PUBLIC UTILITIES—COMPREHENSIVE ADJUSTMENT CLAUSE HAS A SUFFICIENT NEXUS TO RATE PROCEEDING TO BE STATUTORILY PERMISSIBLE AS AN INTERIM RATE INCREASE—*In re Board's Investigation of Telephone Cos.*, 66 N.J. 476, 333 A.2d 4 (1975).

On December 13, 1973, New Jersey's Board of Public Utility Commissioners (the Board) entered an order[1] allowing New Jersey Bell Telephone Company (Bell) to include in its tariffs a Comprehensive Adjustment Clause (CAC)[2] in order "to provide interim relief or adjustment based upon costs which are beyond the direct control of the utility."[3] Pursuant to this order, Bell submitted a new tariff sheet for the Board's approval. Included in these new tariffs were sums calculated on the basis of the CAC.[4] On December 20, 1973, the Board issued an order accepting the new tariffs.[5]

Rate counsel, the representative of the public interest in these

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[1] *Re* Adjustment Clause In Tel. Rate Schedules, 3 P.U.R.4th 298 (N.J. Bd. Pub. Util. Comm'nrs 1973).

[2] This is the first time such a clause has been before New Jersey courts and it is probably the first time such a clause has been used in this country. *In re* Board's Investigation of Tel. Cos., 66 N.J. 476, 479 n.2, 333 A.2d 4, 6 (1975).

The CAC utilizes four separate categories of expenses to determine periodic adjustments:

(1) Salaries and wages, including fringe benefits.
(2) Depreciation expense.
(3) Other expenses, a catch-all classification.
(4) Taxes including federal income taxes, real-estate taxes, revenue taxes, and social security taxes (which have been segregated from fringe benefits).

Re Adjustment Clause In Tel. Rate Schedules, 3 P.U.R.4th 298, 302 (N.J. Bd. Pub. Util. Comm'nrs 1973).

Although recognition was given to the validation and adoption of the CAC in New Jersey, the Illinois Commerce Commission recently rejected the proposal to adopt a similar clause in the rates of Illinois Bell. Order at 1, 4, 9, Illinois Bell Tel. Co., No. 58916 (Ill. Commerce Comm'n, Feb. 26, 1975). In rendering its opinion, the Commission felt that in adopting an automatic adjustment clause it would be abrogating its public responsibility to have open hearings before any "significant action" was taken by the utilities. *Id.* at 4.

[3] *Re* Adjustment Clause In Tel. Rate Schedules, 3 P.U.R.4th 298, 299 (N.J. Pub. Util. Comm'n 1973). The clause was discussed by the Board at an earlier stage of the proceeding. Order of Public Utilities Commission at 4-5. *In re* N.J. Bell Tel. Co., No. 722-153 (N.J. Bd. Pub. Util. Comm'nrs, Dec. 29, 1972). The adoption of a CAC was at least partially in response to a proposal made by the Executive Director of the Board. Remarks of Dr. Arthur A. Schoenwald, Executive Director, New Jersey Board of Public Utility Commissioners, before the Utility Section of the New Jersey Bar Association, Dec. 7, 1972. The concept of the adjustment clause has even received support from parties who oppose the clause's operation in practice, as a theoretical means of compensating for inflation. *See* Backman & Kirsten, *Comprehensive Adjustment Clause for Telephone Companies,* PUB. UTIL. FORT., March 28, 1974, at 24-26. Kirsten served as rate counsel during the proceedings at which time the CAC was approved. *See In re* Board's Investigation of Tel. Cos., 66 N.J. 476, 478, 333 A.2d 4, 5 (1975).

[4] Order Accepting Tariff Revisions at 2, *In re* Board's Investigaton of Tel. Cos., No. 732-134 (N.J. Bd. Pub. Util. Comm'nrs, Dec. 20, 1973).

[5] *Id.*

matters,[6] had participated both in the proceedings which led up to the order adopting the CAC and in prior related proceedings before the Board in which Bell had petitioned for rate increases.[7] Subsequent to the Board's acceptance of the new tariffs, rate counsel moved for rehearing and reargument before the Board on the matter of the CAC.[8] This motion was denied.[9] Rate counsel then appealed the Board's decision to the appellate division,[10] contending that the Board lacked the power to adopt the CAC and that the clause was therefore illegal.[11]

While the appeal was pending in the appellate division, the Supreme Court of New Jersey certified the matter on its own motion,[12] and in *In re Board's Investigation of Telephone Cos.*[13] upheld the validity of the CAC,[14] finding it to be a statutorily permissible interim rate increase.[15] Justice Pashman filed a single dissent in which he argued that, since there was no formal rate case pending,[16] the adoption of the CAC could not represent interim relief as provided for by statute,[17] and without requisite notice, full

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[6] Traditionally, the public interest in rate matters was represented by rate counsel appointed by the Attorney General. Law of Dec. 5, 1951, ch. 357, § 1, [1951] N.J. Laws 1474, *as amended*, Law of Dec. 12, 1962, ch. 198, § 18 [1962] N.J. Laws 929 (codified at N.J. STAT. ANN. § 48:2-31.1 (1969)). These powers have been recently transferred to the Department of Public Advocate, Division of Rate Counsel. *See* N.J. STAT. ANN §§ 52:27E-17 to -20 (Supp. 1975-76).

[7] *See* Order of Public Utilities Commission at 1-2, *In re* N.J. Bell Tel. Co., No. 722-153 (N.J. Bd. Pub. Util. Comm'nrs, Dec. 29, 1972).

[8] Motion for Rehearing, Reargument and Reconsideration of Decision and Order Entered herein on Dec. 13, 1973, *In re* Board's Investigation of Tel. Cos., No. 732-134 (N.J. Bd. Pub. Util. Comm'nrs, Dec. 20, 1973).

[9] Letter from Ralph C. Caprio, Secretary, Board of Public Utility Commissioners to William E. McGlynn, Dec. 27, 1973 (denying motion of rate counsel).

[10] *In re* Board's Investigation of Tel. Cos., 66 N.J. 476, 479, 333 A.2d 4, 6 (1975).

[11] Brief for Appellant at 12-16, *In re* Board's Investigation of Tel. Cos., 66 N.J. 476, 333 A.2d 4 (1975).

