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The Ghost of Regulation Past: Current Applications of the Rule Against Retroactive Ratemaking in Public Utility Proceedings

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THE GHOST OF REGULATION PAST: CURRENT APPLICATIONS OF THE RULE AGAINST RETROACTIVE RATEMAKING IN PUBLIC UTILITY PROCEEDINGS

*Stefan H. Krieger**

In his article, Professor Krieger discusses the inconsistent and contradictory application of the traditional rule against retroactive ratemaking. The author notes that while many courts adhere to the rule at least rhetorically, they tend to either ignore the literal terms of the rule or to create ad hoc exceptions to it; simultaneously, other courts continue to apply the rule inflexibly. As a result, courts provide little guidance to litigants and their attorneys on the general application of the rule. To remedy the inconsistent application of the traditional rule, Professor Krieger suggests a new formulation of the rule that creates only a presumption against retroactivity. The commission, faced with a retroactivity determination, would engage in an analysis to determine whether the claimant had a reasonable reliance on the prior rate and whether retroactive rate application would produce efficiency incentives or disincentives.

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I. Introduction

From the early days of state public utility regulation, courts have recognized a rule against retroactive ratemaking. Simply put, this rule prohibits a public utility commission from setting future rates to allow a utility to recoup past losses or to refund to consumers excess utility profits.[1] Courts originally developed the rule in the context of reparation

1. Louisiana Power & Light Co. v. Louisiana Pub. Serv. Comm'n, 377 So. 2d 1023, 1029 (La.

cases brought against railroads by shippers who challenged the reasonableness of rates they had paid under commission-approved tariffs.[2] By analogy, the courts later applied the rule to ratemaking by public utility commissions.[3]

In one of the earliest cases, *T.R. Miller Mill Co. v. Louisville & Nashville Railroad*,[4] for example, a mill company sought reparations from a railroad for shipments under a tariff that the Alabama Railroad Commission previously had approved. In August 1914, the commission entered an order allowing the railroad to change its rates, and the railroad filed tariffs changing rates for shipments of "pine doors, sashes, and blinds" from eighteen cents to thirty-one cents per mile.[5] Eight months later, the milling company filed a complaint in the commission challenging the reasonableness of this rate change. The commission found that the railroad's rates were "not in accordance with the letter or spirit of the [August 1914] order" that established the rates and ordered the rates rolled back to eighteen cents.[6] Relying on this finding, the milling company brought suit to recover the excess freight charges paid between August 1914 and the rollback order.

The Alabama Supreme Court held that the company had no claim for reparations. The court first rejected the company's contention that the commission intended the rollback order to operate retroactively. It then held that, even if the commission had intended the order to be retroactive, the commission had no statutory authority to adopt such an order. The court noted that the relevant statutes provided that rates approved by the commission "shall be the lawful rates," and stated:

> Such schedules cannot be made unlawful for and during the period of their approved operation by any subsequent retroactive finding and order of the Commission. Such a practice would be odious to the generally established notions of justice, and would, moreover, be utterly subversive of the policy and utility of any system of rate regulation; for no rate could be relied upon as stable, and neither carrier nor shipper could ever be certain of the basis upon which

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1979); State *ex rel.* Util. Consumers Council v. Public Serv. Comm'n, 585 S.W.2d 41, 59 (Mo. 1979); State *ex rel.* Util. Comm'n v. Edmisten, 232 S.E.2d 184, 194-95 (N.C. 1977); Narragansett Elec. Co. v. Burke, Nos. 84-73-M.P., 84-232-M.P. & 84-342-M.P. at *4 (R.I. Mar. 11, 1986) (LEXIS, RI library, RI file).

2. *See, e.g.*, T.R. Miller Mill Co. v. Louisville & N.R.R., 92 So. 797 (Ala. 1921), *reh'g denied* (Mar. 3, 1922); Mathieson Alkali Works, Inc. v. Norfolk & W. Ry., 137 S.E. 608, 612-14 (Va. 1927). *See generally* B. Rogers, Annotation, *Right to Maintain Action Against Carrier on Ground That Rates Which Were Filed and Published by Carrier Pursuant to Law Were Excessive*, 97 A.L.R. 406, 420-31 (1935) (discussion of the early reparation cases brought by shippers).

3. *See, e.g.*, State v. Alabama Pub. Serv. Comm'n, 307 So. 2d 521, 539-40 (Ala. 1975); Michigan Bell Tel. Co. v. Michigan Pub. Serv. Comm'n, 24 N.W.2d 200, 204 (Mich. 1946); Straube v. Bowling Green Gas Co., 227 S.W.2d 666, 671 (Mo. 1950); Commonwealth *ex rel.* Appalachia v. Old Dominion Power Co., 34 S.E.2d 364, 368-69 (Va. 1945).

4. 92 So. 797 (Ala. 1921), *reh'g denied* (Mar. 3, 1922).

5. *Id.* at 798.

6. *Id.* at 799-800.

business was being conducted.[7]

Relying on similar statutory language in enabling statutes for public utility commissions and on the same kind of policy analysis used in the *T.R. Miller* case, state courts over the past seventy years universally have accepted the rule against retroactive ratemaking as a basic canon of public utility regulation.[8] During this period, however, the regulatory process has changed radically from the days when a single shipper would sue a carrier challenging a rate for "pine doors, sashes, and blinds." For most utilities, rate cases now impact hundreds of thousands, if not millions, of customers.[9] Rate cases are populated with numerous intervenor groups, representing residential consumers, industrial and commercial customers, and governmental agencies.[10] With the construction of large nuclear plants and other capital-intensive projects, a single rate filing for a utility can involve hundreds of millions of dollars.[11] Moreover, during

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7. *Id.* at 802. The court also relied on language in the commission's enabling act providing that in a complaint proceeding, the commission was required to establish rates "which shall be charged, imposed, and followed in the future." *Id.* The court suggested that this language only authorized the commission to act prospectively. For an analysis of this basis for the rule against retroactive ratemaking, see *infra* notes 283-91 and accompanying text.

8. *See, e.g.*, Public Serv. Comm'n v. Diamond State Tel. Co., 468 A.2d 1285, 1298 (Del. 1983) ("A pervasive and fundamental rule underlying the utility rate-making process is that rates are exclusively prospective in application . . . ."); Louisiana Power & Light Co. v. Louisiana Pub. Serv. Comm'n, 377 So. 2d 1023, 1028 (La. 1979) ("Pervading the utility rate making process is the fundamental rule that rates are exclusively prospective in application and that future rates may not be designed to recoup past losses."); New England Tel. & Tel. Co. v. Public Util. Comm'n, 358 A.2d 1, 20 (R.I. 1976) ("A fundamental rule of rate-making is that rates are exclusively prospective in nature.").

Closely related to, but distinct from, the rule against retroactive ratemaking is the "filed rate doctrine." That doctrine forbids a utility from charging rates other than those properly filed with the commission. *See* Arkansas La. Gas Co. v. Hall, 453 U.S. 571, 577 (1981). Although courts have relied on the filed rate doctrine as one of the bases for the retroactivity rule, this doctrine is in fact a limitation on the power of utilities, not commissions. *See supra* note 288 and accompanying text.

9. *See* listings in MOODY'S INVESTORS SERV., PUBLIC UTILITY MANUAL (1990) and NATIONAL ASS'N OF REGULATORY UTIL. COMM'RS, RESIDENTIAL ELECTRIC BILLS, SUMMER 1989 (1990). As of December 31, 1989, for example, Commonwealth Edison Co. served 3,180,000 customers; Duke Power Co. had 1,595,000 retail customers; and Illinois Bell Telephone Co. had 5,232,000 customer lines. 1 MOODY'S INVESTORS SERV., *supra*, at 112, 432, 594. As of summer 1989, Pacific Gas & Electric Co. had 3,450,000 residential electric customers; Florida Power & Light Co. had 2,703,635 residential electric customers; and Houston Lighting & Power Co. had 1,192,179 residential customers. NATIONAL ASS'N OF REGULATORY UTIL. COMM'RS, *supra*, at 10, 19, 158.

10. Recently, for example, 21 groups intervened in a Commonwealth Edison rate case: 6 governmental groups on behalf of all ratepayers; 4 government agencies on their own behalf; 2 labor organizations; 2 industrial groups, including a coalition of numerous companies; 3 consumer groups; 2 low-income community organizations; and 2 organizations on behalf of small business and commercial interests. *Re* Commonwealth Edison Co., 84 Pub. Util. Rep. 4th (PUR) 469, 472-73 (Ill. Comm. Comm'n 1987); *see also Re* Pacific Gas & Elec. Co., Decision No. 89-12-057, 1989 Cal. PUC LEXIS 687 at *10-11 (1989) (28 intervenor groups); Consumers Powers Co., 85 Pub. Util. Rep. 4th (PUR) 49, 53 (Mich. Pub. Serv. Comm'n 1987) (13 intervenors, including an association of the utility's shareholders); Houston Lighting & Power Co., Nos. 8425 & 8431 at 3 (May 2, 1990) (Examiners' Report) (19 intervenor groups).

For a description of the different types of consumer intervenor groups, see WILLIAM T. GORMLEY, JR., THE POLITICS OF PUBLIC UTILITY REGULATION 38-53 (1983).

