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NOTES

ADVERTISING BY PUBLIC UTILITIES AS AN ALLOWABLE EXPENSE FOR RATEMAKING: ASSAULT ON MANAGEMENT PREROGATIVE

INTRODUCTION

Formerly, advertising¹ by public utilities² was widely regarded as a proper and beneficial activity. Advertising was considered necessary in order to stimulate the demand required to support large-scale and efficient utility industries.³ The prerogative of utility management to advertise as they pleased, within reasonable limits, was constitutionally protected.⁴

In recent years, this solicitous attitude towards utility advertising has evaporated. Because advertising is a highly visible corporate activity, it is a natural target for criticism and recommendations for greater regulation.⁵ Utilities have become a focal point for consumer resistance to rising costs, the national policy of energy conservation, and concern for the environment.⁶ These pressures have found ex-

1. Advertising has been defined as "any paid form of nonpersonal presentation and promotion of goods, services, or ideas by an identified sponsor." R. STANLEY, PROMOTION 160 (1977). This note does not include consideration of such topics as promotional rates, merchandising operations, lobbying, or charitable contributions.

2. Public utilities are defined here as those privately owned businesses subject to rate regulation which are characterized as natural monopolies. See generally Posner, *Natural Monopoly and its Regulation*, 21 STAN. L. REV. 548 (1969) [hereinafter cited as *Natural Monopoly*]. This includes primarily the telephone, gas, and electric industries, as well as some privately-owned water utilities. Excluded are utilities which are publicly owned, or transportation industries such as trucking which are regulated to operate as cartels.

3. See, e.g., *Wichita Gas Co. v. Public Serv. Comm'n*, 126 Kan. 220, 268 P. 111 (1928). The economic rationale is that these industries are characterized by great economies of scale and depend on growth of the economy and of demand to reduce their own costs and prices. 1 A. KAHN, THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS 11 (1970).

4. *West Ohio Gas Co. v. Ohio Pub. Utils. Comm'n* (No. 1), 294 U.S. 63 (1935).

5. R. STANLEY, *supra* note 1, at 182.

6. See generally Joskow, *Inflation and Environmental Concern: Structural Change in the Process of Public Utility Regulation*, 17 J.L. & ECON. 291 (1974) [hereinafter cited as *Inflation and Environmental Concern*].

pression in the treatment of advertising expenses by state regulatory commissions. In the process, the discretion of utility management to advertise has been severely curtailed.⁷

This note examines the question of whether state commissions, in their control of advertising expenses, have assumed powers to which they are not legally entitled. There can be no doubt that modern commission decisions advance important public policies and conscientiously seek to serve the public interest. There remains, however, the larger question of the appropriate restraints on the expansion of bureaucratic authority. Specifically, regulatory commissions are ignoring long-established constitutional principles which explicitly protect the right of utilities to advertise. It is arguable that these principles are directly contravened by recent commission decisions. It is also questionable whether the policies that commissions are pursuing have any nexus with the purpose of rate regulation, and therefore fall within the statutory jurisdiction of the commission. Even assuming that the current assault on management's prerogative to advertise is beneficial to the general welfare, it should not occur without serious consideration of these issues.⁸

The control of advertising costs will initially be treated from the overall perspective of two basic principles. The first of these is the purpose of ratemaking legislation as a device to prevent the monopolistic exploitation of consumers. The second is the constitutional requirement that an advertising expense not be arbitrarily disallowed. The requirement that advertising costs be reasonable is then examined as it has been applied in a manner consistent with these principles. Finally, the more recent incorporation of broad social goals and value judgments into the criteria for allowing advertising expenses, and the unresolved legal problems posed by this development, are analyzed.

One must first understand the context in which these issues arise. Ratemaking occurs when a utility applies to the regulatory commission for a rate increase. As a part of the procedure, the commission staff reviews the expenses of the firm during a selected test year.⁹ If an expense is approved by the commission, it will be incor-

7. See, e.g., *In re Hawaiian Elec. Co.*, 56 Hawaii 260, 535 P.2d 1102 (1975).

8. For a uniquely candid commentary on the "murky" state of the law in this area, see the concurring opinion of Chairman Cudahy in *Wisconsin Elec. Power Co.*, 9 P.U.R.4th 204, 219-20 (Wis. Pub. Serv. Comm'n 1975).

9. For a brief description of the entire ratemaking process, see *Natural Monopoly*, *supra* note 2, at 592-93. A more extensive analysis may be found in 1 A. KAHN, *supra* note 3, at 25-56.

porated into the rate structure and ultimately passed along to consumers.¹⁰ Technically, the ratemaking process does not determine whether the company may incur an expense.¹¹ It only determines whether the company's customers must continue to pay for it.¹² As a practical matter, the utility will be unlikely to continue incurring an expense for which it cannot be reimbursed.

The decision to allow or disallow an advertising expense must be considered in light of the original purpose behind regulating the rates of public utilities. The central theme offered here is that regulatory commissions are now disallowing advertising expenses for reasons which are unrelated to the principal function of ratemaking. That function is to prevent the utility from exploiting its monopolistic position to the detriment of consumers and the public at large. It is necessary first to consider the relationship between monopoly power and the wasteful spending which can occur when that power is regulated.

ADVERTISING EXPENSE CONTROL AND THE FUNCTION OF RATEMAKING

It is universally recognized that the goal of ratemaking is to impose controls which will simulate the results which would have occurred if the firm were subject to the pressures of competition.¹³ This objective has, on occasion, been judicially acknowledged.¹⁴

10. An allowable expense is often referred to as "above the line."

11. Attempts to directly censor or prohibit certain types of utility advertising have not survived first amendment challenges. See *Schwartz v. Romnes*, 495 F.2d 844 (2d Cir. 1974); *State v. Oklahoma Gas & Elec. Co.*, 536 P.2d 887 (Okla. 1975); *Utility Advertising*, No. 76-467 (Or. Pub. Util. Comm'r July 19, 1976).

12. *E.g.*, *Honolulu Gas Co.*, 36 P.U.R.3d 309 (Hawaii Pub. Utils. Comm'n 1960).

13. "[T]he single most widely accepted rule for the governance of the regulated industries is regulate them in such a way as to produce the same results as would be produced by effective competition, if it were feasible." 1 A. KAHN, *supra* note 3, at 17. See also 1 A.J.G. PRIEST, *PRINCIPLES OF PUBLIC UTILITY REGULATION* 1-2 (1969).

While the objective of regulation is not controversial, there is no such agreement as to whether rate regulation can achieve this goal. For a sample of the debate, see Jordan, *Producer Protection, Prior Market Structure and the Effects of Government Regulation*, 15 J.L. & ECON. 151 (1972); Joskow, *Inflation and Environmental Concern: Structural Change in the Process of Public Utility Regulation*, 17 J.L. & ECON. 291 (1974); Peltzman, *Toward a More General Theory of Regulation*, 19 J.L. & ECON. 211 (1976); Posner, *Taxation by Regulation*, 2 BELL J. ECON. & MAN. SCI. 22 (1971); Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MAN. SCI. 3 (1971).

14. The Supreme Court explicitly recognized this in *Cantor v. Detroit Edison*, 428 U.S. 579, 595-96 (1976).

The substitution of regulatory controls for the restraints of the marketplace arises from the belief that certain industries are natural monopolies. This means that a single firm is intrinsically capable of capturing an entire market. These industries are characterized by enormous initial capital investment. Once that investment is made, a single firm can service an entire market at an average unit cost which will continuously decrease as the firm grows. An established firm therefore has an advantage which effectively forecloses market entry by competitors.¹⁵

A variety of evils are believed to attend uncontrolled monopoly enterprise. Among these is the ability of the monopolist to exploit his position by charging higher prices than would occur if the firm were subject to competition.¹⁶ As a result, the firm is able to preempt some of the welfare gains which would normally accrue to consumers in a free market.¹⁷ Preventing such monopoly profit is one of the primary goals of rate regulation.¹⁸ The commission sets a rate of return to invested capital which it believes is fair. The price of utility service is designed to allow only that rate of return.¹⁹

Where the profits of the firm are controlled, the danger exists that the firm will convert monopoly profits into excessive costs. The regulated firm need not worry about more efficient competitors because it has a legally protected exclusive franchise. There is no incentive to economize on costs in order to make a greater profit because the rate of return is controlled.²⁰ The owners or managers of a utility may therefore spend more money than they would if the

15. 2 A. KAHN, *supra* note 3, at 116-26. In economic terms, a natural monopoly exists when the firm faces declining unit costs over the entire extent of the market because of economies of scale which are internal to the firm. *Id.* at 119. See also A. ALCHIAN & W. ALLEN, EXCHANGE AND PRODUCTION, THEORY IN USE 427 (1969).

16. A. ALCHIAN & W. ALLEN, *supra* note 15. This is particularly true where, as with utilities, a great deal of the demand is believed to be inelastic. See 2 A. KAHN, *supra* note 3, at 102. See also *Natural Monopoly*, *supra* note 2, at 550-51. Posner treats all of the supposed evils of monopoly enterprise. Monopoly pricing is only one of these. Others, such as reduced production and the threat of price discrimination, abound. They do not bear directly on the issue of utility advertising. Posner's analysis concludes that rate regulation to control monopoly enterprise is not justified.

17. *Id.*

18. *Id.* The courts refer more ambiguously to the necessity of protecting consumers from high prices. *Federal Power Comm'n v. Hope Natural Gas*, 320 U.S. 591, 611-12 (1944); *State ex rel. North Carolina Pub. Utils. Comm'n*, 254 N.C. 536, 119 S.E.2d 469 (1961).

19. 1 A. KAHN, *supra* note 3, at 35-54, offers a discussion and analysis of the principles and problems involved in regulating the level of profit allowed to the firm.

20. A. ALCHIAN & W. ALLEN, *supra* note 15, at 428.

firm were subject to competition.²¹ Such wasteful spending will ultimately be passed along to consumers. It may occur as a result of simple indifference, or because the spending adds to the personal wealth or power of the people who authorize it.²²

The regulatory commission therefore must control expenditures as well as profits. Advertising is only one of the expense accounts which the commission must superintend. Wasteful advertising costs, like excessive profits, are a form of monopolistic exploitation.²³ The ultimate objective in reviewing these expenditures is to prevent those costs which would not have been incurred if the firm were subject to the pressures of a normal marketplace.²⁴

Of course, other objectives are possible or even desirable as an element of commission control over utility advertising. However, the only apparent justification for rate regulation in these industries lies with the threat of a natural monopoly exploiting its advantage to the detriment of consumers and the public. There is otherwise no reason to control utility advertising and not that of other large and important industries.

It is clear from the foregoing that ratemaking legislation arises from economic rather than legal principles. Because ratemaking has long been recognized as a legislative function, courts are unconcerned about the objectives sought and will not intervene unless regulation has expanded to the point of confiscation or the utility has been denied due process of law.²⁵

As a result, judicial formulations of the ratemaking function employ ambiguous legal terms that have no independent significance. State regulation is authorized when the business is affected with a public interest.²⁶ The commission is viewed as having the task of setting rates which balance the public interest in reasonable service at a fair price against the right of private owners to a fair return on their investment.²⁷ The court will not question

21. 1 A. KAHN, *supra* note 3, at 26-35.

22. *Id.* See also *Natural Monopoly*, *supra* note 2, at 601-02.

23. See *Natural Monopoly*, *supra* note 2, at 601-02.

24. An unregulated firm seeking to maximize its profits would be expected to spend money on advertising until the marginal revenue product of the advertising was equal to the combined marginal cost of advertising and production. See Wilder, *Public Utility Advertising: Some Observations*, 49 LAND ECON. 458 (1973) [hereinafter cited as *Utility Advertising*].

25. *St. Joseph Stock Yards Co. v. United States*, 298 U.S. 38 (1936).

26. *Nebbia v. New York*, 291 U.S. 502 (1934).

27. *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

the theory applied by the commission, as long as the result is within the zone of reasonableness between these interests and is not unjust.²⁸ In the area of expense control, the commission has the duty of preventing consumers from being burdened with unnecessary or extravagant costs.²⁹

The commission does not have complete discretion in achieving these objectives. There are constitutional limits to the scope of regulatory control over utility advertising.

LEGAL RESTRAINTS ON REGULATORY REVIEW OF ADVERTISING EXPENSES

Despite the necessity of preventing a regulated firm from burdening consumers with wasteful costs, the regulatory commission lacks uncontrolled authority to supervise a utility's advertising policy. It is settled that the fourteenth amendment prohibits state regulation from intruding on private rights to the extent that property is confiscated³⁰ or due process of law is denied.³¹ Attempting to determine the point at which constitutional rights are offended is the only concern of courts which intervene in the ratemaking process.³²

Early decisions by both state and federal courts established the principle that discretion to advertise is an incident to the management of private business which could not be arbitrarily abused by state regulation.³³ The purpose of a regulatory commission is to regulate rates, not to manage the business.³⁴ Management discretion regarding advertising extends to both the amount of the expense and the content of the advertising message.³⁵

Moreover, a simple showing that management may have made a mistake concerning the amount spent on advertising was held insufficient to justify usurping their managerial function. Rather, "the

28. *Id.*

29. *Acker v. United States*, 298 U.S. 426 (1936).

30. *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922).

31. *St. Joseph Stock Yards Co. v. United States*, *supra* note 25.

32. *Id.*

33. *See Wichita Gas Co. v. Kansas Pub. Serv. Comm'n*, 3 F. Supp. 722 (D. Kan. 1930); *Monroe Gas Light & Fuel Co. v. Michigan Pub. Utils. Comm'n*, 11 F.2d 319 (E.D. Mich. 1926); *Wichita Gas Co. v. Kansas Pub. Serv. Comm'n*, 126 Kan. 220, 268 P. 111 (1928).

34. *Monroe Gas Light & Fuel Co. v. Michigan Pub. Serv. Comm'n*, *supra* note 33.

