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COST ADJUSTMENT IN UTILITY RATE SCHEDULES

JOE H. FOY*

For many years public utilities and regulatory commissions have been greatly concerned over the time and expense involved in proceedings relative to utility rates. Few types of legal proceedings are more complex, intricate and expensive than the full-blown utility rate case, with its myriad problems in valuation, economics, accounting, law and engineering. Particularly during inflationary periods, such as the present, mounting expenses of operation confront utilities and commissions with the dismal prospect of repeated applications for rate adjustment and formal hearings thereon. It is not surprising that techniques have been sought to simplify the rate making process, consistent with the duty of regulatory commissions to maintain supervision of utility rates in the public interest. One such technique is a provision which, without formal proceedings, increases or decreases utility rates in proportion to increases or decreases in an operating expense.

The most common of such provisions is the fuel adjustment clause in electric utility rate schedules. By this provision, the electric rate is increased or decreased by a fixed amount for each increase or decrease over or under a certain "base cost" per unit of coal, natural gas or other fuel consumed in the generation of electricity. A similar provision in natural gas schedules increases or decreases rates by the same amount in which increases or decreases occur above or below a certain "base cost" of gas purchased. Utilities have also sought, in recent years, automatic adjustment clauses which would increase rates in proportion to increases in federal, state and local taxes.

The purpose of this article is to review the development of various kinds of adjustment clauses¹ and to discuss their legal and practical basis. This article will be concerned only with those provisions which adjust for increases or decreases in operating costs, excluding from consideration, therefore, the so-called "competitive fuel" clauses and the type of adjustment clause which is geared to changes in the commodity index.

I. HISTORICAL GENERALIZATION

In earlier years, the regulatory commissions very frequently refused to adopt adjustment clauses. The reason most commonly ad-

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1. Although courts and commissions frequently refer to these clauses as "escalator clauses," the use of that terminology will be avoided herein. "Escalation" has come to mean incremental price increases at regular or fixed intervals, whereas an adjustment clause adjusts a utility rate upward or downward, along with increases or decreases in an operating cost.

vanced was that the use of such a provision would be an unlawful delegation to the utility of the commission's authority to regulate rates.² Some commissions thought the technique to be incompatible "with the spirit and purpose" of a regulatory law;³ others, that authority to increase rates could not be made contingent upon a future event.⁴ Another reason sometimes advanced was that fluctuating utility rates would confuse the consumer, who was considered to have a right to know his utility rate with certainty in advance.⁵ Adjustment clauses were denied where competition between suppliers of fuel to a utility tended to keep fuel prices in line.⁶ And it was said that the allowance of automatic adjustment for increases in fuel prices would reduce management's incentive to buy fuel as cheaply as possible.⁷ There was among some of the commissions the feeling that utility rates should not be subject to automatic adjustment upon consideration of only a single cost factor, such as the cost of fuel,⁸ since other costs might have decreased. On the other hand, one Commission denied an automatic adjustment clause which would have been based on all operating costs.⁹

As early as 1917, however, coal cost adjustment clauses were added to electric rate schedules in Illinois and New Hampshire.¹⁰ The following year regulatory bodies in Maryland, Massachusetts and Missouri permitted automatic adjustment of rates for electric service to industrial customers.¹¹ Illinois, in 1924, applied automatic fuel cost adjustment to industrial gas rates of a manufactured gas utility.¹² By 1921, both California and Indiana had extended fuel cost adjust-

2. Rockford Elec. Co., 1917F P.U.R. 196 (Ill. Pub. Util. Comm'n 1917); Jones v. Montpelier and B. Light & Power Co., 1921D P.U.R. 145 (Vt. Pub. Serv. Comm'n 1921).

3. Fox v. Pine Grove Elec. Light, Heat & Power Co., 1920B P.U.R. 380 (Penna. Pub. Serv. Comm'n 1921).

4. Indiana Service Corp., 1930B P.U.R. 278 (Ind. Pub. Serv. Comm'n 1930).

5. Washington Gas Light Co., 1920D P.U.R. 626 (D.C. Pub. Util. Comm'n 1920); Public Service Gas Co., 1920E P.U.R. 395 (N.J. Pub. Util. Comm'n 1920); Jones v. Montpelier and B. Light & Power Co., 1921D P.U.R. 145 (Vt. Pub. Serv. Comm'n 1921).

