compared to industrial firms no longer exists; indeed, the utilities as a group are now more risky than high-grade industrials as a group. This change is primarily attributable to the unprecedented inflation that has occurred since the mid-1960's and to the deeply ingrained expectation that we shall not soon achieve relative price level stability. These facts, plus the problem of regulatory lag, and in many cases, inadequate upward adjustments in allowed rates of return by commissions at both federal and state levels, have resulted in the failure of utility earnings to keep pace with earnings in the industrial sector.

West & Eubanks, *Automatic Cost of Capital Model*, *PUBLIC UTILITIES FORTNIGHTLY* May 22, 1975, at 28-31. See also Lerner, *Impact of Competition on Rate of Return*, *PUBLIC UTILITIES FORTNIGHTLY*, December 5, 1974, at 28-33. *Contra*, *TEXPIRG, REGULATION OF TELEPHONE & ELECTRIC UTILITIES* 2-7 (1975).

rates that would enable a utility "to recover its operating expenses together with a reasonable return on its invested capital."²⁶⁴ The degree to which this can be accomplished is dependent upon the expertise with which the commission staff is able to analyze all relevant data with regard to rate adjustment, and the extent to which hearings on statements of intent to effect rate changes are expedited.²⁶⁵ By abandoning the concept of fair value and thus dealing with fewer intangibles and a more accurate reflection of actual cost, the commission will have the capacity to permit both a reasonable return for the utility and its investors, and to determine rates which are fixed in a manner that is fair to the consumer.²⁶⁶

Equipped with subpoena power²⁶⁷ and the authority to inspect any books, accounts and records of a utility,²⁶⁸ including information regarding affiliates²⁶⁹ and interests within and without the State of Texas,²⁷⁰ the commission will be able to acquire a sufficient composite of data to enable it to consider an entire business enterprise, rather than a mere subunit thereof.²⁷¹ Regulation and rate determination will assume a feature of investigative analysis of the holdings and returns of an entire utility operation not possible under former Texas law. Consideration of the entire business enterprise will include not only affiliated interests, but also the net income of a public utility, specifically any tax benefits which accrue to a consolidated utility which would not otherwise be required to reduce the cost of its property by the intercompany profits realized.²⁷²

Lobbying expenditures are expressly prohibited from entering into rate-making determinations, and the regulatory commission is vested with discre-

264. TEX. LAWS 1975, ch. 721, § 39, at 2341.

265. There is no provision in the Act for an automatic cost of capital adjustment to rates. "No utility may make changes in its rates except by filing a statement of intent . . . at least 35 days prior to the effective date of the proposed change." *Id.* § 43(a), at 2343.

266. The importance of rate base determination is illustrated by the following formula:

Three elements are involved in the determination of allowable earnings, namely, utility plant and accrued depreciation—the two elements used to determine rate base or property value—and rate of return which, when considered in connection with rate base, gives total allowable earnings. . . . The earnings formula can be stated thus:

$$\begin{array}{l} \text{Utility plant} \\ - \text{Accrued depreciation . . .} \\ = \text{Rate base} \\ \times \text{Rate of return} \\ = \text{Allowable earnings} \end{array}$$

R. CAYWOOD, *ELECTRIC UTILITY RATE ECONOMICS* 174-75 (1972 ed.).

267. TEX. LAWS 1975, ch. 721, § 29(a), at 2339.

268. *Id.* §§ 27(d), 29(a), at 2338-39.

269. *Id.* § 3(i), at 2329.

270. *Id.* § 28(a)(1), at 2338.

271. *See* *General Tel. Co. v. City of Wellington*, 156 Tex. 238, 245-46, 294 S.W.2d 385, 390 (1956).