11. In the last several years, for example, Texas Utilities Co. sought a $442,000,000 rate increase to recover costs associated with its Comanche Peak nuclear plant, Eric Lundeman, *Texas Utilities Ask Regulators for Commanche Peak-1 Rate Increase*, NUCLEONICS WK., Jan. 18, 1990, at

the recent periods of high inflation and increased fuel costs, rate cases have become a frequent occurrence with ancillary proceedings interspersed in between major filings specifically addressing adjustments for fuel costs and other rate-related issues.[12] Furthermore, increased federal energy and telecommunications action has resulted in a growth in regulatory activity at the state level.[13] Finally, with increased public scrutiny

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5; Commonwealth Edison Co. requested a $982,000,000 rate increase to recover costs for three of its nuclear plants, Jennifer Nelson, *Commonwealth Edison Seeks $982-million Rate Hike*, NUCLEONICS WK., May 3, 1990, at 13; Philadelphia Electric Co. sought $549,000,000 for the costs of the Limerick-2 plant, Dave Airozo, *PUC Law Judges Recommend Deep Cut in PECO's*, NUCLEONICS WK., Mar. 8, 1990, at 5; and Illinois Power requested a $265,000,000 rate increase to recover costs associated with its Clinton nuclear plant, *Ilinois Power Files New Bid for Rates Tied to Clinton Costs*, NUCLEONICS WK., July 13, 1989, at 5.

Each year the National Association of Regulatory Commissioners (NARUC) publishes a summary of utility rate cases that commissions throughout the country have been or are considering. NARUC reported that during 1989, eight electric cases were pending in state commissions in which the utility had requested rate relief in excess of $100,000,000. *See* NATIONAL ASS'N OF REGULATORY COMM'RS, 1989 ANNUAL REPORT ON UTILITY AND CARRIER REGULATION 354-62 (1990) [hereinafter NARUC REPORT]. Although gas utility rate cases usually involve smaller rate requests, NARUC reports that during 1989, nationally, four gas utilities sought rate relief in excess of $50,000,000. *Id.* at 363-71.

12. In 1963 nationwide commissions reviewed only three electric utility rate cases. By 1969 the number had increased to 19, and by 1975, it had grown to 114. Douglas D. Anderson, *State Regulation of Electric Utilities*, *in* THE POLITICS OF REGULATION 22 (James Q. Wilson ed., 1980). Nationwide, in 1987, there were 168 electric utility rate cases and 125 gas utility rate cases pending before state public utility commissions. NATIONAL ASS'N OF REGULATORY COMM'RS, 1987 ANNUAL REPORT ON UTILITY AND CARRIER REGULATION 322-41. At the same time, commissions frequently considered other rate-related questions, such as fuel cost reconciliation, in ancillary proceedings. *See infra* notes 192-202 and accompanying text.

13. In 1978 for example, Congress passed the Public Utility Regulatory Policies Act of 1978 (PURPA) requiring state commissions to institute proceedings to decide whether or not to adopt certain standards for utility rates. Pub. L. No. 95-617, 92 Stat. 3117 (1978) (codified as 16 U.S.C. §§ 2621-27 (1988)). In response to PURPA, commissions opened rule-making or investigation cases, applicable to all electric utilities under their jurisdiction ("generic dockets"), to decide whether or not to adopt PURPA standards. *See, e.g.*, PURPA Rate Design Standards, 45 Pub. Util. Rep. 4th (PUR) 24 (Ala. Pub. Serv. Comm'n 1981); Public Utility Regulatory Policies Act Standards, 46 Pub. Util. Rep. 4th (PUR) 39 (Alaska Pub. Util. Comm'n 1981); Generic Hearings Concerning Electric Rate Structure, 36 Pub. Util. Rep. 4th (PUR) 6 (Colo. Pub. Util. Comm'n 1979); Consideration of Lifeline Rates, 43 Pub. Util. Rep. 4th (PUR) 355 (Fla. Pub. Serv. Comm'n 1981); Peak-load Pricing for Electric Utilities, 36 Pub. Util. Rep. 4th (PUR) 413 (Fla. Pub. Serv. Comm'n 1980); Interruptible Rate and Load Management Standards, 43 Pub. Util. Rep. 4th (PUR) 163 (Iowa State Comm. Comm'n 1981); Time-of-day and Seasonal Electric Rates, 42 Pub. Util. Rep. 4th (PUR) 494 (Iowa State Comm. Comm'n 1981); Lifeline Rates for Electric Service, 73 Md. Pub. Serv. Comm'n 702 (Nov. 22, 1982) (LEXIS, Utility library, Allpuc file); Proceedings to Consider Electric Rate-making Standards, 35 Pub. Util. Rep. 4th (PUR) 339 (Mich. Pub. Serv. Comm'n 1980); Department of Public Service, 37 Pub. Util. Rep. 4th (PUR) 497 (Minn. Pub. Serv. Comm'n 1980); Investigation Into Rate Structures of Electric Utilities, 38 Pub. Util. Rep. 4th (PUR) 409 (Or. Pub. Util. Comm'r 1980); Cost-of-service Rate-making Standards, 7 Tex. Pub. Util. Comm'n Bull. 250, 44 Pub. Util. Rep. 4th (PUR) 33 (Tex. Pub. Util. Comm'n 1981); Generic Investigation on the Commission's Own Motion, No. 05-UR-9, 1-AC-10, 1-AC-14 (Wis. Pub. Serv. Comm'n Mar. 3, 1981) (LEXIS, Utility library, Allpuc file).

In the telecommunications area, the divestiture by American Telephone & Telegraph Co. (AT&T) of its local operating companies in January 1984, resulted in numerous rate-related cases. Pending court approval of AT&T's reorganization plan, the operating companies filed an unprecedented $10.8 billion in rate requests with state commissions, requesting increases to cover such expenses as access charges on long distance carriers. *See* Paul W. MacAvoy & Kenneth Robinson, *Losing By Judicial Policymaking: The First Year of the AT&T Divestiture*, 2 YALE J. ON REG. 225, 236-39 (1985).

of commission decisions and extremely large rate hikes at stake, appeals of rate orders have become a frequent occurrence.[14] As a result of these changes, at any one time a utility's rates can be the subject of three or four different proceedings at different stages of the regulatory process.[15]

Most courts, however, have not addressed the impact of these sweeping changes in the ratemaking environment on the rule against retroactive ratemaking, but continue to invoke the rule mechanically, simply repeating *T.R. Miller*'s rhetoric about the virtues of "rate stability and certainty."[16] They have failed to examine critically whether or not the application of the rule under current conditions effectuates sound regulatory policy. As a consequence, the decisions invoking the rule have very convoluted and, upon occasion, perverse results.

A good illustration of the problems presented by the application of the rule in recent times is the spate of opinions issued by the Illinois courts in a series of rate cases concerning Commonwealth Edison Co.[17] These cases arose out of a November 1984 request by Edison, a company serving three million customers in the northern third of Illinois, to increase its rates to include its $2.5 billion Byron I nuclear plant in the rate base.[18] The Illinois Commerce Commission held eleven months of hearings in which sixty-four parties intervened,[19] and on October 24, 1985, the commission granted Edison a $494.8 million rate increase, which Edison immediately began to collect (Byron I rates).[20] Various consumer and government intervenors appealed, and in April 1986, the trial court reversed the commission's order because it was inconsistent with the requirements of a recently-enacted statute concerning the inclusion of

14. In William Gormley's study of 12 state public utility commissions, he found that the number of appeals of major utility rate cases increased from 28.6% in 1974 to 46.4% in 1979. GORMLEY, *supra* note 10, at 94 (Table 15).

15. A good example of this phenomenon is the recent spate of cases concerning Commonwealth Edison's requests for rate increases associated with its nuclear production plants. *See infra* notes 17-34 and accompanying text.

16. *See, e.g.,* Indiana Tel. Corp. v. Public Serv. Comm'n, 171 N.E.2d 111, 124 (Ind. App. 1960) (en banc) (holding that "[t]he law of Indiana was not designed or intended to create chaotic conditions in the market where utilities, as well as other businesses go to obtain capital for their legitimate business purposes"); Spintman v. Chesapeake & Potomac Tel. Co., 255 A.2d 304, 308 (Md. 1969) (holding that without the rate stability provided by the rule against retroactive ratemaking, "reasonable ratemaking would prove farcical"); Appeal of Pennichuck Water Work, 419 A.2d 1080, 1083 (N.H. 1980).

17. People *ex rel.* Hartigan v. Illinois Commerce Comm'n, No. 85 CH 1097, slip op. (Cir. Ct. of Cook County Apr. 29, 1986) [hereinafter *Hartigan I*]; People *ex rel.* Hartigan v. Illinois Commerce Comm'n, 117 Ill. 2d 120, 510 N.E.2d 865, 109 Ill. Dec. 797 (1987) [hereinafter *Hartigan II*]; People *ex rel.* Hartigan v. Illinois Commerce Comm'n, 202 Ill. App. 3d 917, 561 N.E.2d 711, 149 Ill. Dec. 341 (1st Dist. 1990), *petition for leave to appeal allowed*, 136 Ill. 2d 553, 567 N.E.2d 341, 153 Ill. Dec. 383 (1991) [hereinafter *Hartigan III*]; *see also* Business & Professional People for the Pub. Interest v. Illinois Commerce Comm'n, 136 Ill. 2d 192, 555 N.E.2d 693, 144 Ill. Dec. 334 (1st Dist. 1990).

18. Commonwealth Edison Co. v. Illinois Commerce Comm'n, 71 Pub. Util. Rep. 4th (PUR) 81, 84-86, 131 (Ill. Comm. Comm'n 1985).

19. *Id.* at 85.