6. Washington Gas Light Co., 1920D P.U.R. 626 (D.C. Pub. Util. Comm'n 1920).

7. Fox v. Pine Grove Elec. Light, Heat & Power Co., 1920B P.U.R. 380 (Pa. Pub. Serv. Comm. 1920).

8. Rockford Elec. Co., 1917F P.U.R. 196 (Ill. Pub. Util. Comm'n 1917); Rochester Gas & Elec. Corp., 1921A P.U.R. 415 (N.Y. Pub. Serv. Comm'n 1920); PUC v. Newport Water Corp., 1933E P.U.R. 1 (R.I. Pub. Util. Comm'n 1933).

9. Plymouth Gaslight Co., 1919A P.U.R. 339 (Mass. Bd. Gas & Elec. Commr's 1919).

10. Alton Gas & Elec. Co., 1917F P.U.R. 12 (Ill. Pub. Util. Comm'n 1917); Rockingham County Light & Power Co., 1917F P.U.R. 24 (N.H. Pub. Serv. Comm'n 1917).

11. Public Service Comm'n v. Consolidated Gas, Elec. & Power Co., 1919A P.U.R. 66 (Md. Pub. Serv. Comm'n 1918); Union Elec. Light & Power Co., 1918E P.U.R. 490 (Mo. Pub. Serv. Comm'n 1918); Westfield, 1919B P.U.R. 34 (Mass. Bd. Gas & Elec. Commr's 1918).

12. Public Service Co., 1924B P.U.R. 386 (Ill. Pub. Util. Comm'n 1923).

ment to domestic rate schedules.¹³

The spread of adjustment clauses into industrial electric rate schedules rapidly became quite general. The same trend was evident in manufactured gas schedules, until the rapid shift into natural gas commenced in the 1940's.¹⁴ However, a feeling persisted in some states that the fuel adjustment clause should not be carried over into domestic and small commercial rate schedules, because the fuel required to generate electricity for these customers was proportionately less significant than that required for industrial service.¹⁵

During the 1940's, the war effort, combined with other factors, brought about the building of long pipelines for the transmission of natural gas from the southwest to the heavily populated east. The use of natural gas became prevalent in the eastern states, both as a burner-tip fuel for the public, and as a fuel used in the generation of other types of power. The rapid growth in the use of natural gas has accelerated the acceptance of adjustment clauses, because of the rapid changes in natural gas prices.

As demand for natural gas has grown in areas outside the southwest, competition for reserves has become very keen. Prices have been bid up to record levels; but in addition, escalation clauses and "favored nations" clauses¹⁶ have triggered further price increases.

The table on the following page shows the increase in weighted average prices at the well head, year by year, for ten major pipeline companies, 1948 through 1957. Obviously, both gas and electric utilities need protection against this continuing and substantial increase in operating expense.

II. LEGAL BASIS

The validity of adjustment clauses has been squarely presented to courts in two recent cases: *City of Norfolk v. Virginia Electric & Power Company*¹⁷ and *City of Chicago v. Illinois Commerce Commission*.¹⁸ In both cases, representatives of the consumers argued that adoption of the clauses was an abdication of the regulatory power and an unlawful sub-delegation of such power to the utility. In answer to this argument the Illinois court, quoting from the earlier

13. Southern Calif. Gas Co., 1922A P.U.R. 536 (Calif. R.R. Comm'n 1921); Los Angeles Gas & E. Corp., 1922A P.U.R. 283 (Calif. R.R. Comm'n 1921); Indiana General Service Co., 1921A P.U.R. 337 (Ind. Pub. Serv. Comm'n 1920).

14. Report of Committee on Rates, American Gas Association, 56 PUBLIC UTILITIES FORTNIGHTLY, 894 (1955).

15. New York Edison Co., 10 (N.S.) P.U.R. 244 (N.Y. Pub. Serv. Comm'n 1935).

16. A "favored nations" clause, in general, provides that if a better price is paid by buyer for gas in any field in a certain area, the seller must also receive the benefit of that price.

17. 197 Va. 505, 90 S.E.2d 140 (1955).

18. 13 Ill. 2d 607, 150 N.E.2d 776 (1958).