272. TEX. LAWS 1975, ch. 721, § 41(c)(2), at 2342.

tion to exclude consumption-inducing and public relations advertising expenses if the commission determines that such expenditures are unreasonable or not in the public interest.²⁷³ The limitation on expenses allowable in consumption oriented advertising could represent an aggregate savings to Texas consumers of more than \$33,000,000 based on the expenditures made by privately owned electric utilities in 1972.²⁷⁴ It should be noted that although most states have the authority to limit such expenses,²⁷⁵ more than \$314,000,000 was spent by privately owned electric utilities nationwide in that same year.²⁷⁶ The commission may require each utility to submit an annual report delineating the expenditures made in these and in related matters.²⁷⁷

A utility is required to give at least 35 days notice prior to the effective date of a proposed rate change to the regulatory authority having jurisdiction over that utility.²⁷⁸ In addition, notice by publication is required once each week for four weeks in a newspaper of general circulation in each county where rates will be affected by the change.²⁷⁹ The commission is required to hold hearings within 30 days of the date on which the change has been or would be effective either on its own motion or on a complaint filed by any

273. *Id.* § 30, at 2339.

274. FPC, STATISTICS OF PRIVATELY OWNED ELECTRIC UTILITIES IN THE UNITED STATES 501-27A (1972). It should be noted that privately owned electric utilities in Texas have spent nearly six times the dollar amount in advertising and sales than in research and development. Listed are the expenditures in each category made by privately owned electric utilities operating in Texas in 1972:

ADVERTISING AND SALES EXPENSES AND RESEARCH AND DEVELOPMENT
EXPENSES OF PRIVATELY OWNED ELECTRIC UTILITIES IN TEXAS—1972^a

COMPANY	\$Research & Development ^b	\$Advertising & Sales ^c	R & D % of A & S
Houston Lighting & Power Co.	2,846,147	4,382,132	65.0
Gulf States Utilities Co. ^d	545,955	2,602,440	21.0
West Texas Utilities Co.	104,672	861,150	12.2
Central Power & Light Co.	377,040	3,138,981	12.0
Texas Electric Service Co.	620,394	5,864,501	10.6
Dallas Power & Light Co.	365,495	3,488,947	10.5
Southwestern Electric Power Co.	204,015	2,933,599	7.0
Texas Power & Light Co.	444,786	6,528,604	6.8
El Paso Electric Co.	31,935	548,849	5.8
Community Public Service Co.	32,035	982,294	3.3
Southwestern Public Service Co.	55,713	2,041,276	2.7
Southwestern Electric Service Co.	0	163,941	—
TOTALS	5,628,187	33,536,714	—

a. FPC, STATISTICS OF PRIVATELY OWNED ELECTRIC UTILITIES IN THE UNITED STATES (1972).

b. *Id.* at 741-44.

c. *Id.* at 509A, 523-24A.

d. Includes operations within and without the State of Texas.

275. FPC, FEDERAL AND STATE COMMISSION JURISDICTION AND REGULATION 38 (1973).

276. FPC, STATISTICS, *supra* note 274.

277. TEX. LAWS 1975, ch. 721, § 30, at 2339.

278. *Id.* § 43(a), at 2343.

279. *Id.* § 43(a), at 2343.

person affected by the proposed change.²⁸⁰ When a "major change" in rates is proposed the commission is required to hold a hearing in every case,²⁸¹ but when no protest of the change has been filed an "informal hearing" is permitted.²⁸² The commission is vested with the authority to suspend any proposed change in rates for a period of 120 days, followed by an extension not to exceed another 30 days.²⁸³ If there is no final determination made on the proposal for rate change, the proposal is to be regarded as having been approved, subject only to the final determination of the commission in a hearing already in progress.²⁸⁴

If the utility initiates a change in rates in any amount found to be unreasonable or in excess of the final determination of the commission, such amounts realized must be refunded or credited with interest to the rate payers.²⁸⁵ Prior Texas law utilized the concept of "water over the dam," and a utility was not required to return excessive profits to the consumer since the authority to fix rates was deemed not to apply to rates already collected.²⁸⁶

The commission is financed by an initial appropriation in the amount of \$2,501,200.²⁸⁷ Augmenting this amount is an assessment of one-sixth of one percent of the gross receipts on rates charged by utilities to Texas consumers.²⁸⁸ This amount is intended to defray the cost of commission operations and regulation, and may be adjusted from year to year by the commission, subject to the approval of the legislature.²⁸⁹

CONCLUSION

The creation of a Public Utility Regulatory Commission for the State of

280. *Id.* § 43(c), at 2343.