20. *Id.* at 133.

new plants in the rate base.[21] Edison appealed this decision.[22]

For the next five years, the Byron I rates remained in effect as the case wended its way through the courts and the commission with no final resolution as to the amount of rates that should have been collected under the original Byron I order.[23] While the Illinois Supreme Court affirmed the trial court decision,[24] the commission took over two years to enter its remand order.[25] Then both Edison and consumer groups appealed this decision.[26] In 1990 the appellate court finally rendered its decision on the remand appeal, but that decision is now on appeal to the Illinois Supreme Court.[27] In the meantime, the commission granted Edison an additional rate increase of $235 million for costs associated with three new nuclear plants (Byron II rates),[28] which itself was reversed on appeal.[29]

Given the length of the appellate and remand process, these cases have raised numerous retroactive ratemaking issues: whether the commission could grant refunds for the periods of the appeal or the remand; whether, if refunds are allowed, the commission could take into account Edison's actual expenses for the remand period in computing the rebates or whether it was limited to an examination of Edison's original estimates of these costs; and whether the commission could consider the Byron II rate order in computing any refunds.

In addressing the issues, the courts adopted varying and, at times,

21. *Hartigan I*, *supra* note 17, at 93; *see Hartigan II*, *supra* note 17, at 127, 510 N.E.2d at 867, 109 Ill. Dec. at 799. The trial court found that the commission violated the requirements of § 9-213 of the Illinois Public Utilities Act, ILL. REV. STAT. ch. 111 2/3, para. 9-213 (1989), in presuming, instead of requiring an affirmative demonstration, that the costs of Byron I were reasonable.

22. *Hartigan II*, *supra* note 17, at 127, 510 N.E.2d 867, 109 Ill. Dec. 797.

23. The *Chicago Tribune* reported in June 1991 that:

> Consumer advocates called it a major victory for the little guy when a Cook County judge overturned a $495 million rate increase designed to pay Commonwealth Edison Co. for building a nuclear power plant. But five years after Judge Richard Curry's ruling, Edison's 3.1 million northern Illinois customers still are waiting for the utility to refund more than $300 million in overcharges. . . . What happened to the great consumer victory?

Rob Karwath, *Edison Using Courts to Bog Down Refunds*, CHI. TRIB., June 23, 1991, § 2, at 1.

24. *Id.* at 2.

25. Commonwealth Edison Co. v. Illinois Commerce Comm'n, 71 Pub. Util. Rep. (PUR) 4th 81 (Ill. Comm. Comm'n Aug. 23, 1989) and 1989 Ill. PUC LEXIS 278 (Ill. Comm. Comm'n Sept. 5, 1989) (supplemental order). In that order, the commission disallowed additional costs of Byron I from rate base and required Edison to refund $194.6 million to ratepayers for the period of May 1986 (the date of the trial court's reversal of the original order) through December 1989. 1989 Ill. PUC LEXIS 278, *23.

26. Edison appealed this order, arguing that the cost disallowances were too high, and consumer groups appealed, contending that the refunds were too low.

27. *Hartigan III*, *supra* note 17, at 963, 561 N.E.2d at 739, 149 Ill. Dec. at 373, *petition for leave to appeal allowed*, 136 Ill. 2d 553, 567 N.E.2d 341, 153 Ill. Dec. 383 (1991).

28. In August 1987 Edison requested a new rate increase of $1.414 billion to cover costs associated with these plants. In December 1988 the commission granted a portion of the requested rate increase. *See* Business & Professional People for the Pub. Interest v. Illinois Commerce Comm'n, 136 Ill. 2d 192, 198-99, 555 N.E.2d 693, 695, 144 Ill. Dec. 334, 336-37 (1990).

29. *Id.* at 248, 555 N.E.2d at 718, 144 Ill. Dec. at 359. In this decision, the Illinois Supreme Court set aside the Byron II rates, remanded the case to the commission, and ordered Edison to rollback its rates to Byron I levels.

contradictory interpretations of the rule. Consistent with a strict interpretation of the rule, the courts prohibited ratepayers from receiving refunds for the period leading up to the trial court's original reversal of the Byron I decision.[30] Although Edison may have reaped excess profits during that period, the courts followed the *T.R. Miller* reasoning and held that the commission could not grant reparations for a period when commission-approved rates were in effect. Foreseeing the possibility of lengthy remand proceedings, however, the courts ruled, contrary to a strict construction of the rule, that the commission could grant refunds for any unlawful rates collected under these very same commission-approved rates for the periods of the appeal to the supreme court and the remand.[31] Moreover, faced with the possibility of huge refunds for a five-year remand period, the Illinois appellate court disregarded the retroactivity rule and allowed the commision, when computing the amount of the Byron I refund, to consider Edison's actual losses throughout the entire Byron I remand period.[32] That same court went even further, al-

30. Because of the rule against retroactive ratemaking, the trial court in the Byron I appeal found that Edison was not required to refund any of the rate increase collected during the six months of the appeal. Relying on established precedent, Mandel Bros., Inc. v. Chicago Tunnel Terminal Co., 2 Ill. 2d 205, 117 N.E.2d 774 (1954) (for a full discussion of the *Mandel Bros.* case, see notes 214-27 and accompanying text), the court reasoned that the rule prohibited the commission from ordering Edison to refund amounts previously collected by it under commission-approved rates—even if a court subsequently reversed those rates. *Hartigan I, supra* note 17, at 94. On appeal the Illinois Supreme Court approved this holding. *Hartigan II, supra* note 17, at 149, 510 N.E.2d at 877, 109 Ill. Dec. at 809.

31. Faced with the prospect that the prohibition on retroactive ratemaking would bar refunds even of overcharges during the remand period, the trial court in the Byron I appeal ordered the commission to rollback the rates to pre-October 1985 levels within 30 days. *Hartigan I, supra* note 17, at 98. The Illinois Supreme Court affirmed the trial court's reversal of the Byron I rates, but held that the court had no authority to issue the rollback order. As to the question whether the rule against retroactive ratemaking prevented refunds of overcharges collected during the remand period, the court held that the retroactivity rule was inapplicable after reversals of commision orders. *Hartigan II, supra* note 17, at 148, 510 N.E.2d at 877, 109 Ill. Dec. at 809.

The court developed an exception to the rule, holding that it was applicable only in "original" ratemaking cases, not proceedings to correct erroneous rate orders. *See id.* Otherwise, the court noted, judicial review of commission orders would be meaningless. *See* Independent Voters of Ill. v. Illinois Commerce Comm'n, 117 Ill. 2d 90, 104-05, 510 N.E.2d 850, 857-58, 109 Ill. Dec. 782, 789-90 (1987) (decided simultaneously with the *Hartigan II* opinion). The court held, however, that during the remand proceedings, the Byron I rates could remain in effect, subject to refund, pending a commission final order. *Hartigan II, supra* note 17, at 148, 510 N.E.2d at 877, 109 Ill. Dec. at 809. Accordingly, the court allowed Edison to continue to collect the increased rates while the commission determined the correct level of Byron I rates on remand.

After the commission entered its remand order, the appellate court stayed this order, and Byron I rates have remained in effect. *Hartigan III, supra* note 17, at 936, 561 N.E.2d at 721, 149 Ill. Dec. at 351.

32. On appeal from the Byron I remand order, the court affirmed the commission's disallowance of additional Byron I costs, but again remanded the case to the commission for recalculation of the refund. *Hartigan III, supra* note 17, at 938-57, 561 N.E.2d at 723-33, 149 Ill. Dec. at 353-65. Despite the rule against retroactive ratemaking, the court ruled that in computing the refunds, the commission could offset any reimbursement to consumers by any additional expenses incurred by Edison during the remand period that were not forecasted in the the original Byron I order. *Id.* at 956-58, 561 N.E.2d at 734-35, 149 Ill. Dec. at 364-65.

All parties in the case agreed that in determining the amount of the refund, the commission should consider Edison's actual revenues—not the revenues projected in the October 1985 order.

lowing the commissison to consider the rate determination in the Byron II remand case when retroactively calculating the amount of rates associated with Byron I that should have been collected after the original Byron II order.[33]

Consumer intervenors argued, however, that Edison should not be able to offset these receipts with any increase it had actually experienced in operating expenses during the remand period. Otherwise, they contended, the commission would be engaged in retroactive ratemaking because it would be allowing Edison to recoup expenses not allowed in the original Byron I rate order. *Id.* at 956-57, 561 N.E.2d at 735, 149 Ill. Dec. at 365. The court, however, rejected this argument, concluding that the rule against retroactive ratemaking would apply only if Edison were seeking surcharges from its customers for amounts in excess of its total revenues for the remand period:

> We do not believe that what the Commission is proposing is retroactive rate-making, but rather a matching of the relevant expenses to revenue for the period in question . . . .
>
> In the present case, if Edison's actual expenses are found to be higher than actual receipts, the policy against retroactive rate-making prohibits Edison from surcharging its customers to make up the difference. We do not believe, however, that if actual revenues are to be used in calculating the appropriate refund amount, Edison should be prohibited from demonstrating an increase in expenses over that which was originally projected. Consistency of approach seem [sic] to demand no less.

Id. at 957, 561 N.E.2d at 735, 149 Ill. Dec. at 365. The court again remanded the case back to the commission to decide the amount of revenues and expenses that should be considered in calculating the refund. *Id.* at 957, 561 N.E.2d at 735, 149 Ill. Dec. at 365.

