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REGULATION OF ELECTRIC UTILITIES BY THE STATE CORPORATION COMMISSION

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On July 1, 1971, the State Corporation Commission of Virginia obtained for the first time a constitutional grant of jurisdiction to regulate electric utilities.¹ Although this relatively recent development has had—and undoubtedly will continue to have—some impact on the regulation of such utilities by the Commission,² it is not as dramatic a development as a stranger to Virginia might think, since the Commission has been regulating the electric utilities pursuant to a statutory grant of jurisdiction since 1914.³

This Article will review briefly the extent to which the State Corporation Commission exercises regulatory jurisdiction of electric companies, although much of the discussion will be equally applicable to the regulation of other utilities. As a means of establishing the proper context for this review, the discussion will begin with a consideration of the rational basis for utility regulation, and continue with an analysis of the present scope of the Commission's power to regulate public utility companies within the Commonwealth.

THE RATIONALE FOR REGULATION—CONSUMER PROTECTION

Consumer protection is thought by many to be a relatively modern concept. Indeed, in recent years there has been an enormous growth of consumer protection activity by government. It should be noted, however, that public utility regulation always has been based on this concept.

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1. Subject to such criteria and other requirements as may be prescribed by law, the Commission shall have the power and be charged with the duty of regulating the rates, charges, and services and, except as may be otherwise authorized by this Constitution or by general law, the facilities of railroad, telephone, gas, and electric companies.

VA. CONST. art. 9, § 2.

2. For example, the constitutional grant of a mandatory duty to regulate electric companies imposes, for the first time, a limitation on the General Assembly's powers to make exceptions to such regulation. The effect of this is presently in litigation. See note 19 *infra* & accompanying text.

3. Va. Acts of Assembly 1914, ch. 340.

It has been noted above that the regulation of electric utilities in Virginia resulted from legislation enacted in 1914. Earlier, the 1902 Constitution had provided for regulation of railroads and telephone and telegraph companies, these being the most fully developed public service companies at that time. Selected excerpts from the remarks of A. Caperton Braxton, Chairman of the Committee on Corporations of the 1901-1902 Constitutional Convention, establish that the protection of consumers was the basis for establishing the State Corporation Commission and giving it this regulatory authority. Chairman Braxton stated:

[T]he question of the control and regulation of railroad companies and the fixing of their rates of charges is . . . the greatest and most important economic question before the civilized world. Fifty years ago the question of transportation was not so important, but to-day it enters into every consideration; it affects every branch of business; it infringes upon every human being in this land. . . . A recent writer on this subject in the *North American Review* expresses this matter [as follows]:

"If consumers, who ultimately bear the cost of transportation in the price of everything they use, or producers, the local value of whose products is determined by deducting from their value at the place of consumption the cost of transportation thereto, *are to be protected* from the rapacity of the common carriers of the country, it must be accomplished by a body organized by the government for the purpose, with due authority to administer equal justice between the two opposite interests. . . ."

....

All of this goes to show one thing, . . . not only that the State has the right to control railroads and to regulate and prescribe their rates, but that the time has come and is now upon us when it is essential for the welfare of this country and *the protection of our people* that the right should be effectively administered. . . .⁴

Protection of the consumer also is the basis for regulation of utilities other than railroads. Without such regulation, public utilities would be free to change their rates and charges so as to promote their own economic interests. This is, of course, generally true in the case of non-regulated businesses, but in the case of most businesses, competition has

4. 2 DEBATES OF THE CONSTITUTIONAL CONVENTION OF 1901-02, Virginia 2142-47 (emphasis supplied).

the effect of keeping prices at a reasonable level. The company that overprices its product will lose business to competing companies which sell the same product for a lower price.