281. A major change in rates is defined as "an increase in rates which would increase the aggregate revenues of the applicant more than the greater of \$100,000 or two and one-half percent . . ." *Id.* § 43(b), at 2343.

282. *Id.* § 43(c), at 2343.

283. *Id.* § 43(d), at 2343.

284. *Id.* § 43(d), at 2343.

285. *Id.* § 43(e), at 2344.

286. *City of El Paso v. El Paso City Lines*, 227 S.W.2d 278 (Tex. Civ. App.—El Paso 1949, writ ref'd n.r.e.).

287. This amount represents the total for the biennium. For the year ending August 31, 1976, \$1,244,000 was appropriated; for the year ending August 31, 1977, the legislature has appropriated \$1,257,200. TEX. LAWS 1975, ch. 743, at 2416. The Act's assessment and appropriation placed Texas in reasonable conformity with other jurisdictions. Twelve states finance their state regulatory commissions exclusively from general tax funds, 14 states finance from taxes and fees levied on utilities, and the remainder utilize a combination of the two methods. FPC, FEDERAL AND STATE COMMISSION JURISDICTION AND REGULATION 136 (1973).

288. TEX. LAWS 1975, ch. 721, § 78, at 2350.

289. *Id.* §§ 78, 79, at 2350. With regard to constitutional due process questions of assessments made upon utilities for the cost of investigation and regulation see *Washington Ry. & Elec. Co. v. District of Columbia*, 77 F.2d 366, 369 (D.C. Cir. 1935), where expenses of investigations and proceedings borne by the public utility as a franchise tax

Texas represents a significant achievement for the consumer.²⁹⁰ The abandonment of the fair value method in the formulation of rate bases, which excludes lobbying expenses and limits allowable expenditures in advertising and public relations, are noteworthy features of the new law. The conflict of interest provisions prescribing civil and criminal penalties for their violation are also important features to weigh when considering the positive aspects of the Public Utilities Regulatory Act.

The most important function of the commission will be to regulate the profits of those utilities within its jurisdiction in such a manner as to be an effective substitute for the forces of competition extant in other business enterprises not so protected by law.²⁹¹ The Act provides the commission with the potential by which it can control the pervasive lack of uniformity in rate determinations which have burdened the Texas consumer in the past.²⁹²

There are serious weaknesses with the new law that must be noted in addition to the features just mentioned. The retention of exclusive original jurisdiction by municipal governing bodies in the regulation of utilities, except telephone utilities, will only weaken the effectiveness of the commission. Except for regulation in rural areas, the jurisdiction of the commission is dependent upon affirmative action by municipal governing bodies, or citizen action which will place the matter before the electorate. The exclusion of a municipality from commission regulation for a five year period after such governing body has reasserted its jurisdictional prerogative is an additional fragmentation of regulatory power of the commission. To some extent the resources of the state regulatory commission will be available on request to assist a municipality retaining or recapturing its jurisdiction over utilities,²⁹³ but the maintenance of local control offers Texas a mere continuation of piecemeal regulation.

The creation of a public utility commission can offer only qualified relief for Texas consumers already burdened with high utility costs. A centralized state regulatory body with the capacity and expertise to coordinate, compile and analyze all relevant factors in determining a rate which is reasonable both for the utility and the consumer can operate to eliminate the regional disparities of rates in Texas. Whether or not such capacity is effectual will depend primarily on the commissioners and on municipalities capable of assessing their limitations in dealing with those utilities within their jurisdiction.

were not unconstitutional when such expenses could be charged to the operating expenses of the company. See TEX. LAWS 1975, ch. 721, § 41(b), (c), at 2342.

290. Formidable opposition to statewide utility regulation in Texas has been commonplace. See, PUBLIC UTILITIES FORTNIGHTLY, December 5, 1974, at 50; THE TEXAS OBSERVER, VOL. LXVII, No. 12, June 20, 1975, at 10.

291. R. CAYWOOD, ELECTRIC UTILITY RATE ECONOMICS 174 (1972 ed.).

292. Fulda, *Telephone Regulation in Texas: Should Regulation by Cities Be Replaced by a State Commission?*, 45 TEXAS L. REV. 611, 649 (1967).

293. TEX. LAWS 1975, ch. 721, § 28(b), at 2339.