33. Because of the unique procedural posture of the case, in the Byron II appeal to the Illinois Supreme Court, the court ordered a rollback of rates to Byron I levels. After the Byron II commision order, consumer intervenors requested a stay of the Byron II rates. In response, Edison agreed to refund the full amount of the Byron II increase if the courts eventually reversed those rates on appeal. Business & Professional People for the Pub. Interest v. Illinois Commerce Comm'n, 136 Ill. 2d 192, 241, 555 N.E.2d 693, 715, 144 Ill. Dec. 334, 356 (1990). Thus, when the Illinois Supreme Court set aside the Byron II rates, it was faced with the question of possible refunds during the pendency of the appeal and of the rates to be collected during the remand period. Like the trial court in the Byron I appeal, this court noted that under the rule against retroactive ratemaking, in the absence of a stay, ratepayers would not be entitled to a refund of any rates paid during the pendency of the appeal. *Id.* at 242, 555 N.E.2d at 716, 334 Ill. Dec. at 357. Nevertheless, it held that, given Edison's agreement to refund the full amount of rates collected if the Byron II rates were reversed, Edison was required to refund immediately all rates collected during the pendency of the first level of the appeal. *Id.* at 247, 555 N.E.2d at 718, 144 Ill. Dec. at 359. Further, because of this agreement, the court did not follow its decision in *Hartigan II* allowing Edison to collect the revised rates during the remand period, but instead ordered an immediate rollback of the rates to pre-January 1, 1989 (Byron I) levels and remanded the case to the commission for a proper determination of Byron II rates. *Id.*

Accordingly, the court on the Byron I remand appeal confronted the issue of the effect of the Byron II remand on refunds in the Byron I case. It held that the commission could wait until its decision in the Byron II remand case to determine the amount of the refunds for the period after the date of the original Byron II order. *Hartigan III*, *supra* note 17, at 962-63, 561 N.E.2d at 738-39, 149 Ill. Dec. at 368-69. In spite of the rule against retroactive ratemaking, the court held that if the expenses allowed in the Byron II remand case were higher than those originally allowed in that case, the commission could reduce the Byron I refund by the difference between the two amounts. *Id.*

Specifically, the issue concerned the amount of the refund for the period after January 1, 1989, the date that the original Byron II rate order went into effect. Edison argued that the Byron I refunds for the period after January 1, 1989 (the effective date of the original Byron II rates) were not yet subject to determination because the commission had not yet entered an order on the Byron II remand. *Id.* at 962, 561 N.E.2d at 738, 149 Ill. Dec. at 368. Consumer intervenors contested this position, arguing that the rule against retroactive ratemaking prohibited the commission in the Byron II remand proceeding from granting any increase in excess of the original Byron II rates. *Id.* at 962-63, 561 N.E.2d at 738-39, 149 Ill. Dec. at 368-69. Thus, they asserted that the Byron I refund calculations should be the same for both the pre- and post-January 1, 1989 periods.

The court rejected the intervenors' argument, holding that in the Byron II remand case:

> [T]he commission is not engaging in original, or retroactive rate-making, but rather attempting again to set proper 1989 rates, this time in accordance with the supreme court's instruction.

Given this five-year history of Edison rate cases, appeals, remands, remand appeals, and second remands, it is certainly clear that the modern regulatory context is far different from the days of *T.R. Miller*. The Edison cases affect over a billion-and-a-half dollars in annual revenue to the utility, impact millions of customers, and attract scores of intervenors. The issues in the cases involve highly technical questions in regard to nuclear plant construction and concern applications of newly-enacted public utility legislation. The cases are a far cry from a suit for reparations by a single customer for payment for a few shipments of goods.

Moreover, while the Illinois courts piously continue to invoke the rule against retroactive ratemaking, it is hard to understand how the Edison saga gives any of the parties in the regulatory process—the utility, investors, or consumers—a sense of fairness, stability, and reliability about the level of Edison's rates.[34] In fact, as a result of these decisions, five years after the original Byron I rate order, the commission is still determining—by looking at past revenues and expenses—the amount of rates that should have been collected for the period of May 1986 through the present.

The Edison cases are good examples of how the courts have had difficulty applying the rule against retroactive ratemaking in a socially beneficial fashion in the modern context. As do many recent cases, the Edison cases concern controversial utility investments, heated opposition by consumer and government groups, newly-enacted legislative standards for commission decision making, and frequent judicial interventions. Instead of reexamining the rule to determine if it has continued validity in this context, however, most courts have applied it in the same manner as the Illinois courts: they pledge fidelity to it but either actually ignore the rule or develop ad hoc exceptions to it when it stands in the way of the decision they want to make.[35] Likewise, most commentators uncritically accept the value of the rule without considering whether it

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> The Commission may determine that an increase of more than $235 million is in order. While Edison is prohibited from collecting more revenues from ratepayers than it has for 1989, a higher rate base will conceivably reduce the refund amount.

Id. at 962-63, 561 N.E.2d at 739, 149 Ill. Dec. at 369. Accordingly, the court held that Edison was not required to refund any post-January 1, 1989 rates until after the Byron II remand decision. *Id.*

34. While it can be argued that the Edison saga is a unique occurrence because most rate orders are not subject to successive judicial reversals, remands, and appeals, the Edison experience of an almost endless ratemaking process is not unusual. As part III of this article illustrates, even if most utilities do not have their rate orders under judicial scrutiny for four or five years, the use by commissions of fuel adjustment clauses, deferred accounting mechanisms, and interim rate orders has transformed ratemaking from "general" cases every several years into an almost uninterrupted process. As the United States Supreme Court has observed in the context of Federal Energy Regulatory Commission rate cases, these cases are "nigh interminable." Atlantic Ref. Co. v. Public Serv. Comm'n, 360 U.S. 378, 389 (1959).

35. *See infra* notes 261-68 and accompanying text. Federal regulatory bodies also apply the rule against retroactive ratemaking. *See, e.g.*, Columbia Gas Transmission Corp. v. FERC, 831 F.2d 1135, 1139-42 (D.C. Cir. 1987). Although the mechanics of federal rate regulation are similar to state ratemaking, there are significant differences between the fixing of rates at the wholesale and retail levels. For that reason, I have narrowed the scope of this article to the application of the rule in state public utility regulation.

has any meaningful role to play in the modern regulatory process.[36]

The purpose of this article is to analyze the application of the rule against retroactive ratemaking in the context of the current regulatory process. I will review first the traditional ratemaking process in state public utility proceedings. I then will examine how the courts have recently applied the doctrine prohibiting retroactive ratemaking in different ratemaking settings. Next, I will discuss the different policies underlying the rule and will examine whether or not the rule, as currently applied, actually realizes these policies. Finally, I will propose a new formulation of the rule that effectuates some of the policies underlying the rule but that also recognizes the flexibility necessary in modern rate regulation.

II. Traditional Public Utility Ratemaking

To comprehend the rule against retroactive ratemaking, it is necessary first to understand the process for the setting of public utility rates. This section describes the broad outlines of the ratemaking process in most states and then discusses how the rule against retroactive ratemaking fits into this process.[37] Although procedures vary from state to state, most of the statutory ratemaking schemes are very similar.[38]

A. *Ratemaking Process*

Changes in rates can be initiated by the filing of new rate schedules by the utility, the institution of an investigatory proceeding by the commission with jurisdiction over the utility, or the filing of a complaint case by ratepayers challenging the reasonableness of current rates.[39] When a

36. *See, e.g.*, E. King Poor, *Utility Rates Pending Judicial Review: A Riddle Wrapped in a Mystery in Illinois*, 17 J. Marshall L. Rev. 743 (1984). The one commentator who has examined the validity of the rule in the modern regulatory context narrowly defines the issue as whether a commission has the authority to reduce a utility's prices retroactively to the date the rate proceedings began. Louis De Alessi, *Private Ownership and Limits to Retroactive Regulation of Utility Rates*, 37 U. Miami L. Rev. 433, 434 n.3 (1983). He fails to address the broader issues of the authority of commissions to grant retroactive relief to all parties, including utilities, or of the power of the commission to modify rates even for the period before the rate proceeding began.

Professor Hardman authored the major articles critiquing the rule against retroactive ratemaking decades before the modern increase in public utility ratemaking activity. *See* Thomas P. Hardman, *Administrative Finality in Claims for Overcharges*, 51 W. Va. L. Rev. 77 (1948) [hereinafter Hardman, *Administrative Finality*]; Thomas P. Hardman, *The Finality of the Filed Rate in West Virginia*, 49 W. Va. L. Rev. 143 (1943) [hereinafter Hardman, *Finality of Filed Rate*].

37. For a general description of the ratemaking process in each of the states, see NARUC Report, *supra* note 11, at 419-43.

38. *See id.* Most states modeled their public utilities commission enabling acts after those enacted by New York and Wisconsin early in this century. Gregg A. Jarrell, *The Demand for State Regulation of the Electric Utility Industry*, 21 J.L. & Econ. 269, 270-71 (1978).

39. Richard J. Pierce, Jr., Gary D. Allison & Patrick H. Martin, Economic Regulation: Energy, Transportation and Utilities 130 (1980); *see, e.g.*, §§ 9-201 and 9-250 of the Illinois Public Utilities Act, Ill. Rev. Stat. ch. 111 2/3, paras. 9-201, 9-250 (1989). Although usually the utility initiates proceedings to change rates, commissions generally can institute proceedings to investigate the reasonableness of existing rates, *see* NARUC Report, *supra* note 11, at 429-30 (Table 9), and customers can usually file a rate complaint before the agency. *Id.* at 440-41 (Table 15).

utility proposes changes in its rates, it must publish notice of these proposed changes,[40] and the commission then has a period of time, usually thirty to forty-five days, to decide whether or not to suspend the rates for hearings on the proposed schedules.[41] If the commission does not suspend the rates, the utility puts them into effect at the end of the waiting period.[42] If the commission suspends the rates, the statutory suspension period ranges from four months to a year, depending upon the enabling legislation.[43] Pending the outcome of the hearings, some states allow utilities to implement the new rates under bond and subject to refund,[44] and most states authorize their commissions to grant interim rate increases, again subject to refund.[45]

In the typical rate case, the hearings address two broad sets of questions: "revenue requirement" and "rate design" issues.[46] In the revenue requirement stage of the case, the commission determines whether the total amount of rates under the proposed schedules meets the statutory "just and reasonable" standard.[47] In the rate design phase of the case, the commission decides whether the utility's proposed allocation of total rates among the different customer classes and within each class violates the statutory proscription against "unduly discriminatory" rates. From an economics perspective, the purpose of this ratemaking process is to replicate as much as practicable the price that would exist for each class of customers if the utility was operating in a competitive market.[48] The purpose of the process is to "provide incentives to adopt new methods, improve quality, increase efficiency, cut costs, develop new markets, and expand output in line with consumer demand."[49]

To decide the revenue requirement issues, the commission first calculates the amount of overall revenue that will allow the utility to have an opportunity to earn a reasonable return on its invested capital and to

40. *See, e.g.*, § 9-201(a) of the Illinois Public Utilities Act, ILL. REV. STAT. ch. 111 2/3, para. 9-201(a) (1989); TEX. REV. CIV. STAT. ANN. art. 1446(c), § 43(a) (Vernon Supp. 1991).