35. *Id.*

constitutional guaranty is not to be avoided merely because management is less than perfect. As to all disbursements actually made within the limits of good faith, the managers' discretion must stand, unless it is abused."³⁶ The Constitution therefore requires some leeway for error on the part of utility management, so long as the error is made in good faith and does not involve gross inefficiency.

The Supreme Court adopted this viewpoint in *West Ohio Gas Company v. Ohio Public Utilities Commission (No. 1)*.³⁷ The commission had disallowed advertising expenses incurred by the company because the advertising had not visibly effected an expansion of the business.³⁸ This was due in part to the depression and the high price of gas being sold by the company.³⁹ The Supreme Court reversed, emphasizing that the requirement of good faith on the part of management does not authorize an unsupported attack on its business judgment.⁴⁰ On the contrary, "good faith is to be presumed on the part of the managers of a business. In the absence of a showing of improvidence, a court will not substitute its judgment for theirs as to the measure of a prudent outlay."⁴¹ The commission had failed to make any showing of such inefficiency or improvidence.

West Ohio did not grant utility management absolute authority regarding its advertising outlays. Rather, Justice Cardozo's opinion affirmed the right of the commission to disallow expenses where the commission could establish, by direct or circumstantial evidence, that the cost was the result of negligence or waste.⁴² The Court did not indicate what would constitute such a cost, though the burden of proof was clearly placed upon the state.⁴³

Some elaboration was offered by the Court a year later in a case involving stockyard rates set by the Secretary of Agriculture.⁴⁴ There was evidence in the record both for and against the necessity and wisdom of the costs incurred to acquire and maintain new business.⁴⁵ The Court rejected the argument that advertising was entirely a matter of management discretion, observing that "regula-

36. *Id.* at 325.

37. 294 U.S. 63 (1935).

38. *West Ohio Gas Co., P.U.R.1933B 433* (Ohio Pub. Utils. Comm'n 1933).

39. *Id.*

40. *West Ohio Gas Co. v. Ohio Pub. Utils. Comm'n (No. 1)*, *supra* note 37.

41. *Id.* at 72 (citations omitted).

42. *Id.* at 68.

43. *Id.*

44. *Acker v. United States*, 298 U.S. 426 (1936).

45. *Id.*

tion cannot be frustrated by a requirement that the rate be made to compensate for extravagant or unnecessary costs for these or any other purposes."⁴⁶ It was sufficient that the record contained substantial support for the disallowance.⁴⁷

While the *West Ohio* case is obviously dated, the principles adopted there have often been restated and remain binding law. Courts have not infrequently been called upon to restrain regulatory commissions from arbitrarily disallowing advertising outlays.⁴⁸ On occasion, a commission has itself observed that it could not substitute its judgment regarding a prudent advertising policy for that of management.⁴⁹

In a leading and relatively recent case, the Supreme Court of Massachusetts forcefully restated the principle of management's prerogative to advertise.⁵⁰ Although the total amount spent for advertising was not found unreasonable, the content of the advertising had been attacked by the commission as being merely institutional advertising designed to foster public goodwill towards the firm.⁵¹ The court rejected the commission's attempt to rule upon the value of the advertising message:

46. *Id.* at 431.

47. *Id.*

48. *City of El Dorado v. Arkansas Pub. Serv. Comm'n*, 235 Ark. 812, 362 S.W.2d 680 (1962); *Southern Bell Tel. & Tel. Co. v. Pub. Serv. Comm'n*, 203 Ga. 832, 49 S.E.2d 38 (1948); *Central Me. Power Co. v. Maine Pub. Utils. Comm'n*, 153 Me. 228, 136 A.2d 726 (1957); *New England Tel. & Tel. Co. v. Dep't of Pub. Utils.*, 360 Mass. 443, 275 N.E.2d 493 (1971); *State ex rel Dyer v. Missouri Pub. Serv. Comm'n*, 341 S.W.2d 795 (Mo. 1960); *State ex rel N.C. Utils. Comm'n v. Piedmont Natural Gas Co.*, 254 N.C. 536, 119 S.E.2d 469 (1961); *State v. Oklahoma Gas & Elec. Co.*, 536 P.2d 887 (Okla. 1975); *Southern Bell Tel. & Tel. Co. v. R.R. & Pub. Utils. Comm'n of Tenn.*, 81 P.U.R. (New Series) 571 (Tenn. App. 1948); *In re New England Tel. & Tel. Co.*, 115 Vt. 494, 66 A.2d 135 (1949); *General Tel. Co. of Wis. v. Wisconsin Pub. Serv. Comm'n*, 46 P.U.R.3d 1 (Wis. Cir. Ct. 1962).

Perhaps an extreme example of deference to management's prerogative to advertise appears in *State v. Virginia Elec. & Power Co.*, 211 Va. 758, 180 S.E.2d 675 (1971), *aff'g* *Virginia Elec. & Power Co.*, 84 P.U.R.3d 1 (Va. State Corp. Comm'n 1970). The commission refused to remove expenses for certain trade ally advertising from the rate base even though the commission had previously disapproved of such advertising and the company discontinued the program. It was reasoned that the company would merely substitute some other promotional activity of equal or greater expense. *Id.*

49. *See Kansas City Power & Light Co.*, 6 P.U.R.4th 321 (Kan. State Corp. Comm'n 1974); *Promotional Activities by Gas & Elec. Corps.*, 68 P.U.R.3d 162 (N.Y. Pub. Serv. Comm'n 1967); *Columbus Gas & Fuel Co. v. Columbus*, 32 P.U.R. (New Series) 321 (Ohio Pub. Utils. Comm'n 1939); *New England Tel. & Tel. Co.*, 35 P.U.R.3d 100 (Vt. Pub. Serv. Comm'n 1960).

50. *New England Tel. & Tel. Co. v. Dep't of Pub. Utils.*, 360 Mass. 443, 275 N.E.2d 493 (1971).

51. For the overruled commission decision, *see* *New England Tel. & Tel. Co.*,

As a business corporation engaged in selling an important service, the Company is entitled to take all reasonable means to promote and to seek to enlarge that business. One of the means used by almost all business corporations is advertising It is no less entitled to advertise by reason of the fact that it is a regulated public utility than is the ordinary business corporation. The type and quantity of such advertising, and the means, media or vehicle used therefor are matters to be decided originally by the duly authorized managers of the Company's business. They must make the decision whether institutional type of advertising is helpful to its business, and if so the amount to be expended therefor.⁵²

The opinion does not foreclose regulatory review of the reasonableness of advertising costs. The court only interpreted *West Ohio* as preventing the commission from disallowing an otherwise reasonable expense on the basis of a value judgment regarding the content of the advertising message.

The concept that a commission's review of the reasonableness of advertising expenses is limited to a consideration of the amount spent, rather than the merit of the messages, did not originate with the Massachusetts Supreme Court. Other courts have refused to allow governmental supervision of advertising beyond the requirement that the dollar volume of the expense be reasonable.⁵³

It may be argued that the reasonableness of the expense naturally depends on the value of the message being paid for. *West Ohio* did not confront this precise issue, but it did prohibit regulators from substituting their judgment for that of management without a showing of inefficiency or improvidence.⁵⁴ If an otherwise reasonable expense may be disallowed because the commission finds no social value in the advertising message, the Supreme Court's opinion is rendered meaningless. Any advertising expense can be

84 P.U.R.3d 130 (Mass. Dep't of Pub. Utils. 1970). See also *Brockton Edison Co.*, 86 P.U.R.3d 90 (Mass. Dep't of Pub. Utils. 1970).

52. *New England Tel. & Tel. Co. v. Dep't of Pub. Utils.*, *supra* note 50, at 517.

53. "[W]e are not concerned with the particular purpose and amount of each charge within the item. In general, promotional expense of the nature under discussion may properly be charged to operation." *Central Me. Power Co. v. Maine Pub. Utils. Comm'n*, 153 Me. 228, 136 A.2d 726, 736-37 (1957). See also *State ex rel. Dyer v. Public Serv. Comm'n*, 341 S.W.2d 795 (Mo. 1960). The advertising in *Dyer* included some that was directed at the political issue of whether utilities should be publicly or privately owned.

54. 294 U.S. at 72.

disallowed if the commission need only find that the advertising has no merit. Such a finding is merely a conclusory assumption, not a showing of negligence or waste.

Furthermore, the concept of a reasonable advertising expense should be consistent with the purpose of rate regulation. As long as the advertising message is consistent with that of competitive businesses, it is not an undesirable effect of the firm's monopolistic advantage.⁵⁵ This is true even where the advertising message contravenes an important public policy. For example, a utility may ignore the policy in favor of energy conservation by attempting to stimulate sales with the promotion of energy-consuming appliances. There is no better reason to prevent such advertising by utilities than by unregulated appliance dealers. In *State v. Oklahoma Gas & Electric Co.*, the Supreme Court of Oklahoma indicated that not all promotional advertising could be disallowed because of a desire to conserve energy as long as the utility had the ability to serve the increased demand.⁵⁶

The position that the allowability of advertising should, pursuant to *West Ohio*, depend on its cost rather than its content has rapidly eroded in recent years. Four state supreme courts have approved commission decisions which incorporate a review of the social value of the advertising message into the determination of the allowability of the expense.⁵⁷ These opinions make no attempt to reconcile this approach with *West Ohio*. Thus the reasonableness of advertising expenses has taken on two distinct meanings. The traditional meaning is consistent with existing constitutional precedent and the acknowledged function of ratemaking in that it focuses on whether the cost of the advertising is excessive.⁵⁸ The modern trend is to determine whether the advertising message is of tangible benefit to the consumer, or consistent with broad public policies.⁵⁹ Reasonableness has become a test to determine whether the content of the advertising is desirable regardless of the cost of the program.

55. Thus, advertising which is a political attempt to influence the outcome of a rate case is usually disallowed. See *infra* note 144.

56. 536 P.2d 887 (Okla. 1975).

57. *Los Angeles v. Public Serv. Comm'n*, 7 Cal. 3d 331, 497 P.2d 785, 102 Cal. Rptr. 313 (1972); *In re Hawaiian Elec. Co.*, 56 Hawaii 260, 535 P.2d 1102 (1975); *Illinois Bell Tel. Co. v. Illinois Commerce Comm'n*, 55 Ill. 2d 461, 303 N.E.2d 364 (1973); *Public Serv. Co. of N.H. v. State*, 113 N.H. 497, 311 A.2d 513 (1973).

58. *E.g.*, *Ohio Bell Tel. Co.*, 82 P.U.R. (New Series) 341 (Ohio Pub. Utils. Comm'n 1949).

59. *E.g.*, *In re Hawaiian Elec. Co.*, *supra* note 57.

Before analyzing this trend, a review of reasonableness in the traditional sense of preventing wasteful spending is appropriate.

**THE REQUIREMENT OF REASONABLENESS:
PREVENTING EXCESSIVE COSTS**

Numerous considerations affect the determination of whether an advertising expense has been excessive. These considerations conform to the concept of reasonableness as a standard which disallows costs in excess of those which would have been incurred if the firm were subject to competition. Costs in excess of that standard are wasteful in that they are the product of the firm's monopolistic advantage. Reasonableness in this sense does not involve any review of the value of the advertising message independent of cost.

Attempting to determine how a utility would act if it were operating in a competitive environment is, of necessity, a task which involves a great deal of judgment.⁶⁰ Commissions have generally relied on objective comparisons of a utility's advertising expense with that of other utilities similarly situated, and on an evaluation of market factors which would affect the willingness of a competitive firm to advertise.

Objective Comparisons

The structural differences between utilities and more competitive businesses make direct comparisons between them of limited significance.⁶¹ Commissions have generally been confined to comparing the advertising outlay of the firm in question with other utilities. Logic supports this approach. If it may be supposed that utilities in general will spend a reasonable amount on advertising, then the expense of a firm which substantially exceeds the norm is naturally suspect.

There is empirical evidence which suggests that utilities as a group engage in reasonable advertising programs. Energy utilities spend relatively little on advertising when compared with non-regulated industries.⁶² This data is consistent with the nature of utility services. Energy, like all utility services, is a standardized product for which consumers have limited informational needs. Moreover, the firm has a limited ability to differentiate its product

60. See Ohio Bell Tel. Co., *supra* note 58.

61. *Utility Advertising*, *supra* note 24, at 461.

62. *Id.*

through advertising, and the demand for energy is derived from the consumer's primary demand for energy-using appliances. The low level of advertising by energy utilities is therefore a reasonable response to the market in which they operate.⁶³ Thus, there is at least some reason to believe that the advertising expenses of utilities generally conform to the expense level one would expect if utilities were not monopolies.

Comparisons to determine if the advertising expense of an individual utility deviates from the industry norm must begin with some measure of the intensity of advertising practiced by the firm. Most often, the commission staff computes advertising intensity as the percentage of advertising expense to gross revenue.⁶⁴ Also employed is the cost of advertising per customer during the test year,⁶⁵ and occasionally the percentage of advertising expense to all other operating expenses.⁶⁶ It has been held that the commission is not bound to prefer one measure over another.⁶⁷ These calculations of advertising intensity may be compared with figures for similar local utilities,⁶⁸ a sample of utilities nationwide,⁶⁹ or a national average⁷⁰ in order to determine if the expense is reasonable.