[12] *In re* Board's Investigation of Tel. Cos., 66 N.J. 476, 479, 333 A.2d 4, 6 (1975). N.J.R. 2:12-1 allows the supreme court to certify any action for appeal on its own motion.

[13] 66 N.J. 476, 333 A.2d 4 (1975).

[14] *Id.* at 496, 333 A.2d at 15.

[15] *Id.* at 495, 333 A.2d at 14.

[16] *Id.* at 499-500, 333 A.2d at 17 (Pashman, J., dissenting).

[17] *Id.* at 501, 333 A.2d at 18. Justice Pashman viewed N.J. STAT. ANN. § 48:2-21.1 (1969) as allowing the Board to grant interim relief only in connection with *future* rate proceedings. 66 N.J. at 502, 333 A.2d at 18. Although recognizing that the statute is not completely clear, Justice Pashman interpreted the interim relief provision of N.J. STAT. ANN. § 48:2-21.1 (1969) as suggesting

> that the Legislature contemplated that the PUC would be able to grant interim relief in connection with *rate petitions soon to be filed* or temporarily out of the Board's jurisdiction much as the courts grant temporary restraining orders and emergent relief.

66 N.J. at 502, 333 A.2d at 18 (emphasis added).

hearing, and findings of fact, the Board's adoption of the CAC would be outside of its delegated authority.[18]

The essential controversy presented in this case centered on two interrelated issues: (1) whether the CAC represents a permanent rate increase within the contemplation of section 48:2-21 of the New Jersey statutes or an interim rate increase within the contemplation of section 48:2-21.1; and (2) if the CAC is an interim increase, how far the court is willing to go to find the requisite nexus which ties the interim increase to the full rate case.[19]

The Board is a statutory creature[20] designed to supervise and regulate[21] the public utilities[22] of New Jersey. In performing that function, it is the Board's duty to set "just and reasonable" rates[23] to be charged by utilities providing services within the state.[24] Coincident with its power to set rates, the Board also has the power to increase rates already established.[25]

The statutory authority to fix rates is found in Title 48 of the New Jersey statutes.[26] Section 48:2-21 allows the Board to fix rates

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[18] 66 N.J. at 498, 333 A.2d at 16.

[19] *See* text accompanying notes 98-106 *infra.*

[20] *See* N.J. STAT. ANN. § 48:2-1 *et seq.* (1969), *as amended,* (Supp. 1975-76).

[21] *Id.* § 48:2-13 (Supp. 1975-76).

[22] *Id.* The statute defines a "public utility" as follows:

> The term "public utility" shall include every individual, copartnership, association, corporation or joint stock company . . . that now or hereafter may own, operate, manage or control within this State any railroad, street railway, traction railway, autobus, charter bus operation, special bus operation, canal, express, subway, pipeline, gas, electric light, heat, power, water, oil, sewer, solid waste collection, solid waste disposal, telephone or telegraph system, plant or equipment for public use, under privilege granted or hereafter to be granted by this State or by any political subdivision thereof.

Id.

[23] *Id.* § 42:2-21(b) (1969) provides in pertinent part: "The board may after hearing, upon notice, by order in writing . . . [f]ix just and reasonable . . . rates."

[24] *Id.* § 48:2-21(a) provides in pertinent part:

> The board may require every public utility to file with it complete schedules of [rates] . . . charged or exacted by it for any product supplied or service rendered within this State . . . .

[25] *Id.* § 48:2-21(d) provides in pertinent part:

> When any public utility shall increase any existing individual rates . . . the board . . . shall have power after hearing, upon notice, by order in writing to determine whether the increase . . . is just and reasonable. . . . The board shall approve the increase . . . upon being satisfied that the same is just and reasonable.

[26] *Id.* § 48:2-21 gives the basic authority to the Board to regulate utility rates. *See, e.g.,* Public Serv. Coordinated Transp. v. State, 5 N.J. 196, 215, 74 A.2d 580, 589 (1950).

N.J. STAT. ANN. § 48:2-21.1 (1969) gives the Board the power to adjust rates. The statute provides:

> The board may, during the pendency of any hearing instituted by it, on its own initiative or on petition, in which the approval or fixing of just and reasonable

after public notice and hearing and after the Board has made a full examination of the value of the company's property (the rate base), the company's income and expenses, and the resultant rate of return which the company receives.[27] Once the rate of return has been ascertained, the Board applies to that rate the statutory standard of just and reasonable.[28] If by that standard the rate of return is found to be deficient or excessive, the Board may then make the appropriate rate adjustment so as to comply with the just and reasonable standard.[29]

Section 48:2-21.1 provides a mechanism for the Board to set adjusted interim rates through negotiation and agreement with the

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individual rates, joint rates, tolls, charges or schedules thereof, as well as commutation, mileage or other special rates is in issue, or at any other time, negotiate and agree with any public utility for an adjustment of the individual rates, joint rates, tolls, charges or schedules thereof, as well as commutation, mileage or other special rates for any product or service supplied or rendered by such public utility. Such adjustment may be for, or without, a specified limit of time. In no event shall any such adjustment be regarded as contractual. Such adjustment shall at all times be subject to change through the proceedings provided for by this chapter, or through negotiation and agreement under this section. The board as a part of any such negotiation and adjustment shall provide for the continuance, suspension or other disposition of any hearing of the character aforesaid then pending.

This provision has consistently been interpreted as granting the Board the power to fix rates on an interim basis. *See, e.g., In re* N.J. Power & Light Co., 15 N.J. 82, 93-94, 104 A.2d 1, 7 (1954).

N.J. STAT. ANN. § 48:2-21.2 (1969) is a provision of limited application, which outlines the situations in which the Board need not determine a rate base before ascertaining the justness and reasonableness of a particular rate. *See, e.g., In re* Proposed Increased Intrastate Indus. Sand Rates, 125 N.J. Super. 48, 50-51, 308 A.2d 370, 372 (App. Div. 1973), *aff'd*, 66 N.J. 12, 327 A.2d 427 (1974).

[27] *See* Public Serv. Coordinated Transp. v. State, 5 N.J. 196, 216, 74 A.2d 580, 590 (1950). The court noted:

> The justness and reasonableness of a particular rate of fare can only be determined after an examination of a company's property valuation which constitutes its rate base . . . and the rate of return developed by relating its income to the rate base.