41. *See* NARUC REPORT, *supra* note 11, at 849-52 (Table 209).

42. Ratepayers still can file a complaint case challenging the reasonableness of the rates. *See supra* note 39.

43. NARUC REPORT, *supra* note 11, at 427-28 (Table 8).

44. *Id.* at 426 (Table 7).

45. *Id.* at 424-25 (Table 6); *see infra* note 163. For a discussion of the application of the rule against retroactive ratemaking in the context of interim rate proceedings, see *infra* notes 163-77 and accompanying text.

46. *See* CHARLES F. PHILLIPS, JR., THE REGULATION OF PUBLIC UTILITIES 156-61 (1985). In some cases, commissions formally bifurcate the proceedings into different phases to address these two sets of issues. Also, in some cases, the commission will consider only one of the two sets of issues; for example, when a utility seeks no increase in overall revenue, but only requests a change in its rate design with no effect on revenue requirement, the utility will not present a case on revenue requirement.

47. *See, e.g.*, § 9-101 of the Illinois Public Utilities Act, ILL. REV. STAT. ch. 111 2/3, para. 9-101 (1989) ("All rates or other charges made . . . for any service rendered . . . shall be just and reasonable.").

48. *See* PHILLIPS, *supra* note 46, at 154.

49. *Id.*

pay its reasonable operating expenses.[50] This calculation can be stated as the following formula: $R = O + B(r)$—where R is the company's allowed revenue requirement; O is the utility's operating expenses; B is the firm's rate base (invested capital); and r is the reasonable return allowed the company on its rate base.[51] Once the commission determines the revenue requirement, it then estimates the level of revenue under the proposed rates and determines the extent to which the proposed rates meet or exceed this requirement.

In determining the amount of each of the terms in the ratemaking formula and in making its estimate of revenues under the proposed rates, the commission looks at data for a given "test year" either in the past, present, or future.[52] In this way, the commission attempts to match the revenues, expenses, rate base, and return for the same period.[53] The commission may adjust these data for any unusual circumstances during the test year or for any known and measurable changes forecasted in the future.[54]

The commission bases the precise amount for each of the terms in the formula on evidence obtained from the utility's books and records and from expert testimony. In examining this evidence, the commission is guided by different statutory standards and by its own rules and regulations. As to operating expenses, for example, most statutes allow the utility to recover only those operating expenses that are "reasonable."[55] Further, most commissions have specific accounting rules for the treatment of different kinds of expenses such as tax, lobbying, or advertising expenses.[56] In regard to calculating B—the rate base term—most statutes allow the commission to consider only the cost of property that is used by and is useful to the utility.[57] Many states recently have enacted

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50. *Id.* at 157-60; *see* TEX. REV. CIV. STAT. ANN. art. 1446(c), § 39(a) (Vernon Supp. 1991) ("In fixing the rates of a public utility, [the commission] shall fix its overall revenues at a level which will permit such utility a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over and above its reasonable operating expenses").

51. ERNEST GELLHORN & RICHARD J. PIERCE, REGULATED INDUSTRIES 89 (2d ed. 1987); *see* Citizens Utils. Co. v. Illinois Commerce Comm'n, 124 Ill. 2d 195, 200-01, 529 N.E.2d 510, 512-13, 124 Ill. Dec. 529, 531-32 (1988).

52. PHILLIPS, *supra* note 46, at 158; *see* NARUC REPORT, *supra* note 11, at 438-39 (Table 14). The use of a test year, by its very nature, requires examination of the past experience of the company. Even the use of a future test year involves consideration of historical data adjusted for a future period. Accordingly, in the broad sense of the term, all ratemaking is retroactive. Given humankind's inability to know the future, any attempt to predict the future experience of a utility must be based on consideration of past events. Although the rule against retroactive ratemaking merely prohibits consideration of specific past gains or losses in the setting of rates and does not bar examination of the entire past experience of the company, it is a bit artificial to distinguish between particular gains or losses and the entire past experience of the company, which is nothing more than the aggregate of these gains and losses.

53. Business & Professional People for the Pub. Interest v. Illinois Commerce Comm'n, 136 Ill.2d 192, 219, 555 N.E.2d 693, 705, 144 Ill. Dec. 334, 346 (1990).

54. NARUC REPORT, *supra* note 11, at 438-39 (Table 14).

55. *See, e.g.*, TEX. REV. CIV. STAT. ANN. art. 1446(c), § 39(a) (Vernon Supp. 1991).

56. *See, e.g.*, NARUC REPORT, *supra* note 11, at 464-77 (Tables 26-32).

57. GELLHORN & PIERCE, *supra* note 51, at 107. Commissions in some jurisdictions allow

statutes specifying standards for the inclusion of large generating facilities, such as nuclear plants, in the rate base.[58] In addition, most commissions have rules prescribing depreciation rates for valuation of various classes of property.[59]

Once the commission has determined the appropriate revenue requirement, it turns its attention to the issue of rate design: how to distribute the revenue requirement among different customer classes and within the classes. Under most statutory schemes, commissions have broad discretion in designing rates.[60] They may base the allocation of rates on any of the following factors: the cost of providing service to different customers, the purpose for which the service is used, the quantity or amount of service received, the different character of service furnished, the time or season of use, the constancy or regularity of use, or "any other matter which presents a substantial difference as a ground of distinction."[61] Most commissions, however, emphasize the importance of basing rates on the cost of providing service to different classes of customers and have developed different methodologies to determine this "cost of service."[62] Whatever rate design methodology commissions may adopt, commissions base rate design, like revenue requirement, on usage during the test year period.[63]

After determining the revenue requirement and the correct rate design methodology, a commission will issue an order requiring the utility to file revised rate schedules consistent with the order. In most cases, and especially in large rate cases, commissions will reject the utility's originally proposed rate schedules and will order the filing of new tariffs that are consistent with its findings as to revenue requirement and rate design. Most statutes further provide that once the utility files rate schedules, complying with the commission's order, these rates are there-

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utilities to include at least a portion of construction work in progress (CWIP) in the rate base. *See id.* at 112-16; NARUC REPORT, *supra* note 11, at 449 (Table 19).

58. *See, e.g.*, CONN. GEN. STAT. ANN. § 16-19s (West 1988); IDAHO CODE § 61-502a (Supp. 1991); ILL. REV. STAT. ch. 111 2/3, para. 9-212 (1989); KAN. STAT. ANN. § 66-128 (1985); N.H. REV. STAT. ANN. § 378.30a (1984); N.Y. PUB. SERV. LAW § 66(24) (McKinney Supp. 1991); OHIO REV. CODE ANN. § 4909.15(A)(1) (Anderson Supp. 1990); 66 PA. CONS. STAT. ANN. § 1315 (Purdon Supp. 1990).

59. NARUC REPORT, *supra* note 11, at 456-62 (Tables 23-25).

60. *See, e.g.*, Wood v. Public Util. Comm'n, 481 P.2d 823, 827 (Cal. 1971); Texas Alarm & Signal Ass'n v. Public Util. Comm'n, 603 S.W.2d 766, 772 (Tex. 1980); City of West Allis v. Public Serv. Comm'n, 167 N.W.2d 401, 405 (Wis. 1969).

61. *See, e.g.*, *Texas Alarm & Signal Ass'n*, 603 S.W.2d at 772.

62. *See* GELLHORN & PIERCE, *supra* note 51, at 181-82. The two principal approaches for determining cost of service are embedded cost and marginal cost methodologies. Under the embedded cost method, rates are based on average historical costs of the utility. PHILLIPS, *supra* note 46, at 388. Under the marginal cost method, rates are based on the avoidable cost the utility must incur to produce one more unit of its product at a given level of its output. GELLHORN & PIERCE, *supra* note 51, at 195-96.

63. After the commission determines the utility's revenue requirement for the test year, it then decides the specific rates for the different classes to yield the required revenues for that test year. PHILLIPS, *supra* note 46, at 379.

after to be observed until changed.[64]

After the commission enters its rate order, any party—either the utility or an intervenor—can appeal the decision to a court that, depending on the jurisdiction, could be a trial, appellate, or supreme court.[65] In almost all states, judicial review is based solely on the commission record.[66] Also, under most statutory schemes, during the appeal period, the commission-ordered rates go into effect unless a party obtains a stay of the order.[67] Because courts consider the fixing of specific rates a function solely for the commission, judges will not order new rates if they reverse the commission-ordered rates on review. Instead, they will remand the case to the commission for the setting of new rates consistent with the decision on review.[68]

B. *The Rule Against Retroactive Ratemaking*

Under the rule against retroactive ratemaking, when a commission engages in ratemaking, it can look to the future only. Specifically, the rule requires that when determining each of the terms of the revenue requirement formula, when calculating the amount of revenue to be collected under proposed rates, or when allocating rates between classes or within a class, the commission cannot adjust for past losses or gains to either the utility, consumers, or particular classes of consumers. Even though a commission may use a historical test year to calculate each component of the revenue requirement formula, the rule requires that the commission adjust those data with a view toward the utility's experience in the coming year.[69]

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64. *See, e.g.*, ARK. CODE ANN. § 23-2-304(a)(1) (Michie 1990); CAL. PUB. UTIL. CODE § 728 (West 1975); COLO. REV. STAT. § 40-3-111 (1984); MINN. STAT. § 216B.16 (1990); MISS. CODE ANN. § 77-3-41 (Supp. 1990); 66 PA. CONS. STAT. § 1308(c) (1989); TEX. REV. CIV. STAT. ANN. art. 1446(c), § 43(f) (West Supp. 1991). Courts have relied on this language to support their application of the rule against retroactive ratemaking. *See supra* notes 285-87 and accompanying text.