Weighted Average Prices Paid to Producers for Gas Purchased
in the Field by 10 major pipeline companies
(Includes 745.11 Field Purchases and 745.12 Gasoline Plant Outlet Purchases)
14.65 Psia

Source: FPC Annual Reports

	Cents per Mcf										
	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957	
Arkansas Louisiana Gas Company	3.31	3.59	4.32	6.30	7.72	8.86	9.66	10.31	10.48	10.82	
Mississippi River Fuel Corp.	—	—	9.86	10.88	11.11	11.76	12.14	12.21	13.18	13.19	
Southern Natural Gas Company	5.67	5.94	6.25	6.18	7.03	7.94	9.38	9.76	9.95	11.16	
Tennessee Gas Trans- mission Co.	4.21	4.49	5.02	5.45	6.42	9.21	10.30	12.17	12.08	12.56	
Texas Eastern Trans- mission Corp.	6.58	6.39	6.37	6.42	7.38	11.85	12.18	12.54	12.74	12.93	
Texas Gas Transmis- sion Corp.	—	6.77	6.66	7.22	7.14	9.63	9.75	9.85	10.03	14.09	
Texas Illinois Natural Gas Pipeline Co.	—	—	—	8.55	8.40	8.74	10.34	10.66	11.12	11.71	
Transcontinental Gas Pipe Line Corp.	—	—	8.27	7.08	7.40	7.70	7.78	9.83	10.61	11.09	
Trunkline Gas Company	—	—	—	7.61	7.63	7.91	8.34	10.19	11.25	11.38	
United Gas Pipe Line Company	3.61	4.22	4.95	5.75	7.22	7.86	8.32	8.99	10.36	11.42	
Total (Weighted Average)	4.16	4.71	5.34	6.15	7.31	8.64	9.39	10.22	10.97	11.92	

Virginia decision, said:

The proposed escalator clause is nothing more or less than a fixed rule under which future rates to be charged the public are determined. It is simply an addition of a mathematical formula to the filed schedules of the Company under which the rates and charges fluctuate as the wholesale cost of gas to the Company fluctuates. Hence, the resulting rates under the escalator clause are as firmly fixed as if they were stated in terms of money.¹⁹

The court emphasized that rates for public utility service may be fixed either in dollars and cents or in principle by a standard. Either sufficiently complied with a statute which did not specifically authorize the use of adjustment clauses. Although the utility affected was an affiliate of the wholesaler in proportion to whose price the rate would vary, the Virginia court found this to be no legal objection to the clause.

Other court decisions have established that the approval of an automatic adjustment provision is not an abdication of the administrative power to control utility rates. The Supreme Court of North Carolina recently held that the base cost in a fuel clause may be raised, over the utility's protest, without the necessity of a full rate hearing.²⁰ And the Pennsylvania Superior Court has held that the Commission could amend an adjustment clause by substituting a variable thermal efficiency factor for a fixed thermal efficiency factor.²¹

A number of states have adopted statutes which specifically authorize fluctuating rates. The most explicit of these is the Pennsylvania provision that "any public utility . . . may establish a sliding scale of rates, or such other method for the automatic adjustment of the rates of the public utility as shall provide a just and reasonable return on the fair value of the property used and useful in the public service . . ." ²² Statutes authorizing sliding scale charges, or an arrangement for "the automatic adjustment of charges . . . in relation to the profit to be realized" by the utility, have been adopted in a number of states.²³ Whether specifically authorized by the regulatory statutes or not, there would seem to be little doubt today about the authority of regulatory commissions to provide for the automatic adjustment of utility rates in proportion to a fluctuating cost.

19. 197 Va. 505, 90 S.E.2d 140, 148 (1955).

20. *Utilities Commission v. Carolina Power & Light Co.*, 250 N.C. 421, 109 S.E.2d 253 (1959).

21. *Duquesne Light Co. v. Pennsylvania Public Utilities Comm'n*, 176 Pa. Super Ct. 568, 107 A.2d 745 (1954).

22. PA. STAT. ANN. tit. 66, § 1147 (1941).

23. ARIZ. CODE ANN. § 40-368 (1956); ARK. STAT. ANN. § 73-219 (1947); CALIF. PUB. UTIL. CODE § 457 (1951); COLO. REV. STAT. ANN. § 115-3-7 (1953); MD. ANN. CODE art. 78 § 47 (1956 Cum. Supp.); MO. REV. STAT. § 393.139(4) (1949); N.Y. Pub. Serv. Law § 65.4 (1955); UTAH CODE ANN. § 54-3-9 (1953).