However, in the case of public utilities such as electric companies, it was discovered that in the long run competition did not have this effect. As early as 1924, one commentator stated:

Competition was the earliest form of regulation; but this proved to be bad, in the long run, for the consumers of utility service, as it too often meant duplication of facilities in a field not large or rich enough to support more than one company. The usual outcome of this was consolidation, followed by recoupment, by means of high rates, of losses due to the competition. Whatever may be the value of competition as a regulator of charges in other lines of business, it proved to be a failure in the public utility industry.⁵

Unbridled competition failed because the utilities are "natural monopolies." Due to the public's need for the particular service offered, the substantial investment in fixed plant necessary to render that service, and the existence of substantial economies of scale, utilities possess "technical characteristics leading almost inevitably to monopoly or at least to ineffective forms of competition."⁶

The Commonwealth of Virginia has long recognized the natural monopoly characteristics of public utilities; it is the policy of the Commonwealth that electric, gas, telephone, and water utilities have exclusive service territories. This thinking found legislative acceptance in the Utility Facilities Act,⁷ and the policy against direct competition among similar utilities has been reaffirmed since that Act was passed in 1950.⁸

5. I H. SPURR, GUIDING PRINCIPLES OF PUBLIC SERVICE REGULATION 1 (1924).

6. J. BONBRIGHT, PRINCIPLES OF PUBLIC UTILITY RATES 8 (1961).

7. VA. CODE ANN. §§ 56-265.1 to .9 (Repl. Vol. 1969).

8. The 1962 General Assembly, in Senate Joint Resolution No. 50, noted that duplication of electric facilities "was not in the public interest," and the Virginia Advisory Legislative Council (VALC) report that resulted from the passage of that resolution (S. Doc. No. 5, Reg. Sess. 1964 General Assembly) stated:

"...under the Utility Facilities Act, there has been established a State-wide pattern whereby territory is allocated to that public utility which, in the judgment of the State Corporation Commission, can furnish the service most efficiently and with greatest benefit to subscribers. Since municipalities are not subject to control by the State Corporation Commission, situations have arisen in which expansion of service by a municipality outside of its own boundaries has presented a possibility of *inefficient duplication of services and undesirable competition between the unregulated municipality*

Where there is no competition, and where utilities have territorial monopolies, the basis for regulation is manifest. In the absence of regulation or competition, the utility could charge whatever price the traffic would bear for its service, and where the service is a necessity of modern life, the traffic would necessarily bear a great deal.⁹ Thus a natural monopoly furnishing a necessary service could extract "monopoly profits" from its customers, while its customers would have little, if any, recourse. Similarly, without competition or regulation, the natural monopoly could permit the quality of its service to deteriorate and, again, the consumer would be powerless to remedy the situation.

Thus, the rationale for regulation is consumer protection. Regulation is needed to ensure that rates and charges do not exceed reasonable levels, to ensure that service is adequate and reliable, and to ensure that a natural monopoly without substantial competition is unable to take unfair advantage of its monopolistic power.

There is a popular misconception in the minds of many that regulation exists to guarantee utilities a profit.¹⁰ Quite the opposite is the case: regulation exists to prevent the utilities from earning an unreasonable profit or otherwise taking advantage of consumers. The reason for this misconception is apparent. Although there now exists no question as to the power of the state to regulate utility rates, that power is limited by the utilities' constitutionally protected right not to be deprived of property without due process of law. Thus the State Corporation Commission has the power to fix rates that will prevent a utility from receiving excessive profits, but it cannot fix them so low

and the regulated utility. The basic justification for regulation of utilities is that by their very nature, since they are rendering essential public services, they could be permitted to avoid competition in order that the public can obtain the services offered at a fair rate and yet the utilities can be guaranteed a reasonable profit on their investment." (emphasis supplied).

The 1964 General Assembly confirmed the report of the VALC by following its recommendation and adopting what is now VA. CODE ANN. § 56.625.4:1 (Repl. Vol. 1969). See also VA. CODE ANN. § 15.1-1251 (Repl. Vol. 1964), prohibiting water and sewer authorities from building projects that duplicate existing utilities.

9. Commissioner Catterall of the State Corporation Commission has recognized this on numerous occasions. Application of VEPCO, S.C.C. No. 19027 (June 26, 1972) (dissenting opinion); Application of C & P Tel. Co., S.C.C. No. 18965 (Nov. 17, 1971) (concurring opinion).

10. Professor A. J. G. Priest, in his recent treatise, lists this popular misconception as the first of six "public utility myths" that have developed since the late 1920's. He correctly points out that there is a vast difference between having a fair rate of return guaranteed, and being given an opportunity to earn a fair rate of return. 2 A. PRIEST, PRINCIPLES OF PUBLIC UTILITY REGULATION 787-89 (1969).

as to constitute confiscation of the utility's property.¹¹ This limitation on the power of the Commission is misconstrued by some as being tantamount to a guarantee of profitability, while in actuality it is merely a prohibition against affirmative action that would deprive the utility of a fair opportunity to earn a reasonable return.