Viewing such data over a period of time may also provide useful information.⁷¹ A utility may attempt to exploit the regulatory

63. *Id.*

64. *See, e.g.,* Southern Cal. Gas Co., 35 P.U.R.3d 300 (Cal. Pub. Utils. Comm'n 1960); Honolulu Gas Co., 86 P.U.R.3d 307 (Hawaii Pub. Utils. Comm'n 1970); Kansas City Power & Light Co., 6 P.U.R.4th 321 (Kan. State Corp. Comm'n 1974); Southern Union Gas Co., 12 P.U.R.4th 219 (N.M. Pub. Serv. Comm'n 1975); National Fuel Gas Distribution Corp., 17 P.U.R.4th 138 (N.Y. Pub. Serv. Comm'n 1976); Utah Power & Light Co., 95 P.U.R. (New Series) 390 (Utah Pub. Serv. Comm'n 1952); Wisconsin Natural Gas Co., 92 P.U.R.3d 164 (Wis. Pub. Serv. Comm'n 1971); Mountain States Tel. & Tel. Co., 14 P.U.R.4th 149 (Wyo. Pub. Serv. Comm'n 1976).

65. *See, e.g.,* Sierra Pacific Power Co., 7 P.U.R.4th 209 (Cal. Pub. Utils. Comm'n 1960); Honolulu Gas Co., *supra* note 64; Kansas Gas & Elec. Co., 95 P.U.R.3d 247 (Kan. State Corp. Comm'n 1972).

66. *See* Southern Cal. Gas Co., *supra* note 64; Northwestern Bell Tel. Co., 8 P.U.R.4th 75 (Minn. Pub. Serv. Comm'n 1974); Southern Union Gas Co., *supra* note 64.

67. National Fuel Gas Distribution Corp., *supra* note 64.

68. *See* Sierra Pacific Power Co., *supra* note 65; Southern Cal. Gas Co., *supra* note 64; Honolulu Gas Co., 36 P.U.R.3d 309 (Hawaii Pub. Utils. Comm'n 1960); Kansas Gas & Elec. Co., *supra* note 65; National Fuel Gas Distribution Corp., *supra* note 64; Wisconsin Gas Co., 99 P.U.R.3d 160 (Wis. Pub. Serv. Comm'n 1973).

69. *See* Utah Power & Light Co., *supra* note 64.

70. *See* Wisconsin Gas Co., *supra* note 68; Mountain States Tel. & Tel. Co., *supra* note 64.

71. *See* Southwestern Bell Tel. Co., 19 P.U.R.4th 1 (Kan. State Corp. Comm'n 1977); Kansas City Power & Light Co., 6 P.U.R.4th 321 (Kan. State Corp. Comm'n

system by inflating its test year expenses in order to justify higher rates.⁷² A commission can therefore disallow advertising expenses which are shown to be abnormal or nonrecurring.⁷³

Several cases have demonstrated that these comparisons may not be mechanically applied to work an unjust result. In New York the commission held that it was unfair to compare the advertising cost per customer of a gas utility with a combination gas-electric company.⁷⁴ The commission recognized that advertising is naturally less expensive for electricity customers, inasmuch as gas companies "have a particularly heavy responsibility to promote conservation and must keep the issue of safety prominent in the public's awareness."⁷⁵ Accordingly, the commission set the allowable cost per customer at the average of gas-only New York utilities in the staff sample.⁷⁶

The practice of viewing the company's advertising expense over a period of time may also be abused. In Tennessee, the Court of Appeals reversed a commission decision disallowing a portion of the expenses incurred in the post-war test year (1946) because it compared unfavorably with figures for a pre-war year (1936).⁷⁷ The court based its decision on *West Ohio*; there had been no further showing of extravagance, mismanagement, or an abuse of discretion.⁷⁸

1974); *Public Utils. Comm'n v. New England Tel. & Tel. Co.*, 75 P.U.R.(New Series) 275 (Me. Pub. Utils. Comm'n 1948).

72. *See Public Utils. Comm'n v. New England Tel. & Tel. Co.*, *supra* note 71.

73. *See Pennsylvania Pub. Utils. Comm'n v. Scranton Steam Heat Co.*, 34 P.U.R.3d 322 (Pa. Pub. Utils. Comm'n 1960), where the contract with the advertising agency had not been renewed after the test year. *But see Southwestern Bell Tel. Co.*, *supra* note 71. In that case the advertising expense during the test year was thirty-two per cent greater than the preceding year. The commission held that it was allowable without a further showing by the staff that the advertising was of no benefit to the customers of the company. *Id.* at 28. *See also*, *New England Tel. & Tel. Co.*, 35 P.U.R.3d 100 (Vt. Pub. Serv. Comm'n 1960).

74. *National Fuel Gas Distribution Corp.*, 17 P.U.R.4th 138 (N.Y. Pub. Serv. Comm'n 1976).

75. *Id.* at 146-47. In fact, the tendency of combined gas and electric utilities to advertise less than gas-only companies is probably due to the fact that they need not compete with an alternative energy source, rather than a result of any particularly heavy responsibility borne by gas suppliers. *See* notes 94-96 *infra*, and accompanying text.

76. *National Fuel Gas Distribution Corp.*, *supra* note 74.

77. *Southern Bell Tel. & Tel. Co. v. R.R. & Pub. Utils. Comm'r of Tenn.*, 81 P.U.R.(New Series) 571 (Tenn. App. 1948).

78. *Id.* at 579.

The commission staff is not always the party guilty of generating unacceptable figures for the purpose of comparing advertising expenses. In one case the commission rejected the company's data favorably comparing itself with utilities in neighboring states that had a different regulatory scheme.⁷⁹ The commission preferred to rely on an overall national average as their basis of comparison.⁸⁰

On the other hand, a decision by the North Carolina Public Utilities Commission was overruled because they used a national average as their basis of comparison without considering the specific situation of the firm.⁸¹ The gas retailer in that case had recently made a heavy capital investment to convert from manufactured to natural gas, and was anxious to promote sales in order to cover its costs. There was intense competition in the area from retailers of fuel oil and an electric utility. Moreover, the commission had made no effort to find the average advertising intensity for companies in this utility's class or territory.⁸² Therefore, despite the fact that the company's advertising cost per customer was almost three times the national average,⁸³ the court ruled that the expense must be allowed. This decision also relied on *West Ohio* principles, and held that management had acted within the limits of its discretion.⁸⁴

This North Carolina case further illustrates the fact that a commission may, in its determination of reasonableness, constructively look to market factors which would affect the willingness of a competitive firm to advertise. The commission is not limited to comparative data in fulfilling its duty of protecting consumers from monopolistic exploitation. On the contrary, where an allowance for selling expenses was attacked because of imperfections in the comparative data, it was held sufficient that the regulatory agency had attempted to compensate for the defects.⁸⁵ The court observed that "a lint-picking critique [of the statistics] will not serve to undermine

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

80. *Id.* at 16.

81. *State ex rel. Utils. Comm'n v. Piedmont Natural Gas Co.*, 254 N.C. 536, 119 S.E.2d 469 (1961).

82. *Id.* at 479-80.

83. *Id.*

84. *Id.* at 477.

85. *Trans World Airlines, Inc. v. CAB*, 385 F.2d 648 (D.C. Cir. 1967), *cert. denied*, 390 U.S. 944 (1968). This case dealt with an airline rather than a public utility as defined here. See note 2 *supra*. The court, however, recognized that in this context the analysis is comparable in that the regulation of airlines or utilities are both "intensely practical affair[s]," and relied on precedents dealing with utilities. *Id.* at 658.

a regulatory surveillance that has the hallmark of a conscientious effort merely because it cannot and does not purport to attain anything like the refinement of a mathematical discipline."⁸⁶ The agency's action does not contravene *West Ohio* so long as it is supported by substantial evidence in the record.⁸⁷ A commission may clearly apply an element of informed judgment to its determination of reasonableness.

Market Considerations

Factors other than objective comparisons may influence commission decisions regarding the level of advertising by the firm. The factors treated here pertain only to the amount spent on advertising, and not directly to the content of the advertising message. Even where the general prerogative of a utility to advertise is unchallenged, if it is doing so under circumstances inconsistent with the level of advertising being carried on, the expense may be disallowed as unreasonable. By the same token, if the market environment of the firm is such that would ordinarily encourage a firm to advertise, the expense is more likely to be approved.

The most obvious consideration is the degree to which the firm and its product are established in the market. Advertising is particularly useful as a mechanism for stimulating primary demand for a new product or service,⁸⁸ and for overcoming the resistance consumers display towards new ideas.⁸⁹ Thus, some earlier decisions in favor of utility advertising recognized the company's need for initial market development.⁹⁰ This is currently of little significance. Few people today are unaware of the advantages or availability of utility service.

86. *Id.* at 658.

87. *Id.* at 657.

88. "Advertising and publicity are of great importance in informing buyers of the existence of the product and its qualities at a low cost per thousand people reached. If the product is an entirely new concept, primary demand will have to be developed before selective demand can take place." R. STANLEY, *supra* note 1, at 342. Primary demand is the demand for a general class of products or services, as opposed to selective demand for a specific brand within the class. *Id.* at 169. Inasmuch as utilities have a monopoly, selective demand is only important where there is a readily available substitute for the monopolized service.

89. *Id.* at 1-2.

90. See *Milwaukee v. Milwaukee Light Co.*, 92 P.U.R. (New Series) 133 (Wis. Pub. Serv. Comm'n 1952); *Pennsylvania Pub. Utils. Comm'n v. Pennsylvania Power & Light Co.*, 14 P.U.R.3d 438 (Pa. Pub. Utils. Comm'n 1956).

The mere fact that a utility has a monopoly has repeatedly been rejected as a basis for disallowing advertising.⁹¹ The amount that is spent on advertising, however, should reflect the competitive pressures to which the firm must respond. Although a utility may monopolize a particular service, it must confront the challenge posed by substitutes for that service.⁹²

This is particularly true for utilities that distribute energy. Although a company may have a geographic monopoly on the distribution of natural gas, it often must compete with an electric utility or unregulated fuel oil vendors.⁹³ This competition is frequently intense, and has been cited as justifying the amount of the firm's advertising expense.⁹⁴

Based upon the same logic, commissions have disallowed advertising outlays where the same utility provided both gas and electricity.⁹⁵ A competitive firm does not ordinarily waste money in

91. See *Kansas City Power & Light Co.*, 6 P.U.R.4th 259 (Kan. State Corp. Comm'n 1974); *Northwestern Bell Tel. Co.*, 8 P.U.R.4th 75 (Minn. Pub. Serv. Comm'n 1974); *Cleveland Elec. Illumination Co.*, 3 P.U.R.4th 259 (Ohio Pub. Utils. Comm'n 1973). For court decisions affirming the right of utilities to advertise, see generally cases cited notes 37, 48 *supra*. But see *Los Angeles v. Public Utils. Comm'n*, *supra* note 57, wherein the court approved the disallowance of institutional advertising in part because the utility was a monopoly with "captive consumers." *Id.* at 800.

92. A. ALCHIAN & W. ALLEN, *supra* note 15, at 140. For example, the telephone faces some competition from the mails, telegraph, microwave, or even personal travel. "No one is an absolute monopolist since all goods are substitutable to some degree. But degrees are important." *Id.* See also R. STANLEY, *supra* note 1, at 5. In *Promotional Practices of Elec. & Gas Utils.*, 65 P.U.R.3d 405 (Conn. Pub. Utils. Comm'n 1966), the commission stated that the competition for space heating business between gas and electric utilities made these businesses less than natural monopolies in the traditional sense.

93. The efficacy of advertising to inspire selective demand and maintain the firm's market share against alternative energy sources will depend in part on the degree to which the service can be differentiated. R. STANLEY, *supra* note 1, at 4, 173. "Thus, electric utilities proclaim the virtues of 'clean, flameless electric heat,' while natural gas utilities propound the corresponding arguments in favor of gas heat." *Utility Advertising*, *supra* note 24, at 459.

94. See *West Ohio Gas Co. v. Ohio Pub. Utils. Comm'n* (No. 1), 294 U.S. 63 (1935); *State ex rel. Utilities Comm'n v. Piedmont Natural Gas Co.*, 254 N.C. 536, 119 S.E.2d 469 (1961); *Arkansas Louisiana Gas Co.*, 40 P.U.R.3d 209 (Ark. Pub. Serv. Comm'n 1961); *Southern Cal. Gas Co.*, 35 P.U.R.3d 300 (Cal. Pub. Utils. Comm'n 1960); *Union Elec. Co.*, 81 P.U.R.3d 85 (Ill. Commerce Comm'n 1969); *Milwaukee v. Milwaukee Gas Light Co.*, 92 P.U.R. (New Series) 133 (Wis. Pub. Serv. Comm'n 1952). But see *In re Hawaiian Elec. Co.*, 56 Hawaii 260, 535 P.2d 1102 (1975); *Southern Cal. Edison Co.*, 90 P.U.R.3d 1 (Cal. Pub. Utils. Comm'n 1971), discussed at note 118, *infra*.

95. *Pacific Gas & Elec. Co.*, 87 P.U.R.3d 270 (Cal. Pub. Utils. Comm'n 1971); *San Diego Gas & Elec. Co.*, 26 P.U.R.3d 129 (Cal. Pub. Utils. Comm'n 1958); *Montana-Dakota Utils. Co.*, 22 P.U.R.3d 505 (N.D. Pub. Utils. Comm'n 1958).

order to foster competition between its own departments. There is, moreover, evidence which shows that combined gas and electric utilities nationwide generally advertise less than utilities which must compete with an alternative energy retailer.⁹⁶

Also relevant to a reasonable advertising policy is the ability of the company to service the new demand generated by its promotional program. If a firm has as much business as it can handle, money spent to increase consumption is wasted.⁹⁷ The firm will be unable to capitalize on the product of its advertising program.⁹⁸

The most apparent short-term limitation on a company's ability to service new demand is existing plant capacity. Capacity problems usually occur at electric or telephone utilities, although one decision has expressed concern over the limited carrying capacity of the company's gas mains.⁹⁹ Advertising by companies operating at or near capacity has frequently been found unreasonable where the apparent effect of the advertising would be to increase peak load.¹⁰⁰ In one case the company had even been advertising to promote consumption at the same time that peak load problems were threatening service to existing users.¹⁰¹

Closely related to the factor of plant capacity is the inability of some energy utilities to receive adequate fuel supplies. The problem has become acute in recent years for some vendors of natural gas. As a result of supply difficulties, the firm may be unable to service

96. *Utility Advertising*, *supra* note 24, at 461-62.