III. MODERN JUSTIFICATION AND APPROVAL

An overwhelming majority of the commissions have found great practical justification for approving adjustment clauses. In the absence of such a clause, each increase in the cost of fuel or of purchased gas must be made the subject of an application for a rate increase if the utility is to be made whole. The resulting rate investigation and hearing is expensive and time-consuming, both for the utility and the commission. In the usual situation, a utility is not permitted to collect the increased rate pending the final order of the commission, and thus revenues are lost to the utility forever since a utility is not permitted to collect rates compensating for past losses.²⁴ The Virginia State Corporation Commission justified the inclusion of a purchased gas cost adjustment clause by the following language:

But the main purpose of the escalator clause is procedural: When prices are rising, the time that necessarily elapses between the date when earnings fall below the permissible minimum rate of return and the date when the commission enters its order allowing increased rates, is a time during which the utility earns less than a fair and reasonable return. When prices are falling, the process is reversed

The inevitable delay between the happening of an event that entitles a party to legal relief and the date when he gets relief, makes it impossible in some kinds of cases for law and equity to do complete justice. Ever since Hamlet mentioned "the law's delay" as one of the things that made him wonder whether it would be better "to be or not to be," lawyers and legislators have sought ways of overcoming so far as possible the time lag in the machinery of justice.²⁵

In its 1955 report, the Committee on Rates of the American Gas Association pointed out that the adjustment clause has served to reduce the volume of rate cases and to conserve the time of regulatory bodies.²⁶ In this connection, the Virginia Commission predicted that "the alternative to the escalator clause, in view of the many changes in the cost of natural gas to the Company, is a series of rate cases—perhaps one or more major rate cases for each gas distributor in Virginia every year."²⁷ The Maine Public Utility Commission has stressed the need for flexibility in utility rates as a reason for adopting fuel adjustment clauses:

Now, as a general principle, the fuel adjustment clause points the way toward the solution of one of the more acute problems in the utility

24. *N.J. Power & Light Co. v. State Dep't of Public Utilities*, 15 N.J. 82, 104 A.2d 1 (1954).

25. *Lynchburg Gas Co.*, 6 P.U.R. 3d 33, 35 (Va. St. Corp. Comm. 1954).

26. 56 *PUBLIC UTILITIES FORTNIGHTLY*, 894 (1955).

27. *Virginia Elec. & Power Co.*, 7 P.U.R. 3d 108, 114 (Va. St. Corp. Comm'n 1954).

rate-making field, namely, that of integrating public utility rates, which are generally of a rigid nature, into a flexible national economy. The economic system of the country has been subjected to an increasing degree of strain by virtue of the tension occasioned by rigid public utility rates in a nonrigid general price situation. Anything that can be done to bring utility rates more nearly into harmony with the general economic system, is to that extent a public gain.²⁸

The Maine Commission was also impressed by the fact that the adjustment clause provides a means of keeping utility rates more nearly in line with consumer purchasing power. "Fuel adjustment clauses also bring about a reduction in customer payment during a period of falling prices in depression eras, when customers are most in need of reducing their living expenses. Likewise, the increase in price to a customer occurring in an upward swing of price levels, takes place at a time when the ability of a customer to pay, as measured in dollars, has in most instances, moved upward."²⁹ In a period of declining prices, the clause is of immediate benefit to the consumer, and the regulatory lag, which then would work against the consumer's interest, would again be avoided. Fuel cost adjustment is now incorporated in electric rate schedules in at least 40 states and the District of Columbia.³⁰ Purchased gas cost adjustment clauses are in use in 37 states and the District of Columbia.³¹ A number of the orders adopting adjustment clauses have been published. Some of the orders have granted fuel adjustment clauses in industrial electric schedules only,³² while a majority have extended the application of the clause to domestic schedules as well.³³ Purchased gas cost ad-