Once this is understood, it is apparent that the regulation of utilities by the State Corporation Commission does not and cannot guarantee the utility a profit or a fair rate of return. Rather, such regulation imposes a limit on what can be earned, and the Constitution merely guarantees that the limit will not be set so low as to make it impossible for the utility, through prudent management, to earn a fair rate of return.¹² This constitutional guarantee is entirely consistent with the consumers' best interests, because consumers are not benefited when they are served by a utility whose financial condition has declined to a point where its ability to render good service is impaired.¹³

The regulation of electric companies and other Virginia utilities is extremely broad. It starts with the regulation of rates and charges; it extends into the areas of service, facilities, and financial and corporate affairs. Each of these subjects will be reviewed briefly.

REGULATION OF RATES AND CHARGES

As suggested by the preceding discussion, the regulation of rates and charges is the essence of public utility regulation, and since 1914 the State Corporation Commission has had statutory jurisdiction to regulate the rates and charges of electric utilities. The statutory authority for

11. The Supreme Court of Virginia has stated: "That a public service corporation cannot be compelled to consume its property in public service, and thus be forced to submit to confiscation, appears to be perfectly well settled." *City of Portsmouth v. Virginia Ry. & Power Co.*, 141 Va. 44, 51, 126 S.E. 366, 368 (1925). See also *Petersburg Gas Co. v. Petersburg*, 132 Va. 82, 110 S.E. 533 (1922).

12. Interestingly, the cause of consumer protection is served where a utility is able to earn a fair rate of return, since that is the rate of return necessary to maintain the financial integrity of the company. *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). Consumers are not protected when they must depend on a financially insecure company for a necessary service. The question of what constitutes a fair rate of return in any given case involves a fascinating mixture of law and economics, but that question is beyond the scope of this Article.

13. The Virginia Supreme Court also recognizes this: "In fixing a rate, therefore, which will be just and reasonable, it must be borne in mind that the utility shall be allowed to realize such a net income upon the value or amount of its investment as will, when prudently managed, render its securities attractive to the investing public. Otherwise, there will result inferior service to the public and ultimately bankruptcy of the utility, and disaster, as well to the public as the utility." *Petersburg Gas Co. v. Petersburg*, 132 Va. 82, 90, 110 S.E. 533, 536 (1925).

such rate regulation is found in Chapter 10 of Title 56 of the Code of Virginia and, as noted above, such jurisdiction now also exists by express constitutional mandate in Section 2 of Article IX of the new Constitution. This authority has been exercised many times;¹⁴ indeed, the substantial inflation in recent years has produced more rate proceedings before the Commission than in any comparable period in history.

Five years after the statutory authority to regulate rates of electric companies was granted to the Commission, the Supreme Court of Virginia held that the rate-fixing power of municipalities, through their franchise powers, could take precedence over the regulatory authority of the Commission.¹⁵ Fortunately, however, this precedent was short-lived; three years later the case was overruled and the paramount authority of the Commission to regulate rates of electric companies was restored.¹⁶

The Commission's jurisdiction over rates of electric companies has not, however, been absolute. The Federal Power Act¹⁷ conferred upon the Federal Power Commission responsibility for regulating wholesale sales of electricity for resale in interstate commerce. This has had the effect of preempting jurisdiction over such rates to the extent that no effective state regulation is now possible. Of equal significance is the fact that sections 56-232 and 56-234 of the Code of Virginia foreclosed, at least under the old Constitution, jurisdiction of the Commission to regulate the rates of services which are provided to agencies and entities of municipal, state, and federal governments. The absence of regulation of such rates has been the subject of criticism by at least one commissioner.¹⁸ It has been suggested that the language in Article IX,

14. The continuing exercise of such jurisdiction on an informal basis will not appear in reported cases, but the extent to which there has been formal regulation of electric rates is indicated by the following: *Commonwealth v. VEPCO*, 211 Va. 758, 180 S.E.2d 675 (1971); *Board of Supervisors v. VEPCO*, 196 Va. 1102, 87 S.E.2d 139 (1955); *Application of VEPCO*, S.C.C. No. 19027 (June 28, 1972); *Application of VEPCO*, S.C.C. No. 18987 (Sept. 2, 1971); *Application of VEPCO*, 1970 S.C.C. Report 65; *Lynchburg Traction & Light Co.*, 1921 S.C.C. Report 137; *Virginia Ry. & Power Co.*, 1921 S.C.C. Report 61. It has similarly exercised ratemaking jurisdiction over telephone, gas and water companies.