Id.

[28] *See, e.g., In re* N.J. Power & Light Co., 9 N.J. 498, 508, 89 A.2d 26, 30 (1952); Central R.R. of N.J. v. Department of Pub. Util., 7 N.J. 247, 260, 81 A.2d 162, 168 (1951). The standard of reasonableness which has been adopted in this state seeks to protect both consumer and company. *In re* N.J. Power & Light Co., 9 N.J. 498, 508, 89 A.2d 26, 30 (1952). A reasonable rate

> can never be more than the reasonable worth of the service supplied; neither can it be fixed so low as to be confiscatory. If within these limits and supported by competent evidence, rates set by the Board would clearly be just and reasonable.

Public Serv. Coordinated Transp. v. State, 5 N.J. 196, 225, 74 A.2d 580, 595 (1950). *See generally* J. BONBRIGHT, PRINCIPLES OF PUBLIC UTILITY RATES 147-58 (1961) [hereinafter cited as BONBRIGHT].

[29] *See* N.J. STAT. ANN. § 48:2-21(d) (1969) (conferring power on the Board, on either complaint or the Board's own initiative to determine reasonableness). If the Board determines that the utility has received excessive revenues, it may order that refunds be made. *In re* Board's Investigation of Tel. Cos., 66 N.J. 476, 492, 333 A.2d 4, 13 (1975).

utility.[30] This section of the statute is a complement to the normal rate making procedure[31] and gives the Board the power to grant increases in order to prevent the loss of just earnings which might result between the time of filing the petition and the allowance adjustment by the Board—the problem of "regulatory lag."[32] The judicial interpretation of these two sections firmly establishes the principle that section 48:2-21.1 can only function when the adjustment can be related to a rate base and rate of return determined in a proper proceeding under the authority of section 48:2-21.[33]

Pursuant to this statutory scheme, the Board heard the petition of Bell for an increase in certain of its rates.[34] After a full rate case during which a voluminous record was compiled, the Board decided to separate the proceedings into two phases.[25] In Phase I, the Board determined that: (1) Bell's rate base had a fair value of $1,511,348,000;[36] (2) a fair rate of return for Bell would be 8.15%

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[30] N.J. STAT. ANN. § 48:2-21.1 (1969). The text of this section is set forth in note 27 *supra*.

[31] *See In re* N.J. Power & Light Co., 15 N.J. 82, 96; 104 A.2d 1, 9 (1954).

[32] Both courts and commentators have been aware of the problem of "regulatory lag" which has been described as

> the loss of proper earnings claimed by the utility between the time that a petition for a rate increase is filed and the rate relief actually becomes effective by administrative or judicial determination.

State v. New Jersey Bell Tel. Co., 30 N.J. 16, 28, 152 A.2d 35, 42 (1959). The concept of "regulatory lag" has been the basis for justifying escalator clauses generally. *See* Trigg, *Escalator Clauses in Public Utility Rate Schedules,* 106 U. PA. L. REV. 964, 967 (1958).

Regulatory lag is one of three factors which erode a utility's rate of return. Inflation and attrition are the others. Wirth, *Attrition,* PUB. UTIL. FORT., May 24, 1973, at 15.

[33] *See In re* Proposed Increased Intrastate Indus. Sand Rates, 66 N.J. 12, 25, 327 A.2d 427, 434 (1974).

[34] *See* Order of Public Utilities Commission at 2, *In re* N.J. Bell Tel. Co., No. 722-153 (N.J. Bd. Pub. Util. Comm'nrs, Dec. 29, 1972).

[35] *Id.* at 4.

[36] *Id.* The concept of "rate base," which is the starting point of all rate regulation, is a term that is at best elusive and at worst hopelessly confusing to both experts and newcomers to the field of rate regulation. In its simplest terms the rate base is the value of the company's property. *See, e.g., In re* N.J. Power & Light Co., 9 N.J. 498, 508, 89 A.2d 26, 30 (1952). But the simple definition of rate base belies its complexity:

> [T]he rate base . . . is the fair value of the property of the public utility that is *used and useful in the public service* at the time of its employment therein and is determined by viewing the *plant as an integral and unitary whole,* considering all the elements properly entering into the ascertainment of a reasonable return for supplying the public need.

Id. at 509, 89 A.2d at 31 (emphasis added). *See also* Public Serv. Coordinated Transp. v. State, 5 N.J. 196, 217, 74 A.2d 580, 591 (1950).

One commentator has noted that the concept of the rate base has been "the most widely disputed legal issue in the history of American public utility regulation." BONBRIGHT, *supra* note 28, at 159. The generally accepted standard for the rate base is the true cost of the company's plant and equipment with " 'reasonable' " amounts for interest and "working capital." *Id.*

applied to the rate base;[37] (3) at the time of the rate proceeding, the rate of return for Bell, based on pro forma operating income, was 6.37% and therefore not a fair rate of return;[38] and (4) Bell should submit a new tariff schedule which would produce an added $55,215,000 in operating income so as to give Bell the fair return of 8.15% on its rate base.[39]

In anticipation of Phase II, the Board included the following announcement of its plan to incorporate the CAC into Bell's rate structure:

> In recognition of economic conditions and the resultant financial straits into which utilities have been forced, the Board proposes to initiate a comprehensive adjustment clause. This clause will be designed to make rate regulation more responsive to the financial needs of a utility, which is required to provide safe, adequate, and proper levels of customer service.[40]

The Board indicated that all notice requirements would be met before the CAC was adopted. The Board also made clear that the proceedings which were to follow were simply an extension of the main rate case.[41]

The Board anticipated that the adjustment clause would provide relief to the utility of a type more closely related to operating costs and, therefore, more reflective of actual needs. The Board's opinion was that such relief was preferable to the addition of a fixed dollar amount of relief to the utility's rate at its inception to provide for future needs.[42] In addition, the CAC is more closely tied to fixed operating cost factors. Therefore, it provides for gradual increases and obviates the need for a full-blown rate case each time such determinate operating cost increase. A saving to consumers would result since the cost of rate proceedings is ultimately passed on to the customer.[43]

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[37] Order of Public Utilities Commission at 4, *In re* N.J. Bell Tel. Co., No. 722-153 (N.J. Pub. Util. Comm'n, Dec. 29, 1972). A fair rate of return in New Jersey can only be determined by viewing a utility's income in relation to its rate base. Public Serv. Coordinated Transp. v. State, 5 N.J. 196, 216, 74 A.2d 580, 590 (1950). Bonbright points out that although it is a generally accepted proposition that regulated utilities are entitled to a reasonable return on their investment, the criteria for judging a fair return is one of the most debated subjects in the area of utility regulation. BONBRIGHT, *supra* note 28, at 147.