28. Central Maine Power Co., 22 P.U.R. 3d 466, 467 (Me. Pub. Util. Comm'n 1958).

29. *Ibid.*

30. EDISON ELEC. INSTITUTE RATE BOOK (1957).

31. AMERICAN GAS ASS'N RATE SERVICE (1957).

32. San Diego Gas & Elec. Co., 52 (N.S.) P.U.R. 222 (Calif. R.R. Comm'n 1943); Southern Calif. Edison Co., Ltd., 41 (N.S.) P.U.R. 292 (Calif. R.R. Comm'n 1941); Potomac Elec. Power Co., 8 P.U.R. 3d 76 (D.C. Pub. Util. Comm'n 1955); Georgia Power & Light Co., 74 (N.S.) P.U.R. 69 (Ga. Pub. Serv. Comm'n 1948); Georgia Power & Light Co., 74 (N.S.) P.U.R. 65 (Ga. Pub. Serv. Comm'n 1948); Gulf States Utilities Co., 88 (N.S.) P.U.R. 225 (La. Pub. Serv. Comm'n 1950); Central Louisiana Elec. Co., Inc., 74 (N.S.) P.U.R. 110 (La. Pub. Serv. Comm'n 1948); Detroit Edison Co., 78 (N.S.) P.U.R. 360 (Mich. Pub. Serv. Comm'n 1949); Community Public Service Co., 93 (N.S.) P.U.R. 18 (N.M. Pub. Serv. Comm'n 1951); Carolina Power & Light Co., 73 (N.S.) P.U.R. 33 (N.D. Pub. Util. Comm'n 1948); Cooper Tire & Rubber Co. v. Central Ohio Light & Power Co., 10 P.U.R. 3d 430 (Ohio Pub. Util. Comm'n 1955); United Ice & Coal Co. v. Pennsylvania Coal & Ice Co., 89 (N.S.) P.U.R. 432 (Pa. Pub. Util. Comm'n 1951); Southern Utah Power Co., 77 (N.S.) P.U.R. 109 (Utah Pub. Serv. Comm'n 1949); Virginia Elec. & Power Co., 7 P.U.R. 3d 108 (Va. St. Corp. Comm'n 1954); Wisconsin-Michigan Power Co., 76 (N.S.) P.U.R. 153 (Wis. Pub. Serv. Comm'n 1948).

33. Arkansas Power & Light Co., 13 P.U.R. 3d 1 (Ark. Pub. Serv. Comm'n 1956); Hartford Elec. Light Co., 95 (N.S.) P.U.R. 161 (Conn. Pub. Util. Comm'n 1952); Uniform Fuel Clause, 57 (N.S.) P.U.R. 250 (Conn. Pub. Util. Comm'n 1945); Uniform Fuel Clause for Electric Companies, 54 (N.S.) P.U.R. 57 (Conn. Pub. Util. Comm'n 1944); The Connecticut Light & Power Co., 44 (N.S.) P.U.R.

justment schedules are generally applicable to all classes of rates,³⁴ although some of the orders have applied them to industrial or large consumer rates only.³⁵

Adjustment clauses geared to changes in taxes and other costs not directly proportional to the volume of business done have not gained any substantial acceptance.³⁶ Two requirements seem to govern the general acceptability of automatic adjustment provisions. First, the expense in proportion to which automatic adjustment is sought should be a relatively uncontrollable expense; otherwise, the utility management could cause rate increases either deliberately or by improvidence.³⁷ Secondly, the expense should bear a direct relation to the volume of business done; otherwise, the adjustment cannot be made so as to recover for the utility precisely the increase which has occurred in operating costs.³⁸

The purchased gas cost adjustment clause obviously operates more precisely than either the fuel cost adjustment clause or the tax adjustment clause since the commodity purchased is merely resold

65 (Conn. Pub. Util. Comm'n 1942); Florida Power & Light Co., 19 P.U.R. 3d 417 (Fla. R.R. & Pub. Util. Comm'n 1957); Florida Public Utility Co., 16 P.U.R. 3d 474 (Fla. R.R. & Pub. Util. Comm'n 1956); Rush County Rural Elec. Membership Corp., 72 (N.S.) P.U.R. 128 (Ind. Pub. Serv. Comm'n 1947); Southeastern Indiana Power Co., 71 (N.S.) P.U.R. 148 (Ind. Pub. Serv. Comm'n 1947); Central Maine Power Co., 22 P.U.R. 3d 466 (Me. Pub. Util. Comm'n 1958); Boston Edison Co., 24 P.U.R. 3d 153 (Mass. Dep't Pub. Util. 1958); Cambridge Elec. Light Co., 18 P.U.R. 3d 318 (Mass. Dep't Pub. Util. 1957); Plymouth County Elec. Co., 18 P.U.R. 3d 315 (Mass. Dep't Pub. Util. 1957); Duke Power Co., 75 (N.S.) P.U.R. 33 (N.C. Util. Comm'n 1948); Public Service Co. of N.M., 21 P.U.R. 3d 234 (N.M. Pub. Serv. Comm'n 1957); Pennsylvania Pub. Util. Comm'n v. Metropolitan Edison Co., 13 P.U.R. 3d 29 (Pa. Pub. Util. Comm'n 1956); National Forge & Ordnance Co. v. Pennsylvania Elec. Co., 99 (N.S.) P.U.R. 161 (Pa. Pub. Util. Comm'n 1953); Narragansett Elec. Co., 21 P.U.R. 3d 113 (R.I. Dep't Bus. Reg., Pub. Util. Admin. 1957).