15. *Virginia Western Power Co. v. Clifton Forge*, 125 Va. 469, 99 S.E. 723 (1919).

16. *Victoria v. Victoria Ice, Light & Power Co.*, 134 Va. 134, 114 S.E. 92 (1922). See also *Commonwealth ex rel. Page Milling Co. v. Shenandoah River Light & Power Corp.*, 135 Va. 47, 115 S.E. 695 (1923).

17. 16 U.S.C. §§ 824, 824d & 824e (1970).

18. *Application of VEPCO*, S.C.C. No. 19027 (June 26, 1972) (Catterall, Comm'r dissenting); *Application of VEPCO*, 1970 S.C.C. Report 66 (Catterall, Comm'r concurring).

Section 2 of the new Constitution, giving the Commission regulatory jurisdiction over electric companies, has rendered the exclusions from jurisdiction unconstitutional. Currently, this issue is being litigated before the Commission.¹⁹

As has been noted, the purpose of rate regulation by the Commission is to ensure the protection of consumers. A new dimension was added to the mechanism for achieving this purpose in 1970, when a Division of Consumer Counsel was created in the office of the Attorney General. The Division is charged with the responsibilities of representing "the interests of the people as consumers [and appearing] before governmental commissions, agencies and departments, including the State Corporation Commission, to represent and be heard on behalf of consumers' interests . . ." ²⁰ The Attorney General's Office has been both diligent and effective in carrying out this statutory directive.

The Commission recently has taken a novel step in an attempt to make utility rate regulation more responsive to the changing conditions in modern society. It has adopted regulations providing for annual review of the rates of every major utility in the Commonwealth.²¹ Since the first such review will not commence until early 1973, it is too early to appreciate its impact. However, it has the potential for benefiting both the consumer and the utility by tending to make rate changes more gradual and by minimizing the likelihood of a utility's sliding into a financial crisis. It is submitted that this procedure also will ensure that no utility will be able to earn excessive profits for an appreciable length of time.

REGULATION OF SERVICE

The Commission's jurisdiction to regulate the service of electric companies originates in the same sources as its jurisdiction over rates: the 1914 act (now embodied in Chapter 10 of Title 56) and, more recently, Section 2 of Article IX of the new Constitution. As discussed below, one area of the Commission's jurisdiction over electric service originated in the 1950 Utility Facilities Act.²²

The majority opinion in the latter case, in its discussion of non-jurisdictional retail sales, by implication suggests that it would be in the public interest for that jurisdictional gap to be closed. S.C.C. Report 66 at 28-30.

19. Application of VEPCO, S.C.C. No. 19176 (Nov. 17, 1972).

20. VA. CODE ANN. § 2.1-133.1 (Cum. Supp. 1972).

21. Commonwealth *ex rel.* S.C.C., S.C.C. No. 19147 (July 6, 1972).

22. VA. CODE ANN. §§ 56-265.1 to .9 (Repl. Vol. 1969).

Basically, the regulation of service covers three areas: quality of service, discrimination in service, and territorial allocation. The Commission's regulation of the quality of electric service has been relatively informal, but nevertheless effective. Quality of service includes such technical matters as electrical safety, reliability, and dependability. It also encompasses such ordinary matters as customer relations, the handling of inquiries and complaints, and customer billing.

Unlike the Commission's regulation of safety in the gas utility industry, no detailed safety regulations for the electric utilities have been adopted. The Commission informally ensures, however, that the electric utilities subject to its jurisdiction comply with the requirements of the National Electrical Safety Code, published by the Bureau of Standards of the United States Department of Commerce. Questions of safety may be raised in licensing and certification proceedings, and in such cases the Commission resolves those questions formally.