97. For example, where three thousand people were waiting to get telephones, the commission disallowed further advertising to stimulate demand. *Public Utils. Comm'n v. New England Tel. & Tel. Co.*, 75 P.U.R. (New Series) 275 (Me. Pub. Utils. Comm'n 1948).

98. Obviously, an unregulated firm could capitalize on the increased demand resulting from advertising by raising prices as well as by selling greater quantities. *R. STANLEY*, *supra* note 1, at 6. This would be the ordinary response to capacity problems. Utilities, however, do not have the discretion to raise their prices at will. To allow them to do so because they were operating at capacity would thwart the entire purpose of rate regulation.

99. *Boston Consol. Gas Co.*, 30 P.U.R. (New Series) 260 (Mass. Dep't of Pub. Utils. 1939).

100. See *Southern Cal. Edison Co.*, 90 P.U.R.3d 1 (Cal. Pub. Utils. Comm'n 1971); *Kansas Gas & Elec. Co.*, 95 P.U.R.3d 247 (Kan. State Corp. Comm'n 1972); *Public Utils. Comm'n v. New England Tel. & Tel. Co.*, 80 P.U.R. (New Series) 397 (Me. Pub. Utils. Comm'n 1949); *New York Tel. Co.*, 92 P.U.R.3d 321 (N.Y. Pub. Serv. Comm'n 1971); *Montana-Dakota Utils. Co.*, 22 P.U.R.3d 505 (N.D. Pub. Utils. Comm'n 1958); *Washington Utils. & Transp. Comm'n v. Pacific Power & Light Co.*, 7 P.U.R.4th 470 (Wash. Utils. & Transp. Comm'n 1974).

101. *New York Tel. Co.*, *supra* note 100.

increased demand regardless of the capacity of its plant. Advertising in the face of such difficulties has been held to be wasteful.¹⁰²

Only advertising directly designed to promote consumption is unreasonable for a firm limited by its peak load capacity. For example, it has been held that even though a company had more orders for telephones than it could fill, the commission was without authority to disallow informational advertising directed at existing users.¹⁰³ The advertising was for the purpose of acquainting customers with the use of party lines, directories, and the possibility of converting from manual to dial instruments. The court, relying on *West Ohio*, held that disallowing this program was an impermissible invasion of management's prerogative to advertise.¹⁰⁴

A problem with peak load capacity also should not inhibit advertising off-peak use in order to achieve a more balanced load.¹⁰⁵ Examples of this strategy include promoting long-distance calls at night, gas air conditioning in the south and electric space heating in the north.¹⁰⁶ Load balancing has often been cited as a legitimate objective of advertising,¹⁰⁷ even where the commission has disapproved promotional advertising in general.¹⁰⁸ However, even promoting off-

102. See *Kansas Gas & Elec. Co.*, 95 P.U.R.3d 247 (Kan. State Corp. Comm'n 1974); *Consumers Power Co.*, 3 P.U.R.4th 350 (Mich. Pub. Serv. Comm'n 1974); *New York State Elec. & Gas Co.*, 93 P.U.R.3d 302 (N.Y. Pub. Serv. Comm'n 1971); *Public Serv. Co. of N.C.*, 19 P.U.R.4th 109 (N.C. Utils. Comm'n 1977); *Carolina Power & Light Co.*, 88 P.U.R.3d 283 (N.C. Utils. Comm'n 1971); *Narragansett Elec. Co.*, 93 P.U.R.3d 417 (R.I. Pub. Serv. Comm'n 1972); *Roanoke Gas Co.*, 96 P.U.R.3d 91 (Va. State Corp. Comm'n 1972); *Milwaukee v. Milwaukee Gas Light Co.*, 92 P.U.R. (New Series) 133 (Wis. Pub. Serv. Comm'n 1952). See also *Wisconsin Pub. Serv. Corp.*, 92 P.U.R.3d 278, 298-99 (Wis. Pub. Serv. Comm'n 1971) (Chairman Eich, dissenting).

103. *Southern Bell Tel. & Tel. Co. v. Public Serv. Comm'n*, 203 Ga. 832, 49 S.E.2d 38 (1948). See also *New York State Elec. & Gas Corp.*, 93 P.U.R.3d 302 (N.Y. Pub. Serv. Comm'n 1971).

104. *Southern Bell Tel. & Tel. Co. v. Public Serv. Comm'n*, *supra* note 103, at 65-66.

105. *Washington Utils. & Transp. Comm'n v. Pacific Power & Light Co.*, *supra* note 100.

106. Such promotion of off-peak use is based on the principle that as the company's utilization of capacity improves, the unit cost of providing service will decline. *Utility Advertising*, *supra* note 24, at 458-59.

107. See *Southern Cal. Gas Co.*, 35 P.U.R.3d 300 (Cal. Pub. Utils. Comm'n 1960); *Mountain States Tel. & Tel. Co.*, 8 P.U.R.4th 514 (Colo. Pub. Utils. Comm'n 1974); *Kansas City Power & Light Co.*, 6 P.U.R.4th 321 (Kan. State Corp. Comm'n 1974); *Michigan Bell Tel. Co.*, 15 P.U.R.4th 209 (Mich. Pub. Serv. Comm'n 1976); *Northwestern Bell Tel. Co.*, 8 P.U.R.4th 75 (Minn. Pub. Serv. Comm'n 1974); *Cleveland Elec. Illumination Co.*, 3 P.U.R.4th 259 (Ohio Pub. Utils. Comm'n 1973).

108. See *Alabama Power Co.*, 97 P.U.R.3d 371 (Ala. Pub. Serv. Comm'n 1972); *Public Serv. Co. of Colo.*, 13 P.U.R.4th 40 (Colo. Pub. Utils. Comm'n 1975); *Penn-*

peak use will aggravate the problems of a utility having supply problems. Such advertising has been disallowed because it increases overall consumption, thereby making fuel even more scarce.¹⁰⁹

All of the foregoing considerations are independent of any judgment by the commission regarding the intrinsic value or social utility of the advertising message. Rather, they are based on attempts to define reasonableness objectively as an advertising program which is not wasteful and does not burden the consumer with exploitive costs. While this objective remains a valid aspect of regulatory review of advertising expenses, it has become relatively less significant. State commissions have rapidly expanded their inquiry to include their opinion as to whether the advertising message is desirable as a matter of public policy.

THE REQUIREMENT OF REASONABLENESS: NEW DIMENSIONS

In recent years a variety of policy considerations have exerted a strong influence on the allowability of utility advertising. Commission decisions have reflected public concern over rising costs, energy conservation, and environmental damage.¹¹⁰ As a result, the overwhelming number of decisions in the last ten years have been unfavorable towards utility advertising. The prerogative of management to select the advertising message has been greatly limited. This development is desirable if one considers the policies pursued by the commissions to be of paramount importance. There remains, however, the larger issue of whether commissions have the authority to serve these policies by disallowing utility advertising.

Central to this discussion is the thesis that these changes have occurred for reasons unrelated to the threat of monopolistic exploitation by the utility. Commissions are now disallowing advertising expenses because they disapprove of the content of the advertising. This occurs regardless of the amount spent by the utility, and in the absence of any showing that the amount spent was unusually large or inconsistent with the behavior of unregulated businesses

sylvania Pub. Utils. Comm'n v. Metropolitan Edison Co., 96 P.U.R.3d 113 (Pa. Pub. Utils. Comm'n 1972).

109. See Kansas Gas & Elec. Co., 95 P.U.R.3d 247 (Kan. State Corp. Comm'n 1972); Narragansett Elec. Co., 93 P.U.R.3d 417 (R.I. Pub. Utils. Comm'n 1972).

110. *E.g.*, Promotional Practices of Electric Utilities, 8 P.U.R.4th 268 (Fla. Pub. Serv. Comm'n 1975); Potomac Elec. Power Co., 10 P.U.R.4th 13 (Md. Pub. Serv. Comm'n 1975); Michigan Power Co., 18 P.U.R.4th 418 (Mich. Pub. Serv. Comm'n 1977). See generally Joskow, *Inflation and Environmental Concern: Structural Change in the Process of Public Utility Regulation*, 17 J.L. & ECON. 291 (1974).

which do not have a monopoly. These decisions omit any reference to *West Ohio* or its progeny. They make no attempt to reconcile their position with the principle that commissions may not simply substitute their judgment for that of management.

Accordingly, the review of advertising now tends to center on a discussion of whether a given type of advertising, in the opinion of the commission, is of benefit to the ratepayer or the public at large. Where no benefit is perceived, the expense for that type of advertising is disallowed.¹¹¹ Advertising to promote energy consumption and advertising to promote public goodwill have been the particular targets of this treatment.

Advertising to Promote Energy Consumption

Until recently, advertising to promote energy consumption was generally regarded as a proper activity of gas and electric utilities.¹¹² Such advertising was presumed to contribute to a healthy growth of the industry.¹¹³ This attitude reflects the economics of a natural monopoly.¹¹⁴ Increased consumption reduces the average unit cost of service.¹¹⁵ This means that as more energy is sold, the cost of delivering that energy continually declines. As a result, advertising to stimulate demand and increase consumption ultimately benefits all consumers by making utility service cheaper.¹¹⁶

111. *E.g.*, Arkansas Power & Light Co., 15 P.U.R.4th 153 (Ark. Pub. Serv. Comm'n 1976); Public Serv. Co. of N.C., 19 P.U.R.4th 109 (N.C. Utils. Comm'n 1977).

112. *See* West Ohio Gas Co. v. Ohio Pub. Utils. Comm'n (No. 1), 294 U.S. 63 (1935); City of El Dorado v. Arkansas Pub. Serv. Comm'n, 235 Ark. 812, 362 S.W.2d 680 (1962); Central Maine Power Co. v. Maine Pub. Utils. Comm'n, 153 Me. 228, 136 A.2d 726 (1957); State *ex rel.* Dyer v. Missouri Pub. Serv. Comm'n, 341 S.W.2d 795 (Mo. 1960); State *ex rel.* Utils. Comm'n v. Piedmont Natural Gas Co., 254 N.C. 536, 119 S.E.2d 469 (1961); Public Serv. Co. of N.H. v. State, 102 N.H. 150, 153 A.2d 801 (1959), *overruled*, Public Serv. Co. of N.H. v. State, 113 N.H. 497, 311 A.2d 513 (1973); Arkansas Louisiana Gas Co., 40 P.U.R.3d 209 (Ark. Pub. Serv. Comm'n 1961); Southern Cal. Gas Co., 35 P.U.R.3d 300 (Cal. Pub. Utils. Comm'n 1960); Union Elec. Co., 29 P.U.R.3d 254 (Mo. Pub. Serv. Comm'n 1959); Promotional Activities By Gas & Elec. Corps., 68 P.U.R.3d 162 (N.Y. Pub. Serv. Comm'n 1967); Pennsylvania Pub. Serv. Comm'n v. Pennsylvania Power & Light Co., 14 P.U.R.3d 438 (Pa. Pub. Utils. Comm'n 1956); Utah Power & Light Co., 95 P.U.R. (New Series) 390 (Utah Pub. Serv. Comm'n 1952).

113. *E.g.*, West Ohio Natural Gas Co. v. Ohio Pub. Utils. Comm'n (No. 1), *supra* note 112, at 72.

114. *See* note 15 *supra*. For a decision following *West Ohio* and discussing the economics of energy utilities, *see* Promotional Practices of Elec. & Gas Utils., 65 P.U.R.3d 405 (Conn. Pub. Utils. Comm'n 1966). This opinion deals primarily with promotional practices other than advertising.

115. *See* Public Service Co. of N.H. v. State, *supra* note 112; State v. Oklahoma Gas & Elec. Co., 536 P.2d 887 (Okla. 1975); Utah Power & Light Co., *supra* note 112.

116. El Dorado v. Arkansas Pub. Serv. Comm'n, *supra* note 112.

With few exceptions,¹¹⁷ this position has been abandoned since the energy crisis became an issue of national prominence. Recent decisions have almost unanimously condemned advertising which promotes energy consumption in order to endorse the national policy in favor of energy conservation.¹¹⁸

Promotional advertising by telephone companies continues to receive support from some commissions, so long as the advertising is not merely an attempt to improve the corporate image. See *Mountain States Tel. & Tel. Co.*, 8 P.U.R.4th 514 (Colo. Pub. Serv. Comm'n 1974); *Southwestern Bell Tel. Co.*, 19 P.U.R.4th 1 (Kan. State Corp. Comm'n 1977); *Michigan Bell Tel. Co.*, 15 P.U.R.4th 209 (Mich. Pub. Serv. Comm'n 1976); *Northwestern Bell Tel. Co.*, 15 P.U.R.4th 289 (S.D. Pub. Utils. Comm'n 1976). But see *Illinois Bell Tel. Co. v. Illinois Commerce Comm'n.*, 55 Ill. 2d 461, 303 N.E.2d 364 (1973); *Northwestern Bell Tel. Co.*, 3 P.U.R.4th 486 (S.D. Pub. Utils. Comm'n), *aff'd*, 3 P.U.R.4th 473 (S.D. 6th Cir. 1974). The logic offered in support of advertising in these cases is identical to that used to justify promotional advertising by energy utilities prior to the energy crisis. The Supreme Court of Massachusetts has held that both institutional and promotional advertising by a telephone company are allowable. *New England Tel. & Tel. Co. v. Dep't of Pub. Utils.*, *supra* note 50.

117. *State v. Oklahoma Gas & Elec. Co.*, *supra* note 115. See also, *Northern States Power Co.*, 6 P.U.R.4th 38 (N.D. Pub. Serv. Comm'n 1974), *aff'g* *Otter Tail Power Co.*, 87 P.U.R.3d 204 (N.D. Pub. Serv. Comm'n 1970).