65. NARUC REPORT, *supra* note 11, at 897-98 (Table 221).

66. *Id.*

67. *See, e.g.*, IDAHO CODE § 61-635 (1976); ILL. REV. STAT. ch. 111 2/3, para. 10-204 (1989); MINN. STAT. § 216B.53 (1990); N.M. STAT. ANN. § 62-11-6 (1978). In most states, the appealing party must post a bond in order to obtain a stay of the rate order. *See, e.g.*, ILL. REV. STAT. ch. 111 2/3, para. 10-204(c) (1989). If the public utility appeals a rate order and obtains a stay of the order, the originally filed tariffs go into effect pending the appeal.

68. *See, e.g.*, *In re* Diamond State Tel. Co., 113 A.2d 437, 442-46 (Del. 1955). Reviewing courts remand the cases to the commission, rather than set rates themselves, because they view ratemaking as a "legislative," rather than "judicial" function. *Id.* For a discussion of the legislative/judicial distinction in the retroactive ratemaking context, *see supra* notes 292-98 and accompanying text.

69. *See* United Tel. Co. v. Public Serv. Comm'n, 406 N.E.2d 1268 (Ind. Ct. App. 1980). Although most cases confront the retroactive ratemaking issue in the revenue requirement setting (either compensation of utilities for past losses or reimbursements of ratepayers for past utility gains), several decisions address the doctrine in the rate design context. *See, e.g.*, Georgia Pub. Serv. Comm'n v. Atlanta Gas Light Co., 55 S.E.2d 618 (Ga. 1949); Long Island Lighting Co. v. Public Serv. Comm'n, 429 N.Y.S.2d 1004 (N.Y. Sup. Ct. 1980); Commonwealth *ex rel.* Appalachia v. Old Dominion Power Co., 34 S.E.2d 364 (Va. 1945). In *Georgia Public Service*, for example, the commission readjusted past billings to a certain class of customers, whose service had been interrupted, to calculate the charges at the interruptible rate. *Georgia Pub. Serv.*, 55 S.E.2d at 628. The court

In support of the rule, courts point to the prospective nature of the ratemaking process: a utility files with the commission rates that it proposes to charge in the coming years. In its final order the commission fixes rates that are "thereafter to be observed." Even if the court reverses a rate order on appeal, the court remands the case to the commission to fix rates for the future. Once the commission fixes rates, the argument goes, any changes can be prospective only.

III. Current Applications of the Rule Against Retroactive Ratemaking

A. *Application of the Rule in the Context of Commission Changes in Its Accounting Methodology*

As is apparent from the above description of the traditional ratemaking process, the commission must base its calculation of each of the terms in the ratemaking formula on accounting entries in the utility's books. In many rate cases, some of the most hotly contested issues concern the proper methodology for accounting of certain operating expenses or rate base items.[70] Over time, the commission itself may change its accounting treatment for specific items.[71]

Under a strict construction of the rule against retroactive ratemaking, courts should allow such changes only if they do not affect past losses or gains to the utility. At least one court has adopted such a construction of the rule. In *Montana-Dakota Utility Co. v. Public Service Commission*,[72] the court considered the change in treatment of a utility's investment tax credit (ITC) for ratemaking purposes. The utility elected to account for the ITC by deducting it entirely from its rate base when it was taken and restoring it to the rate base over a set period. This procedure provided an immediate benefit from the credit to the utility's customers and a delayed benefit to its shareholders.[73] Although the company depreciated the property for which the credit was allowed over twenty-six years, it selected a twenty-year amortization period for restoring the credit to the rate base.

While in previous cases the commission had approved this procedure,[74] in this particular case the commission determined that the amortization period for the restoration of the tax credit should match the

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reversed the finding that the commission had no authority to change its previously-approved rates to that class of customers. *Id.* at 630-31.

70. *See, e.g.*, Northern Ind. Pub. Serv. Co., 85 Pub. Util. Rep. 4th (PUR) 605, 670-72 (Ind. Util. Regulatory Comm'n 1987) (accounting treatment of deferred taxes); Niagara Mohawk Power Corp., 83 Pub. Util. Rep. 4th (PUR) 97, 141-43 (N.Y. Pub. Serv. Comm'n 1987) (accounting treatment of nuclear plant expenses).

71. *See, e.g.*, *Wisconsin PS Load Management Goals Hiked, Profit Okayed on Investment*, Elec. Util. Wkly., Jan. 21, 1991, at 9 (discussing changes by the Wisconsin commission in accounting treatment for utility investment in conservation programs).

72. 431 N.W.2d 276 (N.D. 1988).

73. *Id.* at 280.

74. *Id.* at 280-81.

depreciation period of twenty-six years. The commission further ordered the utility to recompute its unamortized ITC balance to reflect a twenty-six, rather than twenty-year, period. Accordingly, the commission reduced the utility's rate base by almost half a million dollars.[75]

On appeal the utility did not object to the prospective change in amortization periods, but did challenge, on retroactive-ratemaking grounds, the commission's requirement that it restate its unamortized balance as if it had used a twenty-six-year period from the beginning.[76] The court accepted this argument, holding that the commission's order "decreases future rates to compensate for previous higher rates, which were based, in part, upon the [commission's] initial acceptance of the twenty-year . . . amortization period."[77]

In contrast to *Montana-Dakota Utilities*, several courts have not taken such a rigid approach to the rule against retroactive ratemaking and have not prohibited changes in accounting methodology, even if these modifications alter the treatment of prior gains or losses already realized by the utility.[78] In *Washington Gas Light Co. v. Public Service Commission*,[79] for example, the court rejected a challenge to a commission order altering the commission's treatment of gains realized by the utility on reacquisition of long-term debt. In that case, for over twenty years, the utility periodically had repurchased some of its outstanding long-term debt as part of its predetermined sinking fund obligation. When the company was able to reacquire its debt at less than its par value, the utility realized a gain. In prior rate cases, the commission had allowed the utility to account for these gains as part of the company's retained earnings to the benefit of its shareholders.[80]

In this case, however, the commission determined that this treatment of the gain was "unrealistic and inequitable."[81] The commission reasoned that "[a]ny reduction in or savings associated with the cost of

75. *Id.* at 280.

76. *Id.*

77. *Id.* at 281.

78. Washington Gas Light Co. v. Public Serv. Comm'n, 450 A.2d 1187 (D.C. 1982); Southern Union Gas Co. v. Railroad Comm'n of Texas, 701 S.W.2d 277 (Tex. Ct. App. 1985); *see also* Citizens of the State v. Florida Pub. Serv. Comm'n, 415 So. 2d 1268 (Fla. 1982). In *Citizens of the State*, the utility, in a prior case, had entered into a stipulation with intervenors agreeing to refund to customers any amounts earned in 1979 over a 9.02% return on average net investment. *Id.* at 1268-69. Subsequently, the commission approved an equipment depreciation increase for the utility that adversely affected the amount of the refunds. *Id.* at 1269. On appeal the Public Counsel argued that the depreciation represcription was not merely a bookkeeping entry but a retroactive change in rate base. *Id.* The court rejected this argument, holding that the commission:

> was not [engaged in] rate-making but, rather, was considering depreciation represcription. We acknowledge, as did the commission, that new depreciation allowance does have an effect on the . . . stipulation and refund. The [commission] determined, however, that this was a factor that all parties knew or should have known would affect the . . . refund.

Id. at 1270.

79. 450 A.2d 1187 (D.C. 1982).

80. *Id.* at 1215. The company took the retained earnings into account when it declared shareholder dividends. *Id.*

81. *Id.* at 1216.

debt should be passed on to the customers," not the shareholders.[82] Accordingly, it ordered the utility to amortize the gains realized for each repurchase over the life of the particular debt retired and to offset its overall cost of debt by these amortized amounts each year during what would have been the remaining life of the debt.[83] Because commissions consider a utility's cost of debt in determining the utility's overall rate of return, this change in accounting treatment shifted the benefit of the gains realized from the repurchases from the shareholders to the ratepayers.[84]

In implementing this change in methodology, the commission considered all the gains realized from repurchases of debt for the twenty years since the repurchasing scheme began and treated those gains as if the utility had amortized them from the time of repurchase over the life of the debt involved. For the test year, it offset the cost of long-term debt by the sum of the portion of the gains that the utility would have amortized in that year under the newly adopted methodology.[85]

Although the utility did not contest this change in accounting methodology, it contended that the rule against retroactive ratemaking prohibited the commission from considering any gains realized from debt repurchases before the test year.[86] Similar to the utility in *Montana-Dakota Utilities*, the company argued that by offsetting the cost of long-term debt for the test year and successive years by a portion of the gains realized in the past twenty years, the commission violated the retroactivity rule.[87] Relying on the classic formulation of the rule that "past excessive earnings belong to the utility,"[88] the company argued that its

82. *Id.* (quoting Proposed Opinion and Order No. 6051, at 12 (Feb. 13, 1979) (D.C. Pub. Serv. Comm'n)).