Similarly, the Commission informally regulates the reliability and dependability of service by monitoring the plans of the utilities for major additions of capacity to meet the growth in electric load. Licensing and certification proceedings almost invariably involve questions of this character, which the Commission must resolve. In the field of customer relations, the Commission, again informally, insists that the utilities handle all customer complaints and inquiries promptly, courteously, and fairly. When a complaint to the Commission cannot be resolved to the satisfaction of the complainant through informal proceedings, a formal proceeding can be instituted, but this almost never occurs.

The governing statute expressly authorizes Commission action to eliminate any practices or services that are preferential or unjustly discriminatory.²³ As is true in the other enumerated instances, questions of discrimination generally are resolved informally upon complaint of the customer, although formal proceedings can be instituted where necessary.

The Commission's jurisdiction with respect to allocations of service territory was established in a separate statute, the Utility Facilities Act.²⁴ That statute allows the Commission to allocate exclusive service territories among the various utilities, and to issue to such utilities certificates of public convenience and necessity authorizing them to serve

23. *Id.* § 56-247 (Repl. Vol. 1969).

24. *Id.* §§ 56-265.1 to .9 (Repl. Vol. 1969).

those territories.²⁵ Certificates are granted upon application by the utility if the Commission makes the appropriate finding of public convenience and necessity. Once a certificate has been granted, no other certificate to furnish the same service in the same geographic area will be granted so long as the certificated utility continues to render adequate service.²⁶ The purpose of this territorial allocation is to eliminate duplication of costly utility facilities and the increased rates to consumers that would necessarily result from such duplication.²⁷

From this discussion it is apparent that the regulation of electric service, like the regulation of electric rates, is based on consumer protection, including protecting the consumer from poor service, from discriminatory service, or from wastefully duplicative service. The Commission has substantial authority in this area and exercises it effectively.

REGULATION OF FACILITIES

The constitutional grant to the Commission of regulatory jurisdiction over utility facilities contains a limitation that is not applicable to the regulation of rates, charges, and services. Section 2 of Article IX of the Constitution provides that the Commission shall regulate utility facilities "except as may be otherwise authorized by this Constitution or by general law. . . ." The distinction was explained by the Commission on Constitutional Revision:

This distinction recognizes the fact that localities and other state agencies besides the SCC are concerned with certain aspects of utility operations. Localities have an obvious interest in such matters as the location of utility facilities, such as poles and wires, and compliance with zoning ordinances. Similarly, other state agencies besides the SCC may be concerned with utility facilities, for example, state agencies charged by law with administering air and water quality standards.²⁸

The Commission nevertheless has jurisdiction over the facilities of electric companies. The first grant of such jurisdiction appears in the Utility Facilities Act, particularly in section 56-265.2. That provision makes it unlawful for any public utility to build any facilities, other

25. *Id.* § 56-265.3 (Repl. Vol. 1969).

26. *Id.* § 56.265.4 (Repl. Vol. 1969).

27. See note 8 *supra*.

28. REPORT OF THE COMM'N ON CONSTITUTIONAL REVISION 286 (1969).

than ordinary extensions within its service territory, without first obtaining a certificate of public convenience and necessity from the Commission. For a number of years the Commission interpreted this statutory provision as requiring Commission approval for anything a utility constructed outside of its service territory, but not for most facilities constructed within its service territory, taking the position that the latter facilities were "ordinary extensions."²⁹ In 1972, however, the General Assembly enacted section 56-46.1, which directed the Commission to publish notice and, upon request, to hold hearings prior to permitting construction of any electric transmission lines of 200 kilovolts or greater. The new provision also required the Commission to give consideration to the environmental effect of electric utility facilities and to take steps to minimize adverse environmental impact. As a result of this legislative mandate and the Utility Facilities Act,³⁰ the Commission substantially has expanded its regulation of electric utility facilities.³¹

The Commission also has authority to approve or disapprove hydroelectric power dams and works under the Water Power Act.³² This jurisdiction has been held to extend also to dams and facilities designed to create a cooling reservoir for a thermal generating station that produces electricity in interstate commerce.³³ The statute requires the Commission to "weigh all the respective advantages and disadvantages from the standpoint of the State as a whole and the people thereof . . .,"³⁴ and provides further that a license shall be granted only when the Commission finds, among other things, "that the general public interest will be promoted thereby"³⁵