Commissions in a few other jurisdictions continue to honor judicial precedent in favor of promotional advertising by utilities. Ohio has abided by the *West Ohio* decision despite challenges based on conservation and environmental considerations. *Cleveland Elec. Illumination Co.*, 3 P.U.R.4th 259 (Ohio Pub. Utils. Comm'n 1973). In Massachusetts, the commission is bound by *New England Tel. & Tel. Co. v. Dep't of Pub. Utils.*, *supra* note 50. See *Boston Gas Co.*, 12 P.U.R.4th 405 (Mass. Dep't of Pub. Utils. 1975); *Boston Edison Co.*, 99 P.U.R.3d 417 (Mass. Dep't of Pub. Utils. 1973). In other jurisdictions where the state supreme court has held such advertising to be generally allowable, some decisions indicate that the company has discontinued the practice, apparently of its own choice. See *Central Me. Power Co.*, 8 P.U.R.4th 277 (Me. Pub. Utils. Comm'n 1975); *The Gas Service Co.*, 6 P.U.R.4th 99 (Mo. Pub. Serv. Comm'n 1974).

118. See, e.g., *In re Hawaiian Elec. Co.*, 56 Hawaii 260, 535 P.2d 1102 (1975); *Public Serv. Co. of N.H. v. State*, 113 N.H. 497, 311 A.2d 513 (1973); *Alabama Power Co.*, 97 P.U.R.3d 371 (Ala. Pub. Serv. Comm'n 1972); *Southern Cal. Edison Co.*, 100 P.U.R.3d 257 (Cal. Pub. Utils. Comm'n 1973); *Public Serv. Co. of Colo.*, 13 P.U.R.4th 40 (Colo. Pub. Utils. Comm'n 1975); *Promotional Practices of Elec. Utils.*, 8 P.U.R.4th 268 (Fla. Pub. Serv. Comm'n 1975); *Gasco Inc.*, 14 P.U.R.4th 561 (Hawaii Pub. Utils. Comm'n 1976); *Michigan Power Co.*, 18 P.U.R.4th 418 (Mich. Pub. Serv. Comm'n 1977); *Michigan Consolidated Gas Co.*, 1 P.U.R.4th 229 (Mich. Pub. Serv. Comm'n 1973); *Southern Union Gas Co.*, 12 P.U.R.4th 219 (N.M. Pub. Serv. Comm'n 1975); *Rochester Gas & Elec. Corp.*, 14 P.U.R.4th 475 (N.Y. Pub. Serv. Comm'n 1976); *Iroquois Gas Corp.*, 91 P.U.R.3d 511 (N.Y. Pub. Serv. Comm'n 1971); *Duke Power Co.*, 7 P.U.R.4th 239 (N.C. Pub. Utils. Comm'n 1974); *Portland Gen. Elec. Co.*, 8 P.U.R.4th 393 (Ore. Pub. Util. Comm'r 1974); *Pennsylvania Pub. Utils. Comm'n v. Metropolitan Edison Co.*, 96 P.U.R.3d 113 (Pa. Pub. Utils. Comm'n 1972); *Wisconsin Fuel & Light Co.*, 4 P.U.R.4th 368 (Wis. Pub. Serv. Comm'n 1973).

Some decisions have attacked the rationale that energy utilities need to advertise in order to compete with an alternative energy supplier. It is argued that such

The use of ratemaking as a tool to support a national energy policy must be carefully distinguished from the fuel supply problems discussed earlier. The energy crisis is a public policy which prevents fuel suppliers from acquiring "windfall profits."¹¹⁹ Fuel prices are therefore held at less than market equilibrium, and shortages are the inevitable result.¹²⁰ Thus energy shortages are an undesirable by-product of the political decision to hold energy prices at an artificially low level.¹²¹ An emphasis on energy conservation attempts to alleviate this problem.

If a company is individually affected by an inability to acquire more fuel at existing prices, then advertising to stimulate increased consumption is wasted because the company will be unable to serve that demand.¹²² On the other hand, where advertising is disallowed without any showing that the company is limited by supply problems, the commission is imposing a public policy on the firm. Competitive businesses, such as gas stations, will not generally stop pro-

competition does not benefit the ratepayer because the electric and gas companies simply advertise to a standstill, i.e., the advertising of each simply nullifies the advertising of the other. See *In re Hawaiian Elec. Co.*, *supra*. Thus each company in turn may seek to have an ever higher advertising budget approved in order to gain an advantage, thereby "whipsawing" an unjustifiably high and essentially useless expense item into the rate structure. See *Southern Cal. Edison Co.*, 90 P.U.R.3d 1, 17 (Cal. Pub. Utils. Comm'n 1971). This reasoning does not independently justify disallowing all promotional advertising. Of course, if the expense is unreasonably high by any objective standard, an adjustment should be made. However, the logic offered in these cases ignores the fact that defensive advertising is common in unregulated industries where the government finds no compelling reason to intervene in order to protect the consumer's pocketbook. Moreover, even if the advertising by a utility does only tend to offset the efforts of its rival and has no appreciable effect on its market share, the consumer benefits at least by having been encouraged to make an informed choice between the available alternatives. The fundamental reason for the disallowances in these cases is to conform the utility's advertising program to national energy policy, and not because competitive advertising involves bad business judgment.

119. As the White House has stated:

In 1973-74, the oil-producing countries raised the world oil prices fourfold. Deregulation of oil and gas prices would make U.S. producers the beneficiaries of those arbitrary price rises, and yield windfall profits from the increased value of oil and gas in existing fields. The producers have no equitable claim to that enhanced value because it is unrelated to their activities or economic contributions.

EXECUTIVE OFFICE OF THE PRESIDENT—ENERGY POLICY AND PLANNING, THE NATIONAL ENERGY PLAN 50 (1977).

120. *Utility Advertising*, *supra* note 24, at 459.

121. For a discussion of the relationship between price controls, shortages, and economic rent (often pejoratively referred to as windfall profit), see, e.g., A. ALCHIAN & W. ALLEN, *supra* note 15, at 88, 111-12.

122. See note 102 *supra*, and accompanying text.

moting sales in order to endorse an energy conservation ethic. However, if gas is in short supply and cars are lined up waiting to buy it, promotional activities by gas station owners are unlikely.

The politics of energy is not at issue here, nor is the wisdom of national energy policy questioned. It is apparent, however, that the problem lies with finite supplies of fossil fuels and not with an attempt by utilities to exploit their monopolistic advantage. It is fuel producers, and not utilities, that reap the benefits of high fuel prices. Utilities simply pass the cost along to the public.

Therefore, a commission decision which relies on an energy conservation ethic generally, rather than on a showing of tangible supply problems affecting the particular firm, is based on policies which have no direct relationship to the utility or its monopolistic position. Instead, a public policy external to the operation of the company is imposed on its private owners in the form of control over the firm's advertising policy.

In many cases this distinction is probably one of form rather than substance. Where advertising has been disallowed because of a generalized desire to conserve energy, it is likely that the commission could easily have recorded a finding that the particular firm was anticipating difficulty in acquiring sufficient fuel to meet increased demand.¹²³ This is especially true if the commission may look beyond the immediately foreseeable future. Some cases indicate that the utility is cooperating with the emphasis on conservation, presumably for this reason.¹²⁴ On the other hand, several decisions have disallowed promotional advertising even where the opinion indicates that the utility had access to sufficient fuel and could serve the increased demand.¹²⁵

The desire to conserve fossil fuels is not the only policy which has been cited as justifying the disallowance of promotional adver-

123. The cases cited in note 118 do not refer to such evidence in the record. Instead they appear to justify their policy on the energy crisis in general.

124. See *Promotional Practices of Electric Utils.*, 8 P.U.R.4th 268 (Fla. Pub. Serv. Comm'n 1975); *The Gas Service Co.*, 6 P.U.R.4th 99 (Mo. Pub. Serv. Comm'n 1974); *Long Island Lighting Co.*, 9 P.U.R.4th 21 (N.Y. Pub. Serv. Comm'n 1975); *Washington Utils. & Transp. Comm'n v. Pacific Power & Light Co.*, 7 P.U.R.4th 470 (Wash. Utils. & Transp. Comm'n 1974).

125. "Load building activities are peculiarly inappropriate when gas energy is in short supply on a national basis. Although the Michigan Wisconsin system may be in a better supply system than many, we must regard conservation as the dominant theme of any reasonable gas policy—federal or state." *Wisconsin Gas Co.*, 99 P.U.R.3d 160, 163-64 (Wis. Pub. Serv. Comm'n 1973). See also *Michigan Power Co.*, 18 P.U.R.4th 418, 426 (Mich. Pub. Serv. Comm'n 1977); *Southern Union Gas Co.*, 12 P.U.R.4th 219 (N.M. Pub. Serv. Comm'n 1975).

tising. Some jurisdictions have also expressed concern over the undesirable environmental effects caused by the generation, distribution, or consumption of energy.¹²⁶

Economists recognize the environmental problems associated with productive activities as external costs. Costs are externalized by a firm when they can be effectively shifted onto society as a whole, rather than being paid for by the firm and passed along in the price of the product. Pollution is a classic example of this problem of externalities, inasmuch as the general public bears the burden of pollution rather than the firm which caused it.¹²⁷

Any firm, regardless of whether it is a monopolist, has an obvious incentive to shift costs onto the public in order to decrease its own costs. The public may respond with legislation to internalize these costs by, for example, requiring pollution control equipment. The decision to internalize a cost is difficult because the price eventually reflects the expense and is paid for by consumers. Moreover, the activity of the company may involve external benefits as well as costs. These benefits will be reduced if the price rises, causing demand and production to fall. This is particularly true of energy utilities, where the relationship between energy production and economic health has long been recognized.¹²⁸ It may be necessary to trade off clean air for jobs.

Accordingly, a few decisions have allowed advertising by public utilities to promote industrial development in their service areas.¹²⁹ Some of these allowances were made despite language in the same opinions disallowing advertising to promote energy consumption generally.¹³⁰ The anomaly is apparent, inasmuch as industrial development must necessarily increase the overall demand for power. The contradiction arises from a desire to conserve energy

126. See *In re Hawaiian Elec. Co.*, *supra* note 118; *Southern Cal. Edison Co.*, 90 P.U.R.3d 1 (Cal. Pub. Utils. Comm'n 1971); *Pacific Gas & Elec. Co.*, 87 P.U.R.3d 270 (Cal. Pub. Utils. Comm'n 1971); *Public Serv. Co. of Colo.*, 13 P.U.R.4th 40 (Colo. Pub. Utils. Comm'n 1975); *Promotional Practices of Elec. Utils.*, 8 P.U.R.4th 268 (Fla. Pub. Serv. Comm'n 1975).

127. 1 A. KAHN, *supra* note 3, at 193-95.

128. *Id.*

129. See *Alabama Power Co.*, 97 P.U.R.3d 371 (Ala. Pub. Serv. Comm'n 1972); *Consumers Power Co.*, 38 P.U.R.3d 355 (Mich. Pub. Serv. Comm'n 1961); *Michigan Consol. Gas Co.*, 36 P.U.R.3d 289 (Mich. Pub. Serv. Comm'n 1960); *Rochester Gas & Elec. Co.*, 14 P.U.R.4th 475 (N.Y. Pub. Serv. Comm'n 1976).

130. *Alabama Power Co.*, *supra* note 129; *Rochester Gas & Elec. Co.*, *supra* note 129.

while simultaneously preserving the external benefits of energy production.

The trade-off between the external costs and benefits of energy production is a difficult policy question involving a compromise between competing values. However, the issue is unrelated to the fact that utilities are monopolies. The problem is identical when applied to unregulated businesses.¹³¹ Despite this, utilities are being required to conform their advertising messages to the policy decisions of the commissions.

Another reason appearing in some commission decisions to justify the disallowance of promotional advertising expenses is a concern for the general inflationary trend of costs. Advertising budgets are cut simply because of a desire to economize in the face of higher costs elsewhere.¹³² These opinions do not hold that the advertising outlay is the result of waste or inefficiency by management.¹³³ Rather they are the product of a vague consumerist sentiment. One student of the ratemaking process has observed that "many laymen somehow believe that they may be able to stop all prices from rising except their own wages, with appropriate action."¹³⁴ Advertising is therefore disallowed because it is not directly related to providing utility service.¹³⁵

Regardless of the merits of this policy, it has no bearing on the question of monopolistic exploitation. Any firm will eventually have to raise its prices in order to cover increased costs for plant, equipment, supplies and labor. The government does not ordinarily intervene by preventing the company from passing advertising costs along to consumers in order to combat inflation. A commission that disallows an otherwise reasonable advertising expense in order to

131. 1 A. KAHN, *supra* note 3, at 194.

132. See *Public Serv. Co. of N.H. v. State*, 113 N.H. 497, 311 A.2d 513 (1973); *Southern Cal. Edison Co.*, 90 P.U.R.3d 1 (Cal. Pub. Utils. Comm'n 1971); *Promotional Practices of Elec. Utils.*, 8 P.U.R.4th 268 (Fla. Pub. Serv. Comm'n 1975); *Michigan Consol. Gas. Co.*, 1 P.U.R.4th 229 (Mich. Pub. Serv. Comm'n 1973); *Detroit Edison Co.*, 3 P.U.R.4th 209 (Mich. Pub. Serv. Comm'n 1974); *Portland Gen. Elec. Co.*, 8 P.U.R.4th 393 (Ore. Pub. Util. Comm'r 1974).

133. "Waste" is used here to mean that the amount of the expense was unreasonably high, rather than that the content of the advertising was without merit.

134. Joskow, *Inflation and Environmental Concerns: Structural Change in the Process of Public Utility Regulation*, *supra* note 110, at 313.