34. New Haven Gas Light Co., 70 (N.S.) P.U.R. 187 (Conn. Pub. Util. Comm'n 1947); Washington Gas Light Co., 4 P.U.R. 3d 105 (D.C. Pub. Util. Comm'n 1954); Gainesville Gas Co., 18 P.U.R. 3d 59 (Fla. R.R. & Pub. Util. Comm'n 1957); Western Ky. Gas Co., 21 P.U.R. 3d 394 (Ky. Pub. Serv. Comm'n 1957); Brooklyn Borough Gas Co., 100 (N.S.) P.U.R. 271 (N.Y. Pub. Serv. Comm'n 1953); Haverhill Gas Light Co., 79 (N.S.) P.U.R. 423 (Mass. Dep't Pub. Util. 1948); Arlington Gas Light Co., 74 (N.S.) P.U.R. 442 (Mass. Dep't Pub. Util. 1948); Piedmont Gas Co., 71 (N.S.) P.U.R. 19 (N.C. Pub. Util. Comm'n 1947); Elizabethton Consol. Gas Co., 96 (N.S.) P.U.R. 487 (N.J. Pub. Util. Comm'n 1952); South Jersey Gas Co., 96 (N.S.) P.U.R. 71 (N.J. Pub. Util. Comm'n 1952); Ohio Fuel Gas Co., 25 P.U.R. 3d 207 (Ohio Pub. Util. Comm'n 1958); Lynchburg Gas Co., 6 P.U.R. 3d 33 (Va. St. Corp. Comm'n 1954); Wisconsin Southern Gas Co., 24 P.U.R. 3d 378 (Wis. Pub. Serv. Comm'n 1958); Wisconsin Power & Light Co., 9 P.U.R. 3d 422 (Wis. Pub. Serv. Comm'n 1955).

35. Southern Counties Gas Co. of Calif., 1 P.U.R. 3d 475 (Calif. Pub. Util. Comm'n 1953); Macon Gas Co., 78 (N.S.) P.U.R. 236 (Mo. Pub. Serv. Comm'n 1949).

36. See Montana-Dakota Utility Co., 13 P.U.R. 3d 523 (Wyo. Pub. Serv. Comm'n 1956) and Montana-Dakota Utility Co., 18 P.U.R. 3d 166 (Wyo. Pub. Serv. Comm'n 1957).

37. Lynchburg Gas Co., 6 P.U.R. 3d 33 (Va. St. Corp. Comm'n 1954).

38. South Carolina Generating Co., 23 P.U.R. 3d 499, 508 (Fed'l. Power Comm'n 1958).

without transferring it into a different form of energy. At least one state has permitted gas cost adjustment while denying fuel cost adjustment.³⁹

On the other hand, the Federal Power Commission regularly permits the filing of electric rate schedules containing fuel cost adjustment clauses,⁴⁰ but its regulations specifically prohibit the inclusion of adjustment clauses in natural gas tariffs.⁴¹ In Texas, although 414 cities have permitted fuel cost adjustment for electric utilities operating within their jurisdiction, only 26 cities have permitted similar clauses for natural gas utilities; and the Texas Railroad Commission, having jurisdiction over intrastate pipeline rates, has denied automatic⁴² and conditionally automatic⁴³ gas cost adjustment clauses in two recent orders. The apparently inconsistent attitude of this southwestern state towards its native natural gas industry is perhaps based upon the intuitive assumption that a gas utility has a greater degree of control over the cost of gas purchased than does an electric utility.

In spite of the widespread and increasing usage of adjustment clauses, there are still a few commissions that have refused to approve them. The Montana Commission has expressed the belief that the public should always have an opportunity to be heard before utility rates are increased, pointing out also that not every increase in gas costs necessitates a rate increase since other operating costs may have decreased.⁴⁴ At one time, California approved adjustment clauses but now rejects them.⁴⁵ Utah also apparently has changed its position in the same way.⁴⁶ Arkansas recently disapproved a gas cost adjustment clause in industrial rates without comment.⁴⁷

In making its change of position, the Utah Commission argued "that an automatic adjustment of rates to compensate for increased