83. *Id.*

84. *Id.*

85. *Id.* at 1217.

86. *Id.*

87. *Id.* In its order, the commission denied that it was indulging in retroactive ratemaking:

> [Our] decision does not deprive stockholders of any past gains to which they were entitled prior to our decision in this case. They are permitted to keep all those gains which would have been amortized prior to the test year had the Commission instituted a policy of passing on the gains to the customers at the time the gains were realized. The customers get only the remaining pro forma unamortized gains which fall within the test period and in successive years. Under these circumstances, we do not think it can be fairly said that we have engaged in retroactive ratemaking.

Id. (quoting Final Opinion and Order No. 6060, at 7 (Mar. 16, 1979) (D.C. Pub. Serv. Comm'n)).

88. The company relied on Board of Public Utility Commissioners v. New York Telephone Co., 271 U.S. 23 (1926), in which the Court struck down an order that a utility make up future earnings deficiencies out of excessive depreciation reserves accumulated in the past. In that case, the Court held:

> The revenue paid by the customers for service belongs to the company. The amount, if any, remaining after paying taxes and operating expenses, including the expense of depreciation, is the company's compensation for the use of its property. If there is no return, or if the amount is less than a reasonable return, the company must bear the loss. Past losses cannot be used to enhance the value of the property or to support a claim that the rates for the future are confiscatory. . . . And the law does not require the company to give up for the benefit of future subscribers any part of its accumulations from past operations. Profits of the past cannot be used to sustain confiscatory rates for the future.

shareholders were entitled to the full amount of gains realized prior to the test year.[89]

On review the court affirmed the commission's order and rejected the utility's retroactive ratemaking argument, asserting that the company's arguments "denie[d] the realities—as well as the equities—of long-term debt financing."[90] The court reasoned:

> When a utility repurchases a debenture in the open market at a discount, the effect of such a transaction is to reduce the company's embedded cost of debt. This is true regardless of whether the discount is treated for accounting purposes as a reduction in debt expense or, as has been [the utility's] practice, as retained earnings. In other words, gains on reacquired debt reduce the company's embedded cost of debt, irrespective of the utility's accounting practices.[91]

It further noted that ratepayers, rather than shareholders, had been burdened with the payment of the income taxes on the gains realized, as well as the cost of financing new debt issued by the company to replace the retired debt.[92] Faced with this economic "reality," the court held that the commission's prior methodology for treatment of the gains "did not reflect the actualities or the equities of debt financing [and] provides an insufficient basis to hold that [the utility's] stockholders acquired an immediate 'vested' interest in all gains realized prior to the . . . test year."[93]

Using a similar "reality of the situation" rationale, the court in *Southern Union Gas Co. v. Railroad Commission*,[94] affirmed the commission's change in accounting treatment for investment tax credits. In that case, the utility had filed a request for a rate increase in 1983.[95] The commission requested that the utility prepare and file an exhibit showing all of the investment tax credits taken by the company since 1971. For each item of utility property, the commission then amortized the amount of the credit over the life of the property producing the credit and calculated a ratable portion of the tax credit to be applied against federal income tax liability in the test year.[96] As in *Washington Gas Light Co.*, the utility invoked the rule against retroactive ratemaking, arguing that the money saved from the tax credits over the prior twelve years already had been spent on dividends to shareholders, other investments, or expenses. Accordingly, it argued that ratepayers could not recoup the utility's past gains.

The court rejected this argument, noting that the utility in past years had included all the property that produced the tax credits in its

Id. at 31-32 (citations omitted).

89. 450 A.2d at 1217.
90. *Id.* at 1218.
91. *Id.*
92. *Id.* at 1218-19.
93. *Id.* at 1219.
94. 701 S.W.2d 277 (Tex. Ct. App. 1985).
95. *Id.* at 278.
96. *Id.* at 279-80.

rate base and sought a return on the total cost of that property including the portion attributable to the tax credits paid with funds from the ratepayers. Thus, the court concluded, "the Commission's treatment does no more than to return a portion of the customer's [*sic*] funds to them. Such does not constitute retroactive rate making."[97]

B. Application of the Rule in the Context of Commission Efforts to Remedy Mistakes in Rate Orders

Although a rigid interpretation of the rule against retroactive ratemaking would also prohibit any modification by the commission of a prior rate order that affects past utility gains or losses, courts have allowed such changes in situations in which the commission is remedying procedural mistakes. In *Mike Little Gas Co. v. Public Service Commission*,[98] for example, the court approved a commission's amended order, issued nearly three months after its original order, correcting a clerical error in the first order.[99] The court rejected the retroactive ratemaking challenge, holding that the amended order was merely a *nunc pro tunc* order, not a new rate order. Further, it reasoned that it would be unfair to permit the utility to enjoy a windfall profit at the expense of ratepayers.[100]

Another court expanded this reasoning even to the situation of a commission attempt to remedy a procedural error a decade after the original rate order. In that case, *Buildings Owners & Managers Association v. Public Service Commission*,[101] the commission entered a rate order in 1970 granting the utility a rate increase. In 1973 the circuit court reversed this order on the grounds that the utility had failed to comply with the statutory notice requirement to the City of Detroit. After seven years of proceedings on remand—during which time the utility continued to collect the increased rates—the commission entered an order af-

97. *Id.* at 280; *see also* Citizens of State v. Public Serv. Comm'n, 448 So. 2d 1024 (Fla. 1984). In that case, the commission had adopted an "oil-backout rule" to encourage utilities to develop projects to use nonpetroleum fuels. Under the rule, a utility could recover the revenue requirements of the project through its fuel adjustment clause. For a discussion of fuel adjustment clauses, see *infra* notes 184-210 and accompanying text. Once the commission approved a project under the rule, the utility could recover its costs based on projected fuel adjustment charges for all investor-owned electric utilities on a six-month basis. *Id.* at 1025-26.

In this particular case, after the commission approved the utility's project under the rule, the utility sought approval of its computation of its oil-backout factor. While its application was pending, the commission amended the rule's cost recovery formula, and when it finally approved the utility's oil-backout factor, it used the amended rule. *Id.* at 1026. The state's Public Counsel appealed this decision, arguing that the commission's application of the amended rule constituted retroactive ratemaking. Public Counsel argued that because the initial cost recovery factor was in effect at the time the commission qualified the project under the rule, the commission could not apply the amended rule. *Id.* at 1027. The court rejected this argument, holding that "retroactive ratemaking only occurs when new rates are applied to prior consumption." *Id.*

98. 574 S.W.2d 926 (Ky. Ct. App. 1978).

99. *Id.*

100. *Id.* at 927-28.

101. 383 N.W.2d 72 (Mich. 1986).

firming its 1970 order and allowing the utility to retain all rates collected during the remand period.[102] Certain intervenors appealed this order, arguing that the 1980 validation of the 1970 order amounted to retroactive ratemaking. The court disagreed, holding that a challenge to a rate based on a procedural flaw did not render the commission's 1980 order retroactive ratemaking. The court noted that the remand hearings "supplied the necessary finding of reasonableness after notice to the ratepayer" to support the original order.[103]

When the mistake in the original order is not merely "procedural," however, courts have applied the rule against retroactive ratemaking. In *General Motors Corp. v. Public Service Commission*,[104] for example, the court held that the rule prohibited refunds for the period between an original rate order and an order entered two months later on the reopening of the case. In that case, the commission granted a natural gas utility a rate increase, including in the rate base the utility's synthetic natural gas plant.[105] A little more than two months after this rate order, the utility announced that it was mothballing the plant. The commission immediately reopened the rate proceeding and then issued an order lowering the rates to take into account the disallowance of the plant from the rate base. It denied, however, an intervenor's request for a refund of rates for the period between the original order and the order on reopening.[106] The court affirmed the commission's decision, holding that the grant of a refund would have constituted retroactive ratemaking. The court reasoned that because the change in circumstances (the mothballing of the plant) had occurred two months after the original rate order, the rates collected during that period under commission-approved rates could not have been excessive.[107]

C. *Application of the Rule in the Context of Extraordinary Utility Losses or Gains*

1. *Recognition of the Exception to the Retroactivity Rule for Extraordinary Losses or Gains*

The issue of retroactive ratemaking has arisen numerous times in the context of one-time "extraordinary" losses or gains to the utility. Although the prohibition on retroactivity, by its very terms, allows for no exception for such extraordinary events, some courts have in fact rec-

102. *Id.* at 74-75.
103. *Id.* at 80-81.
104. 438 N.W.2d 616 (Mich. Ct. App. 1988).
105. *Id.* at 617-18. In response to the energy crisis of the early 1970s, some gas utilities built synthetic natural gas plants to address predicted shortages. By the late 1970s and early 1980s, most of these projects faced a number of difficulties, including a natural gas surplus, lower oil prices, declining energy demand, rising construction costs, and high interest rates. PHILLIPS, *supra* note 46, at 609-10.
106. *General Motors Corp.*, 438 N.W.2d at 618-19.
107. *Id.* at 619-20.

ognized an exception. Other courts, however, have kept to an orthodox construction of the rule, even in situations that have greatly prejudiced ratepayers or the utilities.