135. See, e.g., *Illinois Bell Tel. Co. v. Illinois Commerce Comm'n*, 55 Ill. 2d 461, 303 N.E.2d 364 (1973), dealing with both promotional and institutional advertising by a telephone company. In that case it was expressly found that the cost of the advertising was not excessive or improper.

offset increased costs elsewhere is directly substituting its business judgment for that of the utility's managers.

Where promotional advertising is disallowed, the commission usually allows or encourages the utility to advertise in favor of energy conservation.¹³⁶ This policy also extends to allowances for advertisements dealing with environmental problems when promotional advertising has been disallowed because of environmental concerns.¹³⁷

It is thus apparent that advertising by privately owned utilities has become subject to the value judgments and policy decisions of state commissions. The commissions are selecting the topics of advertising they consider desirable, and disallowing all others. This is being done to serve policies which are independent of concern that the utility may be exploiting its monopolistic advantage to the detriment of consumers. There is accordingly no apparent reason why utility advertising should be uniquely subject to these policies. Advertising which is designed to promote a favorable public image for the company, rather than to stimulate demand, has met with similar treatment.

Advertising to Promote Public Goodwill

Many companies, whether regulated or not, seek to favorably influence public opinion towards the firm or towards issues in which the firm has an interest.¹³⁸ Institutional advertising¹³⁹ is particularly

136. See, e.g., Southern Cal. Edison Co., 100 P.U.R.3d 257 (Cal. Pub. Utils. Comm'n 1973); Promotional Practices of Elec. Utils., 8 P.U.R.4th 268 (Fla. Pub. Serv. Comm'n 1975); National Fuel Gas Distribution Corp., 17 P.U.R.4th 138 (N.Y. Pub. Serv. Comm'n 1976); Public Serv. Co. of N.C., 19 P.U.R.4th 109 (N.C. Util. Comm'n 1977); Southern Union Gas Co., 12 P.U.R.4th 219 (N.M. Pub. Serv. Comm'n 1975); Utility Advertising, No. 76-467 (Ore. Pub. Util. Comm'r July 19, 1976); Washington Utils. & Transp. Comm'n v. Pacific Power & Light Co., 4 P.U.R.4th 305 (Wash. Utils. & Transp. Comm'n 1974); Wisconsin Power & Light Co., 4 P.U.R.4th 305 (Wis. Pub. Serv. Comm'n 1974).

137. See Southern Cal. Edison Co., 100 P.U.R.3d 257 (Cal. Pub. Utils. Comm'n 1973); Public Serv. Co. of Colo., 13 P.U.R.4th 40 (Colo. Pub. Utils. Comm'n 1975).

138. R. STANLEY, *supra* note 1, at 255-58.

139. According to the Leading National Advertisers and Publishers Information Bureau, advertising must perform one or more of the following objectives to be classed as institutional:

1. It must educate, inform, or impress the public regarding the company's policies, functions, facilities, objectives, ideals and standards.
2. It must build favorable opinion about the company by stressing the competence of the company's management, its scientific know-how, manufacturing skills, technological progress and product improvements, and contributions to social advancement and public welfare; and, on the

important to utilities because of the natural hostility which a consumer feels towards a firm he did not select and which "presents him with a substantial monthly bill which increases year-to-year as his total annual consumption and (in some cases) rates increase."¹⁴⁰

Institutional advertising may also be important to a utility simply because it is a regulated business. Public opinion that is favorable to the firm may be sought in order to give the utility increased leverage in proceedings before the commission.¹⁴¹ It has been demonstrated that advertising may effectively reduce consumer complaints about the utility to the commission.¹⁴² If such tactics result in a higher rate of return for the stockholders than is otherwise justifiable, it is clearly an attempt by the firm to profit from its status as a regulated monopoly.¹⁴³

Therefore, advertising by utilities that is a political attempt to influence a rate case has usually been disallowed.¹⁴⁴ One court explained that the receipts of a utility were to be treated as a public trust, and not used to acquire further rate increases.¹⁴⁵ The commissioners represented the public, and it was to them that the company should direct its appeals.¹⁴⁶

It should be observed, however, that in some of these cases the commission did not rely on a criticism of the advertising message. Instead, the advertising was disallowed because the expense was abnormal or nonrecurring and therefore should not be incorporated into the future rate structure.¹⁴⁷ Even this view was not universal.

other hand, must offset unfavorable publicity and negative attitudes.

3. It must build up the investment qualities of its securities, to improve the financial structure of the company.

4. It must sell the company as a good place to work (and so is often designed to appeal to college graduates or to people of certain skills).

Id. at 255.

140. *Utility Advertising*, *supra* note 24, at 459.

141. *Id.*

142. *Id.*

143. Such a rate of return would be greater than the firm's cost of capital. *Id.*

144. See *Fort Smith v. Southwestern Bell Tel. Co.*, 220 Ark. 70, 247 S.W.2d 474 (1952); *Southern Bell Tel. & Tel. Co. v. Louisiana Pub. Serv. Comm'n*, 239 La. 175, 118 So. 2d 372 (1960); *Southern Bell Tel. & Tel. Co.*, 4 P.U.R.3d 195 (Ala. Pub. Serv. Comm'n 1954); *Public Utils. Comm'n v. New England Tel. & Tel. Co.*, 80 P.U.R. (New Series) 397 (Me. Pub. Utils. Comm'n 1949); *New Jersey Bell Tel. Co.*, 78 P.U.R. (New Series) 97 (N.J. Board of Pub. Util. Comm'rs 1949).

145. *Fort Smith v. Southwestern Bell Tel. Co.*, *supra* note 144.

146. *Id.*

147. *Southern Bell Tel. & Tel. Co. v. Louisiana Pub. Serv. Comm'n*, *supra* note 144; *New Jersey Bell Tel. Co.*, *supra* note 144. There is, however, some measure of

Some decisions took the extraordinarily lenient viewpoint that the utility was entitled to "present its case in the newspapers," at the public's expense, while the matter of rates was being determined.¹⁴⁸

Advertising which was not directed at a rate proceeding but simply designed to encourage good customer relations¹⁴⁹ was, until recently, generally accepted.¹⁵⁰ It was considered not only desirable, but obligatory that the firm "maintain a contact with the economic and social life of the area it serves."¹⁵¹ In Wisconsin, the commission similarly observed that institutional advertising is "even more necessary with respect to public utility enterprises because of their importance in the economic, industrial and social well-being of all individuals and enterprises and because of their existence in the public interest."¹⁵² Earlier cases which questioned the value of such advertising generally limited themselves to warning or admonishing the utility to scrutinize such expenses carefully.¹⁵³

disapproval regarding the advertising message implicit in these disallowances. If a commission considers an abnormal or nonrecurring expense to be meritorious, it may incorporate the expense into the rate structure by providing that it be amortized over a period of time. *Compare* Rochester Gas & Elec. Corp., 33 P.U.R. (New Series) 393 (N.Y. Dep't of Pub. Utils. 1940) (expense of World's Fair exhibit disallowed), *with* Pacific Power & Light Co., 34 P.U.R.3d 36 (Ore. Pub. Util. Comm'r 1960) (expense connected with Oregon Centennial Exposition amortized over five years).

148. *Cincinnati Gas & Elec. Co. v. Cincinnati*, 75 P.U.R. (New Series) 97, 107 (Ohio Pub. Utils. Comm'n 1948). *See also* *New England Tel. & Tel. Co.*, 83 P.U.R. (New Series) 414 (Vt. Pub. Serv. Comm'n 1950), where the commission allowed the expense even though the propriety of such advertising was questioned.

149. This distinction has been explicitly recognized in the course of allowing institutional advertising. *See* *Consolidated Edison Co. of N.Y.*, 41 P.U.R.3d 305 (N.Y. Pub. Serv. Comm'n 1961).

150. *See* *Central Me. Power Co. v. Maine Pub. Utils. Comm'n*, 153 Me. 228, 136 A.2d 726 (1957); *New England Tel. & Tel. Co. v. Dep't of Pub. Utils.*, 360 Mass. 443, 275 N.E.2d 493 (1971); *State v. Oklahoma Gas & Elec. Co.*, 536 P.2d 887 (Okla. 1975); *Alabama Power Co.*, 97 P.U.R.3d 371 (Ala. Pub. Serv. Comm'n 1972); *Pacific Tel. & Tel. Co.*, 5 P.U.R.3d 396 (Cal. Pub. Utils. Comm'n 1954); *Central Me. Power Co.*, 8 P.U.R.4th 277 (Me. Pub. Utils. Comm'n 1975); *Union Elec. Co.*, 29 P.U.R.3d 254 (Mo. Pub. Serv. Comm'n 1959); *Consolidated Edison Co. of N.Y.*, 73 P.U.R.3d 417 (N.Y. Pub. Serv. Comm'n 1968); *Pennsylvania Pub. Util. Comm'r v. York Water Co.*, 78 P.U.R.3d 113 (Pa. Pub. Util. Comm'r 1968); *Mountain States Tel. & Tel. Co.*, 90 P.U.R. (New Series) 107 (Utah Pub. Serv. Comm'n 1951); *Wisconsin Elec. Power Co.*, 9 P.U.R.4th 204 (Wis. Pub. Serv. Comm'n 1975).

151. *Pennsylvania Pub. Util. Comm'r v. York Water Co.*, *supra* note 150, at 134.

152. *Wisconsin Elec. Power Co.*, *supra* note 150, at 210.

153. *See* *Pacific Tel. & Tel. Co.*, 23 P.U.R.3d 209 (Cal. Pub. Utils. Comm'n 1958); *New England Tel. & Tel. Co.*, 83 P.U.R. (New Series) 414 (Vt. Pub. Serv. Comm'n 1950).

Few decisions in recent years have continued to support the discretion of utility management to enhance the public image of the firm. Instead, institutional advertising is routinely disallowed on the basis that it serves only the interests of the stockholders and is of no benefit to the ratepayer.¹⁵⁴ Most commissions simply assert this without explanation, in the same manner in which institutional advertising was formerly assumed to be beneficial. A few decisions have ventured the opinion that the utility should rely on good, cheap and efficient service in order to curry favor with the public,¹⁵⁵ disregarding the fact that the public will probably ignore or be unaware of such service unless it is brought to their attention.¹⁵⁶

154. See, e.g., *Los Angeles v. Public Utils. Comm'n*, 7 Cal. 3d 331, 497 P.2d 785, 102 Cal. Rptr. 313 (1972); *Illinois Bell Tel. Co. v. Illinois Commerce Comm'n*, 55 Ill. 2d 461, 303 N.E.2d 364 (1973); *Public Serv. Co. of N.H. v. State*, 113 N.H. 497, 311 A.2d 513 (1973); *Arkansas Power & Light Co.*, 15 P.U.R.4th 153 (Ark. Pub. Serv. Comm'n 1976); *Connecticut Light & Power Co.*, 2 P.U.R.3d 379 (Conn. Pub. Utils. Comm'n 1953); *Pacific Tel. & Tel. Co.*, 95 P.U.R.3d 1 (Cal. Pub. Utils. Comm'n 1972); *Public Serv. Co. of Colo.*, 13 P.U.R.4th 40 (Colo. Pub. Utils. Comm'n 1975); *General Tel. Co. of Fla.*, 19 P.U.R.4th 227 (Fla. Pub. Serv. Comm'n 1977); *Southwestern Bell Tel. Co.*, 19 P.U.R.4th 1 (Kan. State Corp. Comm'n 1977); *Potomac Elec. Power Co.*, 10 P.U.R.4th 13 (Md. Pub. Serv. Comm'n 1975); *Michigan Bell Tel. Co.*, 15 P.U.R.4th 209 (Mich. Pub. Serv. Comm'n 1976); *Northwestern Bell Tel. Co.*, 16 P.U.R.4th 207 (Minn. Pub. Serv. Comm'n 1976); *Southwestern Bell Tel. Co.*, 18 P.U.R.4th 27 (Mo. Pub. Serv. Comm'n 1976); *Montana Power Co.*, 96 P.U.R.3d 265 (Mont. Pub. Serv. Comm'n 1972); *Cornhusker State Tel. Co.*, 13 P.U.R.4th 314 (Neb. Pub. Serv. Comm'n 1976); *Southern Union Gas Co.*, 12 P.U.R.4th 219 (N.M. Pub. Serv. Comm'n 1975); *New Rochelle Water Co.*, 7 P.U.R.4th 86 (N.Y. Pub. Serv. Comm'n 1974); *Duke Power Co.*, 7 P.U.R.4th 239 (N.C. Pub. Utils. Comm'n 1974); *Northern States Power Co.*, 6 P.U.R.4th 38 (N.D. Pub. Serv. Comm'n 1974); *Utility Advertising*, No. 76-467 (Ore. Pub. Util. Comm'r July 19, 1976); *General Tel. Co. of the Southeast*, 13 P.U.R.4th 24 (S.C. Pub. Serv. Comm'n 1976); *Northwestern Bell Tel. Co.*, 15 P.U.R.4th 289 (S.D. Pub. Utils. Comm'n 1976); *Wis. Power & Light Co.*, 4 P.U.R.4th 305 (Wis. Pub. Serv. Comm'n 1974).

In Iowa it has been determined that institutional advertising benefits both ratepayers and stockholders. Therefore the cost is split between them. *E.g.*, *Iowa Elec. Light & Power Co.*, 2 P.U.R.4th 288 (Iowa State Commerce Comm'n 1973); *North Central Pub. Serv. Co.*, 99 P.U.R.3d 432 (Iowa State Commerce Comm'n 1973).

155. *Piedmont Natural Gas Co.*, 34 P.U.R.3d 1 (N.C. Pub. Utils. Comm'n 1960), *rev'd*, *State ex rel. Utilities Comm'n v. Piedmont Natural Gas Co.*, 254 N.C. 536, 119 S.E.2d 469 (1961); *Portland General Elec. Co.*, 8 P.U.R.4th 393 (Ore. Pub. Util. Comm'r 1974). See also *In re Hawaiian Elec. Co.*, 56 Hawaii 260, 535 P.2d 1102 (1975) (promotional advertising).

