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UTILITY RATES: FAIR, JUST AND REASONABLE

By John Wolfram

Regulated utilities often refer to their rates as being “fair, just and reasonable.” These words are not arbitrary adjectives but instead are terms of art built upon decades of judicial action and court decisions pertaining to the regulated utility industry. The question of whether rates are fair, just and reasonable is considered in utility rate cases all across the U.S. and an accepted set of principles is relied upon by regulatory entities to make that determination.

In broad terms, for investor-owned utilities, rates should be set such that they balance the interests of the ratepayer with the interests of the shareholder.

From the utility perspective, the concept of fair just and reasonable rates has two central elements: the recovery of costs that are prudently incurred, and the right to earn a reasonable return on investment.

Regulated utilities are entitled to a reasonable opportunity to recover their prudently-incurred costs. This principle was established in the landmark U.S. Supreme Court case, *Federal Power Commission et al v. Hope Natural Gas Co. ("Hope")*, 320 U.S. 591, 603 (1944).

Regulated utilities are also entitled to earn a fair and reasonable rate of return on their capital investments. This principle was established in another landmark U.S. Supreme Court case, *Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia ("Bluefield")*, 262 U.S. 679 (1923).

Hope and Bluefield are cited almost universally by regulated utilities in the United States as a basis for regulators to approve rates that are fair, just and reasonable. Utilities rely upon these decisions to ensure that rates do not become “confiscatory” or constitute an unjust “taking” of those revenues and/or earnings to which the utility shareholders have a legal right.

From the ratepayer perspective, utility rates should be as low as possible, should be understandable, should not change dramatically over time, and should not give any set of customers an unfair advantage over other customers.

Other factors that regulators review when considering the reasonableness of proposed utility rates include those identified by James C. Bonbright et al in the foundational book entitled *Principles of Public Utility Rates.* Bonbright cited the following attributes of a sound rate structure:

Attributes of a Sound Rate Structure *

1. Rates should have the following practical attributes: simplicity, understandability, public acceptability, and feasibility of application.

2. Rates should be free from controversies as to proper interpretation.

3. Rates should effectively yield total revenue requirements under the fair return standard.

4. Rates should provide revenue stability from year to year.

5. Rates themselves should be stable, i.e. rates should experience minimal unexpected changes that are seriously adverse to existing customers.

6. Rates should apportion the total cost of service fairly among different consumers.

7. Rate relationships should avoid "undue discrimination."

8. Rates should promote efficiency, discouraging wasteful use of energy while promoting all justified types and amounts of use.

* Bonbright, James C, *Principles of Public Utility Rates*, Columbia University Press, New York NY, 1961, p. 291

The Bonbright principles, as well as the Hope and Bluefield decisions, help regulators to determine rates for investor-owned utilities that balance the interests of utility ratepayers with those of utility shareholders. While many professionals in the industry would consider ratemaking an art, the established utility case law and the economic, social, and regulatory principles that support such case law do introduce a certain amount of science into the ratemaking process.

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