[38] Order of Public Utilities Commission at 4, *In re* N.J. Bell Tel. Co., No. 722-153 (N.J. Pub. Util. Comm'n, Dec. 29, 1972).

[39] *Id.* at 5.

[40] *Id.*

[41] *Id.*

[42] *Id.*

[43] *Id.* The Board's opinion reflected the views of its Executive Director when he first

In February 1973, the Board ordered the commencement of an investigation into the feasibility of including the CAC in the tariffs of the state's telephone companies.[44] After a public hearing on the matter, the Board issued the order adopting the CAC. It is this order which forms the gravamen of the instant case.[45] The Board, however, did not make the CAC automatic in its application to company rates. In order for Bell to qualify for adoption of the CAC, it had to file detailed financial data with the Board. The data would have to justify the use of the CAC and would give the Board the ability to judge the necessity for, and fairness of, the use of the CAC in future tariffs.[46]

The Board's extensive requirements are important for two reasons. First, they serve as an indication of the Board's intention to keep a close check on the manner in which the CAC is applied by the companies. Second, they demonstrate the Board's intention to treat the operation of the CAC as a part of an ongoing proceeding.

Although the statute gives the Board the power to fix rates, the legislature has not prescribed any specific procedure which must be followed by the Board. The courts of this state have filled this gap by a series of important decisions.[47] The seminal decision

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recommended the adoption of the CAC. Remarks of Dr. Arthur A. Schoenwald, Executive Director, New Jersey Board of Public Utilities Commissioners, before the Utility Section of the New Jersey Bar Association, Dec. 7, 1972. It is important to note that since the CAC, in theory at least, would reduce the number of rate proceedings before the Board, it would held to alleviate one of the Board's main problems—the "numerous and repetitive rate cases." Id.

[44] Order Initiating Investigation, *In re* Board's Investigation of Tel. Cos., No. 732-134 (N.J. Bd. Pub. Util. Comm'nrs, Feb. 15, 1973).

[45] *Re* Adjustment Clause In Tel. Rate Schedules, 3 P.U.R.4th 298, 299, 307-08 (N.J. Bd. Pub. Util. Comm'nrs 1973).

[46] *Id.* at 308. The plan devised by the Board would force the company both to justify the rate adjustments and to provide a device which the Board could use to continually monitor the adjustments allowed under the CAC.

The Board's plan would require the company to: (1) submit proof of an independent audit of its corporate books; (2) present a detailed calculation showing the effect that each CAC expense category would have on the company's total expenses and rate of return; (3) file supplemental tariff statements with the Board, including adjustments allowed by the CAC, detailed calculations as to the effect of the adjustment on the company's income, and such other information as the Board might require; (4) give notice statewide through newspaper publication prior to the incorporation of the CAC into the company's rates; and (5) file financial statements with the Board on a quarterly basis showing separately the adjustments and other factors bearing on the rate of return calculations. *Id.*

[47] *See In re* Board's Investigation of Tel. Cos., 66 N.J. 476, 333 A.2d 4 (1975); *In re* Proposed Increased Intrastate Indus. Sand Rates, 66 N.J. 12, 237 A.2d 427 (1974); State v. New Jersey Bell Tel. Co., 30 N.J. 16, 152 A.2d 35 (1959), *In re* N.J. Power & Light Co., 15 N.J. 82, 104 A.2d 1 (1954); *In re* N.J. Power & Light Co., 9 N.J. 498, 89 A.2d 26 (1952); Central R.R.

in this area was *O'Brien v. Board of Public Utility Commissioners.*[48] The Board, in separate orders, had raised the fare charged to passengers of a railway company from five to seven cents and fixed a charge of one cent on all initial transfers issued to passengers.[49] The increase was intended to compensate the company for increased labor costs resulting from an order of the war labor board.[50] A citizen challenged the orders on the ground that the Board was without jurisdiction to raise rates because it had failed to make an essential finding of fact—the rate base.[51] The court upheld the Board's action as being within the purview of the utility act's negotiation and agreement section, a provision similar in import and operation to the interim relief provision of the present statute.[52] The court contrasted the agreement section with what it described as "proceedings adverse to the 'public utility,' " which necessarily results in costly drawn-out litigation.[53] Thus, instead of requiring a full-blown rate case, the court opted for a method geared to the exigencies of emergency situations which would be

> prompt and comparatively satisfactory, and resulting, if not always in abstract justice, yet in a determination, which in the hands of fair-minded men, is likely to be acquiesced in.[54]

Although the approach adopted by the *O'Brien* court is significant as any early judicial recognition of the problem of "regulatory lag,"[55] the factual context which prompted the court to adopt this approach holds the key to the significance of *O'Brien.* The circumstances which required the railway to seek the increase were beyond the utility's control.[56] The increase simply permitted the utility to make up the expense imposed upon it by order of the

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of N.J. v. Department of Pub. Util., 7 N.J. 247, 81 A.2d 162 (1951); Public Serv. Coordinated Transp. v. State, 5 N.J. 196, 74 A.2d 580 (1950); Atlantic City Sewerage Co. v. Board of Pub. Util. Comm'rs, 128 N.J.L. 359, 26 A.2d 71 (Sup. Ct. 1942), *aff'd,* 129 N.J.L. 401, 29 A.2d 850 (Ct. Err. & App. 1943); O'Brien v. Board of Pub. Util. Comm'rs, 92 N.J.L. 44, 105 A. 132 (Sup. Ct. 1918), *aff'd,* 92 N.J.L. 587, 106 A. 414 (Ct. Err. & App. 1919).