156. One of the primary purposes of institutional advertising is to inform customers of the quality of the service which the company offers, and the value of the company as a member of the community. See note 139 *supra*. For example, in *Pacific Tel. & Tel. Co.*, 95 P.U.R.3d 1 (Cal. Pub. Utils. Comm'n 1972), some of the advertising concerned descriptions of employee helpfulness. The commission considered it of no benefit to the consumer because this message was not sufficiently informative. *Id.* at 10-11. See also *Public Serv. Co. of Colo.*, 13 P.U.R.4th 40 (Colo. Pub. Utils. Comm'n 1975).

The view that institutional advertising is of no tangible benefit to the consumer is true at least to the extent that the value of institutional advertising is speculative. It is impossible to measure the effects of a public relations effort with any degree of certainty.¹⁵⁷ A benefit has been found in the past based on the belief that such advertising helps to attract investment capital and market the firm's securities.¹⁵⁸ This reduces the cost of financing to the firm when it seeks new funds, a saving which theoretically can be passed along as lower rates. Other cases have held that institutional advertising helps to recruit employees¹⁵⁹ or reduces the cost of answering customers' questions.¹⁶⁰ Moreover, it is not unreasonable to suppose that a reduction in negative attitudes towards the utility will reduce losses in such areas as theft of utility service, bad debts and vandalism. These are all acknowledged objectives of institutional advertising which motivate unregulated businesses to spend money in this area.¹⁶¹ The value of such programs is predominantly a matter of business judgment. Nevertheless, most commissions today are unpersuaded that utility customers should pay for such advertising. In particular, the argument that institutional advertising is beneficial because it attracts investment capital has failed to prevent disallowance of the expense.¹⁶²

Some commissions have supported their disapproval of institutional advertising by suggesting that such advertising is only an indirect attempt to influence rate cases by securing the public's acquiescence in another rate increase.¹⁶³ It should be observed,

157. R. STANLEY, *supra* note 1, at 248.

158. *New England Tel. & Tel. Co. v. Dep't of Pub. Utils.*, *supra* note 150; *Alabama Power Co.*, 97 P.U.R.3d 371 (Ala. Pub. Serv. Comm'n 1972); *Southern Cal. Gas Co.*, 35 P.U.R.3d 300 (Cal. Pub. Utils. Comm'n 1960); *Consolidated Edison Co. of N.Y.*, 73 P.U.R.3d 417 (N.Y. Pub. Serv. Comm'n 1968).

159. *See Pacific Tel. & Tel. Co.*, 5 P.U.R.3d 396 (Cal. Pub. Utils. Comm'n 1954); *New York Tel. Co.*, 84 P.U.R.3d 321 (N.Y. Pub. Serv. Comm'n 1970); *Pennsylvania Pub. Util. Comm'r v. Bell Tel. Co. of Pa.*, 93 P.U.R.3d 13 (Pa. Pub. Util. Comm'r 1971).

160. *Pacific Gas & Elec. Co.*, 87 P.U.R.3d 270 (Cal. Pub. Utils. Comm'n 1971) (questions concerning the company's environmental commitment); *Pacific Tel. & Tel. Co.*, *supra* note 159.

161. *See* notes 138, 139 *supra*.

162. *See General Tel. Co. of Fla.*, 19 P.U.R.4th 227 (Fla. Pub. Serv. Comm'n 1977); *Cornhusker State Tel. Co.*, 13 P.U.R.4th 314 (Neb. Pub. Serv. Comm'n 1976). Oregon, however, has excepted institutional advertising specifically designed for investors or potential employees from its general policy of disallowing institutional advertising. *See Utility Advertising*, No. 76-467 (Ore. Pub. Util. Comm'r July 19, 1976).

163. *See Northern States Power Co.*, 11 P.U.R.4th 385 (Minn. Pub. Serv. Comm'n 1975); *Southern Union Gas Co.*, 12 P.U.R.4th 219 (N.M. Pub. Serv. Comm'n 1975).

however, that the public does not grant or refuse a request for increased rates. The commission itself is responsible for this decision, and will presumably rule on the basis of criteria independent of the firm's advertising. Given the hostility of many consumers towards utilities, it is unlikely that institutional advertising will generate public goodwill sufficiently fervent to coerce a commission into approving unreasonably high rates.

Thus, the argument that advertising to promote public goodwill is merely a disguised attempt to influence a rate case is indefensible. It does not justify depriving the utility of an allowance for reasonable expenses to maintain a good relationship with its customers, even in the face of rising rates. Where the costs for this type of advertising are unreasonably high, the commission may always take corrective action.¹⁶⁴

Like promotional advertising, institutional advertising has sometimes been criticized because the commission is concerned generally with rising prices.¹⁶⁵ The advertising budget is therefore sacrificed regardless of whether the expense in itself was reasonable. Some decisions also state that such advertising only aggravates consumers who must pay more for utility service.¹⁶⁶ This comment is made without the support of any showing that institutional advertising is generally ineffective in securing good customer relations.

Institutional advertising is sometimes directed at a specific issue of importance to the utility rather than the image of the firm in general. Where such advertising takes on a political character, commissions have generally been hostile. For example, several commissions have disallowed advertising designed to justify private instead of public ownership of utilities.¹⁶⁷ One court, however, allowed some expense for this purpose as advertising generally within the

164. *E.g.*, *New England Tel. & Tel. Co. v. Dep't of Pub. Utils.*, *supra* note 150.

165. *See* *Promotional Practices of Elec. Utils.*, 8 P.U.R.3d 268 (Fla. Pub. Serv. Comm'n 1975); *Potomac Elec. Power Co.*, 10 P.U.R.4th 13 (Md. Pub. Serv. Comm'n 1975); *Duke Power Co.*, 7 P.U.R.4th 239 (N.C. Pub. Utils. Comm'n 1974); *Portland Gen. Elec. Co.*, 8 P.U.R.4th 393 (Ore. Pub. Util. Comm'r 1974); *Wisconsin Power & Light Co.*, 4 P.U.R.4th 305 (Wis. Pub. Serv. Comm'n 1974).

166. *See* *Illinois Bell Tel. Co. v. Illinois Commerce Comm'n*, 55 Ill. 2d 461, 303 N.E.2d 364 (1973); *Pacific Gas & Elec. Co.*, 87 P.U.R.3d 270 (Cal. Pub. Utils. Comm'n 1971); *Potomac Elec. Power Co.*, 10 P.U.R.4th 13 (Md. Pub. Serv. Comm'n 1975); *New Rochelle Water Co.*, 7 P.U.R.4th 86 (N.Y. Pub. Serv. Comm'n 1974).

167. *See* *Consumers Power Co.*, 29 P.U.R.3d 133 (Mich. Pub. Serv. Comm'n 1959); *Pacific Power & Light Co.*, 34 P.U.R.3d 36 (Ore. Pub. Util. Comm'r 1960); *Utah Power & Light Co.*, 95 P.U.R. (New Series) 390 (Utah Pub. Serv. Comm'n 1952).

realm of management discretion.¹⁶⁸ More recently, some commissions have held advertising on behalf of nuclear power allowable.¹⁶⁹ Oregon, however, has found such a campaign to be of questionable value and has disallowed it.¹⁷⁰

The hostility being exhibited towards institutional advertising does not extend to messages which are not issue-oriented or which are neutral with respect to the utility's image. The result is that utilities are being confined to advertising objective facts concerning such matters as safety, bill computation, and available services. Such messages are deemed of sufficient worth by the commission, and allowed as informational advertising which is of some tangible benefit to the consumer.¹⁷¹

From the foregoing it is apparent that advertising by utilities to gain the goodwill of their customers is being disallowed on the basis of the commission's arbitrary opinion concerning the intrinsic value of the advertising message. Such judgments occur despite the fact that the advertising program may have been similar to that of unregulated and more competitive businesses. They are unrelated to the problems posed by the company's monopolistic advantage.¹⁷²

168. See *State ex rel. Dyer v. Public Serv. Comm'n*, 341 S.W.2d 795 (Mo. 1960).

169. *Central Maine Power Co.*, 15 P.U.R.4th 455 (Me. Pub. Utils. Comm'n 1976); *Rochester Gas & Elec. Corp.*, 14 P.U.R.4th 475 (N.Y. Pub. Serv. Comm'n 1976); *Wisconsin Elec. Power Co.*, 9 P.U.R.4th 204, 219-20 (Wis. Pub. Serv. Comm'n 1975) (Chairman Cudahy, concurring).

170. See *Portland Gen. Elec. Co.*, 8 P.U.R.4th 393 (Ore. Pub. Util. Comm'r 1974). See also *Rochester Gas & Elec. Co.*, *supra* note 169, at 487-88 (Comm'r Berlin, dissenting).

171. See *Los Angeles v. Public Utils. Comm'n*, *supra* note 154; *Illinois Bell Tel. Co. v. Illinois Commerce Comm'n*, *supra* note 154; *Arkansas Power & Light Co.*, 15 P.U.R.4th 153 (Ark. Pub. Serv. Comm'n 1976); *Pacific Gas & Elec. Co.*, 87 P.U.R.3d 270 (Cal. Pub. Utils. Comm'n 1971); *Promotional Practices of Elec. Utils.*, 8 P.U.R.4th 268 (Fla. Pub. Serv. Comm'n 1975); *Consumers Power Co.*, 14 P.U.R.4th 1 (Mich. Pub. Serv. Comm'n 1976); *Southern Union Gas Co.*, 12 P.U.R.4th 219 (N.M. Pub. Serv. Comm'n 1975); *Iroquois Gas Corp.*, 91 P.U.R.3d 511 (N.Y. Pub. Serv. Comm'n 1971); *North Carolina Natural Gas Corp.*, 99 P.U.R.3d 237 (N.C. Pub. Utils. Comm'n 1973); *Otter Tail Power Co.*, 87 P.U.R.3d 204 (N.D. Pub. Serv. Comm'n 1970); *Pennsylvania Pub. Util. Comm'r v. Bell Tel. Co. of Pa.*, 93 P.U.R.3d 13 (Pa. Pub. Util. Comm'r 1971); *Wisconsin Power & Light Co.*, 4 P.U.R.4th 305 (Wis. Pub. Serv. Comm'n 1974).

172. In *Pacific Tel. & Tel. Co.*, 95 P.U.R.3d 1 (Cal. Pub. Utils. Comm'n 1972), the advertising was disallowed even though it was explicitly found that the expense was reasonable as a percentage of revenues. See also *Illinois Bell Tel. Co. v. Illinois Commerce Comm'n*, *supra* note 154. Oregon recognized the reasonableness of the total expense as an entirely separate consideration from that of whether the type of advertising is allowable. See *Utility Advertising*, No. 76-467 (Ore. Pub. Util. Comm'r July 19, 1976).

These decisions appear to be based on an unwillingness by commissioners to defer to the business judgment of utility managers, or to make the equally arbitrary assumption that institutional advertising actually provides ratepayers with some tangible benefit.

The disallowance of both promotional and institutional advertising in modern commission decisions represents a desire on the part of these agencies to judge the social utility of the advertising. This trend is emphasized by the selective allowance of advertising to conserve energy, promote environmental awareness, encourage industrial development, or disseminate facts considered by the commission to be informational. These decisions represent an expansion of the commissions' role in reviewing advertising expenses as they have responded to policies that had not developed at the time of the *West Ohio* decision. In the process, the presumption that management has exercised good faith in their advertising decisions has been abandoned.

THE BURDEN OF PROOF

The mechanism for achieving greater commission control over the advertising policy of public utilities has been a shifting of the burden of proof. This has occurred notwithstanding the prohibition of *West Ohio* and its successors, which required the commission to presume the expense was reasonable and show the opposite with evidence before a disallowance could be made.

As a general principle, the utility has the initial burden of proof when it seeks to justify a rate increase. This has been explained as arising from the utility's trust relationship with the public, and from its superior funds, organization and access to pertinent records.¹⁷³ *West Ohio* limited the utility's duty by establishing that, once the firm has shown that the expense was paid, the burden rests with the commission to show that the cost was unnecessary or wasteful.¹⁷⁴ In that case, the commission's disallowance of the expenditure had "no basis in evidence, either direct or circumstantial."¹⁷⁵ The Court therefore struck down the decision because it was unsupported by anything other than the commission's opinion about advertising.

173. See *El Dorado v. Arkansas Pub. Serv. Comm'n*, 213 Ark. 812, 362 S.W.2d 680 (1962).

174. 294 U.S. at 72.

175. *Id.*

Recently this principle was recast by one court in more modern evidentiary terms. The company must meet the burden of production and establish a prima facie case by showing that the expense was actually incurred. The commission, however, has the burden of proving by substantial and competent evidence that the expense is unreasonable because of inefficiency or bad faith.¹⁷⁶

Despite *West Ohio*, many jurisdictions have now indicated that the company also has the burden of proving that the advertising benefits the consumers.¹⁷⁷ This is a much greater duty than merely showing that the expense was incurred and relying on the commission to rebut the presumption that management has acted in good faith.