39. Kentucky Utility Co., 22 P.U.R. 3d 113 (Ky. Pub. Serv. Comm'n 1958).

40. South Carolina Generating Co., 23 P.U.R. 3d 499, 508 (Fed'l. Power Comm'n 1958).

41. FPC Reg. 154.38(d) (3); Houston, Texas, Gas & Oil Corp., 16 P.U.R. 3d 333 (Fed'l Power Comm'n 1956); Tamborello, 11 P.U.R. 3d 413 (Fed'l Power Comm'n 1955). However, the commission has provided an abbreviated procedure where a pipeline seeks to be compensated only for an increase in the cost of purchased gas which has occurred within twelve months after a previous filing and no material change has occurred in facilities, sales volume or cost of service other than the cost of purchased gas since the previous filing. FPC Reg. 154.63(b) (3).

42. Houston Pipeline Co., Gas Utilities Docket No. 246 (1958).

43. Lone Star Gas Co., Gas Utilities Docket No. 248 (1960).

44. Great Falls Gas Co., 29 P.U.R. 3d 237 (Mont. Pub. Serv. Comm'n 1959).

45. California Elec. Power Co., 23 P.U.R. 3d 275 (Calif. Pub. Util. Comm'n 1958); Pacific Gas & Elec. Co., 21 P.U.R. 3d 48 (Calif. Pub. Util. Comm'n 1951).

46. Utah Power & Light Co., 95 (N.S.) P.U.R. 390 (Utah Pub. Serv. Comm'n 1952); Southern Utah Power Co., 93 (N.S.) P.U.R. 325 (Utah Pub. Serv. Comm'n 1952).

47. Arkansas-Louisiana Gas Co., 10 P.U.R. 3d 407 (Ark. Pub. Serv. Comm'n 1955).

prices paid for fuel may encourage applicant to be less concerned in purchasing fuel at the lowest possible price.⁴⁸ Such an argument would appear to have little weight if the fuel in question is natural gas, in view of the present field market; however, the Virginia Commission has observed that where coal or oil is used as a fuel for generating electric power, it is still possible to bargain effectively for lower prices as between competing suppliers.⁴⁹

It may well be that each of the decisions unfavorable to adjustment clauses may be distinguished upon an unexpressed feeling that the expense, in the circumstances of a particular utility, is either controllable or is not proportional to the volume of business.

IV. REGULATORY PROCEDURES

While granting a more flexible means of operation to the utility, the more thoughtful commissions have taken precautions to prevent any abuse of this privilege. It is probably true that even a completely automatic adjustment clause does not surrender any of the commission's regulatory powers. Authority to investigate the reasonableness of a rate is always retained.⁵⁰ However, it has been found wise to keep the burden of initiating a change upon the utility rather than shifting it to the regulatory authority.

Many of the orders require advance notice of a proposed increase under the terms of an adjustment clause.⁵¹ Possibly to encourage a utility to absorb an increased operating expense whenever possible, many of the clauses make increases optional with the utility's management; but decreases under the clauses are usually mandatory.⁵² The New Jersey Commission has disapproved a proposed adjustment clause which would have limited any decrease to a point at which the utility would earn not less than a six percent return;⁵³ however, leave was granted to amend the clause so as to provide for unlimited and mandatory decreases proportional to decreased gas costs. At least

48. Utah Power & Light Co., 95 (N.S.) P.U.R. 390 (Utah Pub. Serv. Comm'n 1952).

49. Lynchburg Gas Co., 6 P.U.R. 3d 33 (Va. St. Corp. Comm'n 1954).

50. City of Norfolk v. Virginia Elec. & Power Co, 197 Va. 404, 90 S.E.2d 140 (1955).

51. Washington Gas Light Co., 4 P.U.R. 3d 105 (D.C. Pub. Util. Comm'n 1954) (10 days); Western Kentucky Gas Co., 21 P.U.R. 3d 394 (Ky. Pub. Serv. Comm'n 1957) (30 days); Central Maine Power Co., 22 P.U.R. 3d 466 (Me. Pub. Util. Comm'n 1958) (10 days); Worcester Gaslight Co., 9 P.U.R. 3d 152 (Mass. Dep't Pub. Util. 1955) (30 days); Elizabethton Consol. Gas Co., 96 (N.S.) P.U.R. 487 (N.J. Pub. Util. Comm'n 1952) (30 days); Pennsylvania Pub. Util. Comm'n v. Metropolitan Edison Co., 13 P.U.R. 3d 29 (Pa. Pub. Util. Comm'n 1956) (10 days).