[48] 92 N.J.L. 44, 105 A. 132 (Sup. Ct. 1918), *aff'd,* 92 N.J.L. 587, 106 A. 414 (Ct. Err. & App. 1919).

[49] 92 N.J.L. at 45, 105 A. at 133.

[50] *Id.* at 47, 105 A. at 133.

[51] *Id.* at 46, 105 A. at 133.

[52] *Id.* at 46, 53, 105 A. at 133, 136. The statute involved in this case contained provisions similar to the present statutory scheme. *Compare* N.J. STAT. ANN. §§ 48:2-21 to -21.1 (1970) *with* Law of April 21, 1911, ch. 195, §§ 16-17, [1911] N.J. Laws 374, 376-80.

[53] 92 N.J.L. at 46, 105 A. at 133.

[54] *Id.* at 47, 105 A. at 133.

[55] *See* note 32 *supra* and accompanying text.

[56] *See* 92 N.J.L. at 48, 105 A. at 134.

war labor board.[57] Such an increase or adjustment to meet the forced expenses "could not make unreasonably high what was not so before."[58]

More than 30 years after *O'Brien,* the Supreme Court of New Jersey was presented with another question of the Board's power to adjust rates in *Public Service Coordinated Transport Co. v. State.*[59] In that case, the utility filed a petition with the Board seeking an increase in its fares in order to offset an anticipated wage increase precipitated by an arbitration award.[60] Although hearings were held before the Board, "it was made clear that the companies were not undertaking a full-fledged rate case."[61] The utility relied on the *O'Brien* holding as support for the Board's authority to give the utilities emergency relief in the form of a rate increase "without the necessity of redetermining the rate base."[62]The Board allowed the increase to go into effect on an experimental basis.[63] However, the adjusted fares subsequently produced a far greater increase in revenues than was anticipated at the time the order was entered and more than was needed to offset the effects of the wage increases.[64] Since the Board had retained jurisdiction over the increased rates, it issued an order to the company to show cause why the rates should not be reduced.[65] Instead of attempting to justify the increase on the basis of the arbitration award and consequent increase in operating costs, the company attempted to show that the additional revenues represented simply "a fair return on a proper rate base."[66] The companies were thus trying to use the *O'Brien* approach to avoid a full rate case. Despite the changed nature of the case before it, the Board determined that the fares

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[57] *Id.*

[58] *Id.* at 50, 105 A. at 135.

[59] 5 N.J. 196, 74 A.2d 580 (1950).

[60] *Id.* at 202, 74 A.2d at 583.

[61] *Id.*

[62] *Id.* at 203, 74 A.2d at 583. The court recognized the perimeters within which the *O'Brien* approach must be confined:

> To proceed on this theory necessarily required the Board to assume and the companies to admit that the existing rate was fair and reasonable, prior to the wage increase, and supported by an adequate rate base.

Id. at 203, 74 A.2d at 583.

[63] *Id.* at 204, 74 A.2d at 584.

[64] *Id.*

[65] *Id.*

[66] *Id.* at 205, 74 A.2d at 584. The original increase was designed to offset only the increased costs of labor. The court, however, found that the fare increase would produce an annual excess in revenues of $700,000 more than was actually needed to offset the additional costs. *Id.* at 204, 74 A.2d at 584.

were just and reasonable and produced no more than a fair return on the rate base.[67] The court, however, was disturbed by the fact that the Board had accepted the company's financial data without question to support its findings.[68] For this reason, the court rejected the Board's determination on the ground that the Board had failed to adequately determine a rate base.[69]

It is important to note that the court based its decision on the fact that the Board had attempted to set rates as authorized by section 48:2-21 without first determining a rate base.[70] The court explicity dismissed the idea that its decision in any way affected the Board's ability to adjust rates under section 48:2-21.1. However, the court implied that the original rate adjustment to offset the wage increase, although not directly before it in that case, was a valid exercise of the Board's power to grant relief under the negotiation and agreement statute.[71]

Since the *Public Service Coordinated Transport* decision, it has been the position of the New Jersey courts that the determination of a rate base is necessary for any fixing of or increase in utility rate charges.[72] Any interim relief must be effected in connection with

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[67] *Id.* at 206, 74 A.2d at 585.

[68] *Id.* at 218-19, 74 A.2d at 591-92. The court clearly pointed out its dissatisfaction with the Board's basing its findings solely on the company's books:

> Neither this Court nor the Board can accept the books of acount [*sic*] of a public utility at face value in a rate case in which reasonableness is always the primary issue.... There must be proof in the record not only as to the amount of the various accounts but also sufficient evidence from which the reasonableness of the accounts can be determined.... Lacking such evidence, any determination of rates must be considered arbitrary and unreasonable.

Id.

[69] *Id.*

[70] *See id.* at 214-25, 74 A.2d at 589-95.

[71] In a somewhat cryptic comment with an oblique reference to *O'Brien*, the court noted:

> Suffice it for us to say that nothing in our opinion in any wise limits the power of the Board . . . under R. S. 48:2-21.1. That statute was not not construed by us in our opinion. It may be pertinent, however, to observe that it was passed . . . 17 years after the *O'Brien case* . . . .

Id. at 228, 74 A.2d at 596. This comment was contained in the per curiam opinion denying the Petition for Rehearing. *Id.* at 225, 74 A.2d at 595.

The treatment here of *O'Brien* by the court, in dicta, has caused the court recently to question the status of *O'Brien* as valid precedent. *See In re* Proposed Increased Intrastate Indus. Sand Rates, 66 N.J. 12, 23, 327 A.2d 427, 433 (1974). Although the reasoning was questioned, it does not appear that *O'Brien* was overruled. Courts subsequent to *Public Service Coordinated Transport* have considered it valid precedent. *See, e.g.,* Township Comm. v. Lakewood Water Co., 54 N.J. Super. 371, 378, 148 A.2d 885, 889 (App. Div. 1959): Hudson & Manhattan R.R. v. Board of Pub. Util. Comm'rs, 16 N.J. Super. 396, 401, 84 A.2d 736, 739 (App. Div. 1951).