This reassignment of the burden of proof is most evident in the area of institutional advertising. The decisions in this area are not based on evidence. Instead they are based on assumptions as to whether such advertising benefits the consumer or the stockholders. Recent decisions assume that the consumer receives no tangible benefit,¹⁷⁸ whereas commissions in the past have assumed a benefit with equal facility.¹⁷⁹ Inasmuch as commissions disallowing the expense are reasoning on the basis of an irrefutable value judgment, the company cannot offer evidence in support of the advertising other than that the expense was actually incurred. The assignment of the burden of proof under such circumstances is determinative. The "benefit to the consumer" test, when used in this manner, af-

176. *Boise Water Corp. v. Idaho Pub. Utils. Comm'n*, 97 Idaho 832, 555 P.2d 163 (1976). The decision also recognized that utilities have a heavier burden of proof with respect to payments made to affiliated companies. A number of commission decisions show particular disapproval of expenses incurred by a local utility as its pro-rated share of a cooperative national advertising campaign. See *Intermountain Gas Co.*, 18 P.U.R.4th 79 (Idaho Pub. Utils. Comm'n 1976); *Northwestern Bell Tel. Co.*, 16 P.U.R.4th 207 (Minn. Pub. Serv. Comm'n 1976); *New York Tel. Co.*, 92 P.U.R.3d 321 (N.Y. Pub. Serv. Comm'n 1971); *Northwestern Bell Tel. Co.*, 15 P.U.R.4th 289 (S.D. Pub. Utils. Comm'n 1976); *Mountain States Tel. & Tel. Co.*, 14 P.U.R.4th 149 (Wyo. Pub. Serv. Comm'n 1976). *But see* *General Tel. Co. of Wis. v. Wis. Pub. Serv. Comm'n*, 46 P.U.R.3d 1 (Wis. Cir. Ct. 1962), in which the court called the commission "picayunish" because it had disallowed the company's contribution to national advertising by the General Telephone system. There had been no showing by the commission of bad faith, inefficiency, or imprudence. *Id.* at 5.

177. See, e.g., *In re Hawaiian Elec. Co.*, 56 Hawaii 260, 535 P.2d 1102 (1975); *Southern Bell Tel. & Tel. Co.*, 12 P.U.R.4th 252 (Fla. Pub. Serv. Comm'n 1975); *Intermountain Gas Co.*, 18 P.U.R.4th 79 (Idaho Pub. Utils. Comm'n 1976); *Consumers Power Co.*, 14 P.U.R.4th 1 (Mich. Pub. Serv. Comm'n 1976); *Northern States Power Co.*, 11 P.U.R.4th 385 (Minn. Pub. Serv. Comm'n 1975).

178. See note 154 *supra*.

179. See note 150 *supra*.

fords the commission an opportunity to substitute its business judgment for that of management.

Significantly, almost all decisions which require the company to show that its advertising has some intrinsic social value make no reference to *West Ohio*. The few cases which acknowledge *West Ohio's* existence and nevertheless disallow the expense because it is deemed worthless do not actually resolve the issues raised by that decision.¹⁸⁰ Even if it is true that the advertising has no merit, there remains a legitimate issue as to who must prove this and how it can be done. *West Ohio* requires that the commission show waste with evidence in the record. Therefore, in those jurisdictions where state courts have followed *West Ohio*, some commissions have been bound to pay due deference to management's discretion to select the message it believes is desirable.¹⁸¹

Placing the burden of proof upon the commission does not mean that the utility's advertising expenses must go unchallenged. It has been demonstrated that the commission has a great deal of discretion in determining whether the level of the expense is excessive, and courts will invariably defer to the commission's expertise where their decision finds support in the record.¹⁸² Nor is there any question as to who must produce the evidence to resolve the issue. The company will always have the responsibility of providing the commission with all necessary data. However, where the commission must support its disallowance with competent evidence of waste, it should be precluded from inhibiting management's

180. In *Hartford v. Hartford Elec. Light Co.*, No. 112008 (Hartford County C.P. March 31, 1976), the court reviewed a commission ruling which had expressly relied on *West Ohio* in allowing advertising expenses. Judge Bieluch overruled the Supreme Court with the observation that such reasoning is "outdated under present conditions." *Id.* at 32. See also *In re Northwestern Bell Tel. Co.*, 3 P.U.R.4th 473 (S.D. Cir. Ct. 1974); *Portland Gen. Elec. Co.*, 8 P.U.R.4th 393 (Ore. Pub. Util. Comm'r 1974).

181. See *Central Me. Power Co.*, 15 P.U.R.4th 455 (Me. Pub. Utils. Comm'n 1976); *New England Tel. & Tel. Co.*, 11 P.U.R.4th 297 (Mass. Dep't of Pub. Utils. 1975); *New England Tel. & Tel. Co.*, 13 P.U.R.4th 268 (Vt. Pub. Serv. Board 1976). Ohio has continued to adhere to the mandate of the *West Ohio* case. See *Ohio Bell Tel. Co.*, 15 P.U.R.4th 344 (Ohio Pub. Utils. Comm'n 1976).

Elsewhere commissions are ignoring state court decisions in favor of utility advertising as well as *West Ohio*. Compare *El Dorado v. Arkansas Pub. Serv. Comm'n*, *supra* note 173, with *Arkansas Power & Light Co.*, 15 P.U.R.4th 153 (Ark. Pub. Serv. Comm'n 1976); compare *State ex rel. Utilities Comm'n v. Piedmont Natural Gas Co.*, 254 N.C. 536, 119 S.E.2d 469 (1961), with *Duke Power Co.*, 7 P.U.R.4th 239 (N.C. Pub. Utils. Comm'n 1974); compare *State ex rel. Dyer v. Public Serv. Comm'n*, *supra* note 168, with *Southwestern Bell Tel. Co.*, 18 P.U.R.4th 27 (Mo. Pub. Serv. Comm'n 1976).

182. *Acker v. United States*, 298 U.S. 426 (1936); *St. Joseph Stock Yards Co. v. United States*, 298 U.S. 38 (1936).

prerogative to advertise on the basis of simple assertions regarding the value of institutional advertising.¹⁸³

The disallowance of promotional advertising raises more difficult questions, inasmuch as such advertising by energy utilities obviously contravenes important and universally recognized public policies. There is no problem with the assignment of the burden of proof if one assumes that utility advertising which conflicts with public policy is unreasonable by definition. The state can regulate firms affected with a public interest and place special duties upon them.¹⁸⁴ It is necessary to inquire as to what the public interest is, and what duties arise from it. More specifically, one must determine the scope of the commission's statutory jurisdiction to regulate rates.

THE PUBLIC INTEREST

Even if the current trend in commission decisions does not contravene *West Ohio* and raise constitutional issues, there remains a problem with the scope of the commission's statutory mandate. It is clear that modern regulators are dealing with issues which did not confront their predecessors, and which had not arisen at the time of the *West Ohio* decision. It is less clear that those issues are properly placed upon the agenda.

In the context of advertising expenses, there is a dearth of authority on the policies which commissions are entitled to consider. Only the Supreme Court of Oklahoma recognized the issue by assuming for the sake of argument that the commission had jurisdiction over the energy crisis.¹⁸⁵ Elsewhere there has merely been reference to statutory language admonishing the commission to regulate in the public interest.¹⁸⁶

In *NAACP v. Federal Power Commission*, the Supreme Court recently held that the phrase "public interest" is not all encompassing.¹⁸⁷ The Court rejected an attempt by the NAACP to incorporate the goal of nondiscriminatory employment practices into the charter of the Federal Power Commission. While the Court recognized that this was an important national priority, it observed that it had in

183. *New England Tel. & Tel. Co. v. Dep't of Pub. Utils.*, *supra* note 150.

184. *Nebbia v. New York*, 291 U.S. 502 (1934).

185. *State v. Oklahoma Gas & Elec. Co.*, 536 P.2d 887 (Okla. 1975).

186. *E.g.*, *Utility Advertising*, No. 76-467 at 4 (Ore. Pub. Util. Comm'r July 19, 1976).

187. 425 U.S. 662 (1976).

the past "consistently held that the words 'public interest' in a regulatory statute is not a broad license to promote the general welfare. Rather, the words take meaning from the purposes of the regulatory legislation."¹⁸⁸ In this case, the Power and Gas Acts did not contain a directive to eradicate discrimination.¹⁸⁹ Only where such discrimination had a pecuniary impact which bore directly on the issue of just and reasonable rates would there be sufficient nexus between the legislative purpose and the discriminatory practices to justify regulatory action.¹⁹⁰

The purpose of regulating the rates of public utilities is to prevent monopolistic exploitation.¹⁹¹ Absent the belief that these businesses are natural monopolies, there is no better reason to regulate them than other large and economically important companies. Regulatory statutes were passed to assure adequate service at nondiscriminatory and reasonable rates which balanced the interests of the public and the private owners of the utilities.¹⁹² They were not designed to make these industries uniquely responsible for promoting every public policy.

NAACP v. Federal Power Commission, if applied to utility regulation, indicates that where such issues as the energy crisis are unrelated to the purpose of regulating utility rates, the commission is without authority to disallow advertising for that reason. If, however, the energy crisis has a direct pecuniary impact on the usefulness of advertising, then the commission may act. For example, the national energy policy may create fuel shortages which make an individual utility unable to service new demand. Promotional advertising under such circumstances is a waste of money.¹⁹³ On the other hand, if the firm can service new demand, a disallowance based only on the commission's desire to endorse the national energy conservation ethic may be beyond the commission's statutory jurisdiction. This follows from the fact that the regulatory legislation was not enacted for the purpose of conserving energy, and such a goal can not be casually extracted from the phrase "public interest."

Despite this logic, advertising by utilities is now routinely disallowed to serve broad social goals which are entirely unrelated

188. *Id.* at 669.

189. They do, however, explicitly grant authority to consider conservation and environmental questions. *Id.* at 670 n.6.

190. *Id.* at 671.

191. *See* note 13 *supra*.

192. 1 A.J.G. PRIEST, PRINCIPLES OF PUBLIC UTILITY REGULATION 1-5 (1969).

193. *See* note 102 *supra*.

to the problem of monopoly power in these industries. This is particularly true of promotional advertising by energy utilities, where not only the energy crisis¹⁹⁴ but inflation¹⁹⁵ and environmental concerns¹⁹⁶ have successfully intruded on management's traditional prerogative to advertise. One may question whether the expertise of the agency extends to such broad policy matters and justifies the deference of the judiciary. The experience of the commission and its staff with the industry may make them uniquely qualified to identify an excessive expense, but it does not make them competent to determine the appropriate response to inflation or to arbitrate the competing values raised by environmental concerns.

The issue of whether the commission has statutory jurisdiction to disallow advertising because of such policy considerations has not been discussed in any opinion.¹⁹⁷ A challenge to the commission's statutory authority should be decided on the basis of a careful consideration of its enabling legislation, and the practical value of using the ratemaking mechanism to achieve these policies. Ultimately, the decision will turn on the proper balance between public authority and private rights.

CONCLUSION

The above discussion has emphasized two fundamental principles. First, the purpose of controlling a utility's advertising expense is to prevent monopolistic exploitation in the form of wasteful costs. Second, the law forbids regulatory agencies from arbitrarily substituting their judgment for that of management. The commission has the burden of proving that the expense was wasteful. Where there is evidence in the record to support such a finding, a court must defer to the expertise of the commission.

Regulatory commissions have developed standards that are consistent with these principles in order to determine the reasonableness of an advertising expense. An expenditure which

194. See note 118 *supra*.

195. See note 132 *supra*.

196. See note 126 *supra*.

197. The paucity of challenges by utilities to the commission's authority to disallow advertising is possibly due to the fact that the utility does not actually lose any money. It will simply stop incurring the expense. The utility loses the right to advertise as it pleases, but the actual pecuniary loss is likely to fall on an advertising agency. Most of the judicial discussion of the allowability of advertising expenses is appended to rulings on such issues as the scope of the rate base or the rate of return. A utility is more likely to contest these issues because it has a direct financial interest in the decision.

compares unfavorably with that of similarly situated utilities may be found unreasonable. Such comparisons must be fair, but they need not approach mathematical perfection. Furthermore, considering the expense in light of market factors which would affect the willingness of a competitive firm to advertise is consistent with traditional principles. Specifically, the competition from substitute services and the existence of capacity or supply problems may bear on the reasonableness of a company's advertising expense.

Recent decisions have generally exhibited a greater willingness to disallow advertising expenses. This has occurred because commissions have been reluctant to allow advertising that is inconsistent with public policy on such matters as energy conservation and environmental concerns. Commissions have also cut advertising expenses in order to economize because of rising costs elsewhere, and have not hesitated to substitute their business judgment for that of management regarding the value of institutional advertising. These decisions do not generally rely on any showing that the amount spent was wasteful. Instead, they are based on value judgments as to whether the advertising message is socially desirable.

This trend is easily defensible on the basis of the results achieved. Consumers have certainly been spared costs for advertising campaigns which are perceived by many as contrary to the general welfare or, at best, of dubious benefit to the public.¹⁹⁸ Such logic presupposes, however, that government intervention into private decisions is necessarily justified when the object of the intervention is widely regarded as desirable.

The Supreme Court has held that the right of a utility to advertise is protected from arbitrary commission decisions unsupported by evidence that the amount spent was wasteful. The commissions are without constitutional authority to act upon a simple substitution of their judgment for that of the managers of the utility. Moreover, because these decisions are unrelated to the dangers posed by monopoly enterprise, one may question whether there is any nexus between many disallowances and the purpose of the statute which established the commission. Absent such a nexus, the commission is without even statutory jurisdiction to oppose the advertising.

198. See Note, *Public Utilities: The Allowance of Advertising Expenditures for Ratemaking Purposes—Is This Trip Really Necessary?* 29 OKLA. L. REV. 202 (1976).

These problems have generally not prevented state commissions from disallowing advertising expenses for any reason which appeals to their sense of public spirit. The legality of this assumption of power is highly questionable, in view of the uncertain application of *West Ohio* under current circumstances and the absence of explicit legislative guidance.¹⁹⁹ Such arbitrary expansion of bureaucratic authority arguably offends the public interest more than the advertising that has been repressed.

Michael A. Meyer

199. In Connecticut, the legislature has provided the commission express authority to disallow all political, institutional and promotional advertising by gas and electric utilities. See *The Connecticut Natural Gas Corp.*, 11 P.U.R.4th 66 (Conn. Pub. Utils. Comm'n 1975) (disallowing advertising concerning offshore drilling as political).