In connection with the regulation of facilities, the Commission's purpose is broader than simple economic protection of the consumers of the company's service. It also embraces important issues concerning environmental interests and riparian rights of local individuals. But the Commission's role is to balance all of the competing interests, including the interests of consumers in adequate and reliable electricity at

29. See memorandum of Comm'r Catterall, Jan. 6, 1971.

30. VA. CODE ANN. §§ 56-265.1 to .9 (Repl. Vol. 1969).

31. Memorandum from Ernest M. Jordan, Jr., Director of Public Utilities, to All Electric Utilities, July 14, 1972, entitled *Procedures Under The Utility Facilities Act and House Bill 967*.

32. VA. CODE ANN. §§ 62.1-80 to 103 (Repl. Vol. 1968).

33. *Vaughn v. VEPCO*, 211 Va. 500, 178 S.E.2d 682 (1971).

34. VA. CODE ANN. § 62.1-88 (Repl. Vol. 1968).

35. *Id.* § 62.1-89 (Repl. Vol. 1968).

reasonable rates, and to make decisions that promote the overall public interest.

REGULATION OF FINANCIAL AND CORPORATE AFFAIRS

The new Constitution contains no express grant of authority to regulate the financial and corporate affairs of electric utilities. However, such authority probably exists by necessary implication from the grant of regulatory authority over rates. In any event, the authority exists by virtue of express statutory provision. Such authority covers three principal areas: the issuance of securities, transactions between affiliated companies, and the acquisition and disposition of utility assets.

Under Chapter 3 of Title 56, no utility can issue securities, or assume any liability with respect to the securities or obligations of another, without first obtaining the approval of the Commission. Such regulatory authority permits the Commission to take action to ensure that the utility does not raise capital improvidently, or at excessive cost, or in such manner as to impair a sound capital structure. All of these regulatory concerns ultimately are intended to benefit the utility's customers, since the consumer must, in the long run, pay the cost of the capital thus obtained.

Under Chapter 4 of Title 56, every contract with or loan to an affiliated company must have prior approval of the Commission. This, of course, enables the Commission to ensure that an affiliated company of a regulated utility does not receive unjust benefits, to the detriment of the utility's customers.

Chapter 5 of Title 56 requires Commission approval before any utility can acquire or dispose of any utility assets situated within the Commonwealth or any utility securities of any other company.³⁶ This enables the Commission to ensure against improvident acquisitions or dispositions that might be detrimental to their customers.

In this same general area the Commission has prescribed a Uniform System of Accounts which details the proper method of accounting for all financial transactions of the utility. This also ensures uniformity and reasonableness of accounting practices, so that the Commission can determine accurately the financial condition of the utility, and thereby prevent customers from suffering any disadvantage by reason of ac-

36. VA. CODE ANN. § 56-89 (Repl. Vol. 1969). Permission for such acquisition or disposition may be secured upon petition to the Commission pursuant to § 56-90. Violators are subject to fines of not more than \$1,000. VA. CODE ANN. § 56-91 (Repl. Vol. 1969).

counting treatment. Thus, from the foregoing, it is clear that the regulation of financial and corporate affairs furthers the same fundamental purpose that permeates the entire regulatory scheme—the protection of consumers.

CONCLUSION

The State Corporation Commission has pervasive regulatory authority over electric and other utilities. It fully exercises that authority in the public interest and for the benefit of utility consumers. In such exercise, it is constrained by the constitutional rights of the regulated utilities to be free from confiscation of their property. The Commission understands that the interests of consumers are not served by restricting the rates of the utilities to such an extent that their financial integrity is impaired and they cannot finance the construction of new facilities necessary to render adequate and reliable service.

Utility regulation that properly and effectively takes account of all of these factors is a complex and delicate process which is not readily understood by most observers. The law of Virginia—constitutional, statutory and judicial—has given the Commission most of the tools that it requires for this important task, and so long as those tools continue to be used by the Commission and the Office of the Attorney General conscientiously and fairly, both the suppliers and consumers of utility services can be grateful for the quality of utility regulation in Virginia.