[72] *See, e.g., In re* Proposed Increased Intrastate Indus. Sand Rates, 66 N.J. 12, 25, 327

an already existent rate base.[73] The Board and the utilities have therefore been forced to try different techniques of rate regulation in order to meet emergency situations where rate increases were deemed necessary. For example, a utility has attempted to increase rates without a complete finding of a rate base by adding a surcharge to existing rates.[74] The Board has tried to utilize the interim relief provisions of section 48:2-21.1 for the same purpose.[75] Judicial examination has led to a rejection of the surcharge technique.[76] The courts have shown that they will scrutinize the use of section 48.2-21.1 to insure that the formal rate making procedure will not be short-circuited by inappropriate use of the interim increase provision.[77]

This surcharge technique was before the court in *In re New Jersey Power & Light Co.*[78] The Board had denied the company's application seeking a five percent surcharge on its rates to recover deficits incurred in prior years' operations.[79] On appeal, the supreme court affirmed the Board's denial.[80] The court reasoned that since the Board's statutory power allowed it "to fix 'just and reasonable . . . rates,' " the addition of a surcharge to the rates (which are already just and reasonable) would be outside of the powers granted to the Board.[81] The court did not, however, leave the company without an avenue for relief. In dicta, the court pointed out that the company could still seek "*ad interim* relief through negotiation and agreement."[82] Speaking for the court, Chief Justice Vanderbilt pointed the direction for utilities and the Board to take in the future.

A.2d 427, 434 (1974); Central R.R. of N.J. v. Department of Pub. Util., 7 N.J. 247, 263-64, 81 A.2d 162, 170 (1951); Hudson & Manhattan R.R. v. Board of Pub. Util. Comm'rs, 16 N.J. Super. 396, 401-02, 84 A.2d 736, 739 (App. Div. 1951).

[73] *In re* Board's Investigation of Tel. Cos., 66 N.J. 476, 495, 333 A.2d 414 (1975).

[74] *In re* N.J. Power & Light Co., 15 N.J. 82, 84, 104 A.2d 1, 2 (1954).

[75] *In re* Proposed Increased Intrastate Indus. Sand Rates, 66 N.J. 12, 15, 327 A.2d 427, 428-29 (1974).

[76] *In re* N.J. Power & Light Co., 15 N.J. 82, 97-98, 104 A.2d 1, 9 (1954).

[77] *See, e.g., In re* Proposed Increased Intrastate Indus. Sand Rates, 66 N.J. 12, 25, 327 A.2d 427, 434 (1974).

[78] 15 N.J. 82, 104 A.2d 1 (1954).

[79] *See id.* at 84, 86, 104 A.2d at 2-3. In an earlier case involving the utility the Board had denied a requested rate increase to the company. *In re* N.J. Power & Light Co., 9 N.J. 498, 535-36, 89 A.2d 26, 44 (1952). At least partially as a result of this denial, the company was forced into a deficit financial position. 15 N.J. at 85-86, 104 A.2d at 2-3. It was because of these deficiencies that the company sought to implement the surcharge. *Id.* at 84, 104 A.2d at 2.

[80] 15 N.J. at 98, 104 A.2d at 10 (quoting from N.J. STAT. ANN. § 48:2-21(b)(1) (1969)).

[81] 15 N.J. at 92, 104 A.2d at 6.

[82] *Id.* at 93, 104 A.2d at 7.

He recognized that compliance with the statutory scheme would prove more satisfactory than attempts to circumvent it:

> These statutes taken together present a complete statutory program of rate-making designed to produce speedy determinations by the Board, with *ad interim* relief if necessary . . . .[83]

Not until recently has the court had the opportunity to expand on the viability of other interim relief measures under this statutory scheme. During its current term, the Supreme Court of New Jersey, through Chief Justice Hughes, has rendered two opinions, which set certain guidelines within which section 48:2-21.1 will function.[84] In In re Proposed Increased Intrastate Industrial Sand Rates,[85] the Board allowed a railroad to increase certain of its freight charges by issuing " 'a negotiation order' purportedly under the provisions of [section] 48:2-21.1."[86] Although extensive public hearings on the increase were held, the appellate division of the superior court remanded the cause to the Board because " 'the board made no basic findings from which it could make the ultimate finding that the new rates were just and reasonable.' "[87]

On remand, the Board decided that it would be pointless to make determinations of fact concerning the rate of return which the increases would produce: The railroad's overall losses would force an irrational result—a negative rate of return.[88] The appellate court reconsidered the matter and again found the Board's action unauthorized by statute:

> [T]he Board has approved the new rates, which, admittedly, were fixed by way of negotiation . . . on a permanent rather than on an interim basis. Lacking such authority, the others from which

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[83] *Id.* at 96, 104 A.2d at 9. *See also* notes 23-26 *supra* and accompanying text.

[84] *In re* Board's Investigation of Tel. Cos. 66 N.J. 476, 333 A.2d 4 (1975); *In re* Proposed Increased Intrastate Indus. Sand Rates, 66 N.J. 12, 327 A.2d 427 (1974).

[85] 66 N.J. 12, 237 A.2d 427 (1974).

[86] *Id.* at 15, 327 A.2d at 428-29 (footnote omitted). For the full text of the statute see note 26 *supra*.

[87] 66 N.J. at 15-16, 327 A.2d at 429 (quoting from the unreported opinion of the appellate division).

[88] 66 N.J. at 16-17, 327 A.2d at 429-30. In its opinion, the Board noted:

> "Although . . . respondent will still be operating at a loss overall, and the overall rate of return will still be a negative figure. . . . the Board is of the opinion that respondent should have the opportunity to reduce its losses in order to assist it towards a viable reorganization for the purpose of carrying out its public service duties."

Id. at 16, 327 A.2d 429 (quoting from Decision on Remand, No. 718-506 (N.J. Bd. Pub. Util. Comm'nrs, Apr. 12, 1973)).