52. Uniform Fuel Clause for Elec. Cos., 54 (N.S.) P.U.R. 57 (Conn. Pub. Util. Comm'n 1944); Washington Gaslight Co., 4 P.U.R. 3d 105 (D.C. Pub. Util. Comm'n 1954); Worcester Gaslight Co., 9 P.U.R. 3d, 152 (Mass. Dep't Pub. Util. 1955).

53. City Gas Co. of N.J., 5 P.U.R. 3d 17 (N.J. Pub. Util. Comm'n 1954).

one Commission has provided for a "neutral zone" within which fluctuations in fuel costs would not cause either an increase or a decrease, thereby rendering the adjustment clause less sensitive to minor cost variations.⁵⁴

The period over which the increased operating expense must have been experienced prior to adjustment varies from one month⁵⁵ to twelve months.⁵⁶ The use of a longer base period has the advantage of demonstrating that the increase or decrease in fuel or gas costs has become definitely established; the shorter period has the advantage of using only the most recent experience.

Many of the jurisdictions have imposed detailed reporting requirements upon the utility increasing rates under a cost adjustment clause. Kentucky, for example, has required a balance sheet, a twelve-months operating statement, a twelve-months statement of purchased gas costs, and a twelve-months forecast of such costs.⁵⁷ New Jersey has required an automatic gas cost adjustment clause to be amended so as to provide that no increase shall go into effect unless the company shall file sufficient information to establish that the increase is warranted in the light of all factors.⁵⁸ Rather common is a provision which expressly reserves to the commission power to suspend a proposed increase.⁵⁹ A Kentucky order provides that no increase shall go into effect unless first approved by commission order.⁶⁰

A requirement that any increase must be approved by commission order gives the public some assurance that the justifiability of the increase has been considered. For the utility's protection, such a requirement should always be coupled with the provision that unless disapproved within a certain time, the increase shall be deemed to have been approved. Otherwise, the advantages of an adjustment clause could be frittered away by mere inattention or delay on the part of the commission.

An ordinance by the City of Houston, regulating Houston Lighting and Power Company, imposes the additional requirement of annual reports retrospectively covering the operation of the fuel adjustment clause.⁶¹ It provides that any amount collected in excess of the actual

54. Uniform Fuel Cost, 57 (N.S.) P.U.R. 250 (Conn. Pub. Util. Comm'n 1945).

55. Arkansas Power & Light Co., 13 P.U.R. 3d 1 (Ark. Pub. Serv. Comm'n 1956).

56. Western Ky. Gas Co., 21 P.U.R. 3d 394 (Ky. Pub. Serv. Comm'n 1957).

57. Western Ky. Gas Co., *supra* note 56.

58. New Jersey Natural Gas Co., 6 P.U.R. 3d 249 (N.J. Pub. Util. Comm'n 1954).

59. Washington Gas Light Co., 4 P.U.R. 3d 105 (D.C. Pub. Util. Comm'n 1954); Worcester Gas Light Co., 9 P.U.R. 3d 152 (Mass. Dep't Pub. Util. 1955).

60. Western Ky. Gas Co., 21 P.U.R. 3d 394 (Ky. Pub. Serv. Comm'n 1957).

61. Houston, Tex., Ordinance 59-882, June 24, 1959.

increases in fuel costs must be refunded through billing credits over a twelve-months period. This provision will correct any erroneous overcharges occasioned by errors in the conversion factor, or by increased thermal or generating efficiency. While heat content, thermal, generating and delivery efficiency and other technical factors should be carefully considered in advance of any adjustment of electric rates for increased fuel expense,⁶² this retrospective type of examination would seem to be wise also, since the generation of electricity is subject to such rapid and substantial technological improvement.

V. CONCLUSION

Problems of regulatory lag, regulatory expense and rate case volume have become more serious and acute with the inflationary pressures of recent times. Rapid changes in the field price of natural gas have accelerated the growth of these problems. Fuel and purchased gas cost adjustment clauses have provided a practical and sound, partial solution to these problems, and have rapidly acquired almost universal acceptance. While proper administrative safeguards should be provided to prevent abuse, on the whole, such provisions do substantial justice to the utility, conserve the overtaxed time of the regulatory body, and provide for rate reductions, where reductions become appropriate because of decreased fuel or gas costs.

62. *Pennsylvania Pub. Util. Comm'n v. Metropolitan Edison Co.*, 13 P.U.R. 3d 29 (Pa. Pub. Util. Comm'n 1956).