> the appeals are taken cannot be sustained under [section] 48:2-21.1.[89]

In affirming the appellate court's determination, the supreme court discussed situations in which the negotiation statute would be operable.[90] The court noted that under the statute interim relief might be had by "*temporarily* bypassing the establishment of [a] rate base and [a] fair rate of return,"[91] but that the justification for such rates "rests upon the legal umbilical cord which ties them to the anticipated eventual determination of" the rate base and rate of return.[92]

This concept of a "legal umbilical cord" was extended in both length and directional flexibility in *In re Board's Investigation of Telephone Cos.*,[93] wherein the court upheld the validity of the CAC.[94] The court's rationale was grounded on the fact that the CAC was adopted as a part of a two-phase rate proceeding.[95] The first phase involved all of the conventional elements of a "rate case" with notice and hearing and findings of fact supporting a determination of a fair rate base and rate of return.[96] The Board's intention to adopt the CAC was set forth at the close of Phase I, and a simultaneous commitment to initiate Phase II was made.[97] The standards by which the CAC's operation was to be judged were established. The Board set up a detailed procedure for the continuing scrutiny of the CAC's operation.[98] All of these factors were crucial in the court's consideration and final determination of the CAC's validity:

> This Court recently commented on the indispensable "legal umbilical cord" . . . . Fortuitously . . . the state of the present litigation is such as to accommodate such a firm and unimpeachable relationship.[99]

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[89] *In re* Prosposed Increased Intrastate Indus. Sand Rates, 125 N.J. Super. 48, 51, 308 A.2d 370, 372 (App. Div. 1973).

[90] 66 N.J. at 25-29, 327 A.2d at 434-36.

[91] *Id.* at 25, 327 A.2d at 434 (emphasis added).

[92] *Id.*

[93] 66 N.J. 476, 333 A.2d 4 (1975).

[94] *Id.* at 496, 333 A.2d at 15.

[95] *Id.* at 491, 333 A.2d at 12. *See* notes 34-35 *supra* and accompanying text.

[96] Order of the Public Utilities Commission at 4-5, *In re* N.J. Bell Tel. Co., No. 722-153 (N.J. Bd. Pub. Util. Comm'nrs, Dec. 29, 1972). *See* notes 36-37 *supra* and accompanying text.

[97] Order of Public Utilities Commission at 5, *In re* N.J. Bell Tel. Co., No. 722-153 (N.J. Bd. Pub. Util. Comm'nrs, Dec. 29, 1972).

[98] *See* notes 45-46 *supra* and accompanying text.

[99] 66 N.J. at 495, 333 A.2d at 14 (citation omitted).

The approach which the court had taken in validating the CAC is a unique one for two reasons. First, the standard for judging the acceptable length of the umbilical cord is left open except for the required periodic review by the Board.[100] Second, the cord's link or merger function does not have to be prospective, that is, it need not attach to a "rate proceeding" occurring in the future. As the court has applied the "cord" concept to the CAC, the linking occurs with respect to a prior and continuing rate proceeding. This innovative approach to the problem of interim relief adds flexibility to such devices as the CAC and can be an important administrative tool when used to offset such regulatory problems as "lag"[101] and "attrition."[102]

Justice Pashman, in his dissent, voiced concern over the validity of the CAC and highlighted some of the arguments against adoption of the clause. His primary criticism of the majority opinion was that it sanctioned an attempt "to circumvent the requirements" of the rate statute.[103] The problem with such circumvention is that it denies to the public the safeguards of adequate notice, open hearing, and the satisfaction of an order of the Board supported by findings of fact.[104]

Another quarrel with the majority's reasoning was that the CAC cannot be a valid technique under the authority of section 48:2-21.1. Since that section provides the public with a safeguard that is less effective than the full-blown rate case, Justice Pashman felt that interim relief should be "temporary and remain in force over only a very short period of time."[105] Thus, such relief can only be had while the rate case is in progress. According to Justice Pashman, section 21.1 should have ceased to operate when the Board closed Phase II.[106] In addition, it was felt that the statutory scheme required "specific 'negotiation and agreement' between the utility and the [Board]."[107] That requirement, argued Justice

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[100] *Re* Adjustment Clause In Tel. Rate Schedules, 3 P.U.R.4th 298, 307-08 (N.J. Bd. Pub. Util. Comm'nrs 1973).

[101] *See* note 32 *supra* and accompanying text.

[102] For a discussion of attrition *see generally* Wirth, *Attrition,* PUB. UTIL. FORT., May 24, 1973, at 15. Simply defined, "attrition" is the effect which inflation has on the earnings of a utility whose rates are set without either inflation or "lag" being adequately provided for. *See id.* at 15.

[103] 66 N.J. at 498, 333 A.2d at 16.

[104] *Id.*

[105] *Id.* at 503, 333 A.2d at 19.

[106] *Id.* at 499-500, 333 A.2d at 17.

[107] *Id.* at 303, 333 A.2d at 19. Justice Pashman contended that although the two phases of the proceeding were formally joined, to consider that joinder as providing a sufficient

Pashman, is not satisfied where the Board acquiesces in an automatic relief provision such as the CAC. Rather, the statute demands affirmative participation by the Board in every proposed rate increase in order to safeguard the interests of the public.[108]

Finally, Justice Pashman was concerned with the majority's interpretation of the phrase "at any other time" in the interim relief provision as providing the Board with a separate basis for granting a rate increase as an alternative to the traditional approach requiring a case pending before the Board.[109] Such an alternative, it was feared, opened the door to the possibility that the Board could increase rates

> without notice, hearings, findings of fact, or any of the other incidents of rate making . . . essential for the protection of the public, subject only to a vaguely defined duty to hold a full rate proceedings every now and again . . . .[110]

As viewed by the dissent, such an open-ended approach to the question of rate relief ignored the required nexus to a rate proceeding, with appropriate findings of fact, which the court had mandated in *Industrial Sand Rates.*[111]

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basis for providing interim relief "misconstrues the function of [section] 48:2-21.1, and exalts form over substance." *Id.* at 500 n.2, 333 A.2d at 17.

[108] *Id.* at 503-04, 333 A.2d at 19. Justice Pashman was also concerned that the categories of adjustment were too broad and vague and therefore not within the spirit of "negotiation" as required by statute. *Id.* at 504-05, 333 A.2d at 19-20. In order to protect the public, Justice Pashman would, as a minimum, require the CAC to pass-through only those costs which are "truly beyond the control of the utility" and which by "objective standards . . . can be determined with certainty." *Id.* at 504, 333 A.2d at 19. Further, the Justice warned:

> The use of overly permissive automatic adjustment clauses enhances the risk that utility companies will, out of laziness or greed, extract unreasonable charges from the public. This is a problem to which we must be alert, even where, as in this case, there is no evidence that this utility can be charged with such behavior.

Id. at 505, 333 A.2d at 20.

[109] *Id.* at 502, 333 A.2d at 18. The actual language of the majority with which Justice Pashman takes issue is dicta which indicates that the Board may make interim increases at any time by agreement and negotiation. *See id.* at 492-93, 333 A.2d at 13. This approach seems similar in rationale to the approach adopted in O'Brien v. Board of Pub. Util. Comm'nrs, 92 N.J.L. 44, 46-47, 105 A.2d 132, 133 (Sup. Ct. 1918), *aff'd*, 92 N.J.L. 587, 106 A. 414 (Ct. Err. & App. 1919). This reasoning was questioned by the court earlier this term. *In re* Proposed Increased Intrastate Indus. Sand Rates, 66 N.J. 12, 23, 327 A.2d 427, 433 (1974) (*semble*).

[110] 66 N.J. at 502, 333 A.2d at 18.

[111] *Id.* Justice Pashman's position here exhibits somewhat of an inconsistency. While opting for a narrow reading of the statute, his argument concerning the limitation of the duration of the adjustment fails to acknowledge the plain statutory sanction for an open-ended arrangement with the utility. N.J. STAT. ANN. § 48:2-21.1 (1969) provides in pertinent part:

> The board may, during the pendency of any hearing . . . or at any other time, negotiate and agree with any public utility for an adjustment of . . . rates . . . . *Such adjustment may be for, or without, a specified limit of time.*

(Emphasis added).

Although argument can be made in support of Justice Pashman's position, the court appears to have reached a reasonable and practical decision. By recognizing that the CAC was the result of an open and full rate proceeding and that its operation therefore had the requisite nexus to that proceeding, the court has provided a flexible tool which can be used by the Board to help the utilities through periods of financial crisis. Since the Board has a complex monitoring system[112] on the CAC's use, the likelihood of abuse seems rather slight.

One of the most important objections raised by Justice Pashman, however, was that rates cannot be raised permanently without a full rate proceeding and that this tactic was specifically rejected by this court in *Industrial Sand Rates.*[113] However, that case is distinguishable from *Telephone Cos.* In *Industrial Sand Rates,* the Board refused to find a rate base .[114] In contrast, in *Telephone Cos.* the Board had made a full finding as a part of the same proceeding which implemented the CAC as a measure of emergent relief.[115]

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[112] The Board's means of auditing the CAC is described in note 46 *supra.*

[113] 66 N.J. at 497-98, 333 A.2d at 16. In *Industrial Sand Rates,* the court explicitly pointed out that the interim increases are still "predicated upon the justice and reasonableness, in the context of rate base, of a rate of return on its investment." *Id.* at 25, 327 A.2d at 434.

[114] 66 N.J. at 17, 327 A.2d at 430.

[115] *See* Order of Public Utilities Commission at 4-5, *In re* N.J. Bell Tel. Co., No. 722-153 (N.J. Bd. Pub. Util. Comm'nrs, Dec. 29, 1972) (calling for an investigation of the feasibility of the CAC); *Re* Adjustment Clause In Tel. Rate Schedules, 3 P.U.R.4th 298, 299, 307-08 (N.J. Bd. Pub. Util. Comm'nrs 1973) (Adopting the CAC).

Justice Pashman also pointed to the pact that fuel adjustment clauses, used by the majority as analogous support for the CAC, have never been considered by the courts of New Jersey. 66 N.J. at 505, 333 A.2d at 20. Justice Pashman indicated that in some jurisdictions the concept of automatic adjustment clauses has been questioned on policy grounds. *Id.* at 505-06 n.4, 333 A.2d at 20. For example, in *Re* Southern Cal. Edison Co., 94 P.U.R.3d 252, 257-58 (Cal. Pub. Util. Comm'n 1972), it was stated:

> The principal arguments against Edison's fuel clause are: (1) It represents an abdication of the commission's regulatory function; (2) it denies the ratepayer the opportunity to participate in a public hearing and to develop a full and complete record; (3) it has an inflationary effect on the economy; (4) frequent rate changes would result and this is undesirable; (5) there would be no incentive for the utility to attempt to obtain an economical supply of fuel nor to increase efficiency and absorb all or part of fuel cost increases; (6) it ignores other rate-making factors usually considered by the commission in spreading rates, such as competition, characteristics of use, and public benefit; and (7) it segregates and places emphasis on only one factor in setting rates, fuel cost, and ignores possible savings and efficiencies that have occurred in other portions of the utility's operation.

It is important to note, as the dissent did, that despite these objections to the clause, its validity was upheld by the Commission. *Id.* at 258. *See* 66 N.J. at 505-06 & n.4, 333 A.2d at 20 (Pashman, J., dissenting).

The CAC might be subject to attack on at least one other basis. Since the operation of the clause compensates Bell for attrition due to unanticipated costs, a question arises as to whether this is not a surcharge of the type condemned by an earlier court.[116] However, this attack is countered by noting that the CAC looks no more to the past than does any other rate proceeding which of necessity sets prospective goals on the basis of past events.[117]

Although it is not altogether clear what impact *Telephone Cos.* will have on the field of utility regulation generally,[118] it does signal a willingness on the part of the court to make the law more responsive to the critical needs of today. The CAC gives the Board the means to react quickly and equitably to fluctuating prices in an unstable market. But the CAC is something more than a one-time response to an economic stimulus. It is an answer to a recurring regulatory problem—the Board's ability to provide immediate relief to utilities in order to counteract the effects of cost factors beyond their control. Furthermore, it is an answer that operates within the statutory scheme.

Glenn P. Callahan

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[116] *See, e.g., In re* N.J. Power & Light Co., 15 N.J. 82, 97-98, 104 A.2d 1, 9 (1954).

[117] *See* Note, *The Use of the Future Test Year In Utility Rate-Making*, 52 B.U.L. REV. 791, 793 (1972).

[118] Recently, a "cost and efficiency revenue adjustment clause" (CEAC) was rejected by the Illinois Commerce Commission. Order at 7-9 Illinois Bell Tel. Co., No. 58916 (Ill. Commerce Comm'n, Feb. 26, 1975). *See* note 2 *supra*.