The classic situations in which courts recognize an extraordinary loss exception to the rule against retroactive ratemaking are weather-related losses.[108] In the frequently-cited case of *Narragansett Electric Co. v. Burke*,[109] a utility requested a temporary rate adjustment to recoup the "extraordinary" expenses incurred in restoring service to customers after an ice storm. The commission denied the request because it was unable to define the term "extraordinary expenses."[110] Further, the commission concluded, even if the expenses were "extraordinary," the rule against retroactive ratemaking precluded recovery of those expenses.[111]

The Rhode Island Supreme Court reversed the commission's decision, holding that no rule—even the rule against retroactive ratemaking—"should be blindly applied . . . without prior consideration of the underlying policy that originally precipitated its adoption."[112] The court noted that the rule serves two functions: it ensures that present customers will not be required to pay for past deficits of the company and prevents the company from using future rates to ensure shareholders' investments.[113] In regard to the first function, the court noted that it must weigh this policy against the interest of providing immediate service to customers when an unexpected storm occurs. Quoting from a local news story about the heroic utility repair crews who "knitted the power lines—our community umbilicals—back together," the court was concerned that unless it allowed the utility to recover storm-related expenses in this case, the next time a severe storm occurred the utility would have no incentive to restore service swiftly and efficiently.[114]

As to the second function of the rule—giving utilities the incentive to operate their companies efficiently to assure a reasonable return for their investors—the court found that the company did not foresee the storm. Because of the unpredictable and devastating nature of the storm, the court concluded that "it is difficult to perceive how the future efficiency of the utility would be furthered by the application of the rule in this instance."[115] The court cautioned, however, that its ruling did not apply to expenses routinely incurred in connection with "New England's

108. *See, e.g.*, Mississippi *ex rel.* Pittman v. Mississippi Pub. Serv. Comm'n, 520 So. 2d 1355, 1360-63 (Miss. 1987) (allowing a utility to recover storm-damage expenses, but not lost revenues, after Hurricane Elana); Narragansett Elec. Co. v. Burke, 415 A.2d 177 (R.I. 1980) (allowing utility to recover expenses caused by a large ice storm); Wisconsin Envtl. Decade v. Public Serv. Comm'n, 298 N.W.2d 205, 211-12 (Wis. Ct. App. 1980) (affirming commission's grant of expenses caused by ice storm).

109. 415 A.2d 177 (R.I. 1980).

110. *Id.* at 178.

111. *Id.*

112. *Id.*

113. *Id.* at 178-79.

114. *Id.* at 179.

115. *Id.*

usually capricious winter climate," but only to "unusual and nonrecurring expenses."[116]

Other courts have used the same reasoning to allow utilities to recover other types of nonrecurring extraordinary expenses. Some courts, for example, have approved recovery of one-time taxes or assessments on the utility.[117] Others have allowed recoupment of substantial increases in the price of fuel[118] and collection of surcharges by a utility to repay a debt.[119] One court has even suggested that when a utility expends substantial amounts in "start-up" costs to introduce new service into an area, it may recover those costs from present customers.[120]

Courts have also applied this "extraordinary" exception to the retroactivity rule to allow ratepayers to receive refunds when a utility has received an unusual gain. In *Chesapeake & Potomac Telephone Co.*,[121] for example, the court affirmed a commission order requiring a telephone

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116. *Id.* at 180.

117. *See, e.g.*, Office of Consumer Advocate v. Iowa State Commerce Comm'n, 428 N.W.2d 302, 305-07 (Iowa 1988) (allowing utility to recover one-time assessment to utility under Nuclear Waste Policy Act of 1982, 42 U.S.C. §§ 1010-10,226 (1982)); Providence Gas Co. v. Burke, 475 A.2d 193, 197-98 (R.I. 1984) (allowing utility to collect surcharge for property tax increase imposed as result of "dire financial straits of the city").

118. *See, e.g.*, Blackstone Valley Elec. Co. v. Public Util. Comm'n, 542 A.2d 242, 245 (R.I. 1988) (allowing imposition of surcharge to recover adjustment by utility's coal supplier, increasing cost of previously-used fuel); *In re* Green Mountain Power, 519 A.2d 595 (Vt. 1986) (allowing utility to recover costs of replacement power because of an unscheduled, extended outage of nuclear plant). In Kentucky v. Public Service Commission, Nos. 85-CA-28, 85-MR-CA-29-MR (Ky. Ct. App. Dec. 20, 1985) (LEXIS, Ky library, App file), utilities sought to impose a surcharge to recover increased fuel costs. Although acknowledging that the utilities had failed to file timely for rate increases to cover these costs, the court—without any further explanation—asserted that the surcharge did not constitute retroactive ratemaking because "it . . . operates prospectively . . . [and] does not impose a new duty on the customers of the utilities in question." *Id.* at 4. The court noted, however, that this was a case in which the commission was "making the best of an impossible situation. There appears to have been no reasonable alternative in insuring survival of the [utilities] and uninterrupted service to their customers." *Id.*

119. *In re* Woonsocket Water Dep't, 538 A.2d 1011 (R.I. 1988).

120. St. Lawrence Gas Co. v. Public Serv. Comm'n, 368 N.E.2d 1234 (N.Y. 1977). In that case, a new gas utility sought a "going value" adjustment to recover development costs it incurred when it began service. The utility contended that it originally set its rates below those needed to produce an adequate return in order to compete with oil companies. It sought to require present customers to make up for the past revenue deficiencies. *Id.* at 1235.

The commission denied the utility's request, and the court affirmed because the utility had failed to demonstrate that the rate set by the commission was unjust or unreasonable. The court noted, however:

> In some instances . . . if a new utility attempted to set rates to cover its initial costs, it would be unable to attract customers and consequently the service would not become available. In such an instance, it may be necessary, as well as just and reasonable, to charge a portion of these initial costs to later users . . . . In the same fashion, for the reason that future customers also benefit from start-up expenses, it may sometimes be just and reasonable to allow new enterprises to recover high initial costs at a later time.

Id. at 1236 (citation omitted).

In Philadelphia Electric Co. v. Pennsylvania Public Utilities Commission, 502 A.2d 722 (Pa. Commw. Ct. 1985), the court recognized an extraordinary loss exception to the retroactivity rule but refused to apply it in the context of a utility's expenses for a new pollution control device at an existing facility. *Id.* at 724-28.

121. 514 A.2d 1159 (D.C. 1986); *accord* Turpen v. Oklahoma Corp. Comm'n, 769 P.2d 1309, 1331-34 (Okla. 1988). In allowing reimbursements for the refunds from AT&T, the court recog-

company to refund to ratepayers reimbursements it had received from AT&T. Before the breakup of the Bell System, the local Bell operating companies, including Chesapeake & Potomac (C & P), had advanced funds to AT&T for certain development costs, and C & P had included these disbursements in its operating expenses for ratemaking purposes.[122] Just before the Bell reorganization, the Federal Communications Commission (FCC) directed AT&T to reimburse the local operating companies for these funds, and the public service commission ordered C & P to refund the reimbursements. In response to C & P's retroactive ratemaking challenge to the commission order, the court held that the refunds "did not come from 'accumulations from past operations' or 'profits of the past'; rather, it was intended to restore to ratepayers what they themselves had invested in a project that was no longer of any benefit to them."[123]

Similarly, courts have allowed commissions to take into account other extraordinary gains in different contexts. In *Pike County Power Co. v. Pennsylvania Public Utilities Commission*,[124] for example, the court approved a commission order requiring a utility to amortize past extraordinary losses (supposedly available as tax deductions) against present federal income tax liability. In *Richter v. Florida Power Corp.*,[125] the court held that a commission had the authority to consider a ratepayer challenge to past rates paid because of an allegedly illegal procurement scheme devised by the utility's consultant.[126] In *Narragansett Electric*

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nized that it had previously prohibited accounting for mistakes in past rates in the setting of future rates, but noted:

> The treatment of the AT&T reimbursements [which the company] received has nothing to do with mistakes in past ratemaking. In essence, the reimbursements represent an unexpected windfall and the relevant question posed here is who should receive the benefit of this windfall—[the company's] shareholders or [the company's] ratepayers. The Commission would not be engaged in retroactive ratemaking if it considered the proper treatment of the reimbursements.

Chesapeake & Potomac Tel. Co., 514 A.2d at 1332. In fact, the court held that on remand, the commission should consider the reimbursement issue separate from its determination of the question of the revenue requirement of the utility. *Id.* at 1333.

122. *Id.* at 1169-70.

123. *Id.* at 1170. The court noted that the FCC had directed the reimbursements " 'to assure that ratepayers will be reimbursed for *funds that they have provided for these activities* and for which they are not the beneficiaries.' " *Id.* (quoting *American Tel. & Tel. Co.*, 91 F.C.C.2d 578, 593 (1982) (emphasis added)).

124. 487 A.2d 118, 120-21 (Pa. Commw. 1985).

125. 366 So. 2d 798 (Fla. Dist. Ct. App. 1979). *Richter* concerned solely the jurisdictional issue of whether the courts or the commission has jurisdiction over damage claims resulting from the illegal scheme. The plaintiff ratepayers brought the case in court because they believed that the commission did not have jurisdiction to set rates retroactively. *Id.* at 799. The court rejected this argument, affirming the dismissal of the case and holding that the commission was best equipped to handle the issues raised by plaintiffs' claims. *Id.* at 801.

126. Plaintiffs alleged that the utility forced them to pay unreasonably high rates because of an illegal "daisy-chaining" scheme conducted by a fuel consultant employed by the utility. They contended that as a result of this scheme, the utility paid 54 cents per gallon for oil that had an actual value of only 21 cents. Finally, they asserted that the utility knew or should have known of the scheme but passed the costs onto consumers under the fuel adjustment clause. *Id.* at 800. For a discussion of fuel-cost adjustment clauses, see *infra* notes 184-93.

Co. v. Burke,[127] the court even approved a commission order requiring a utility to make refunds to ratepayers in situations in which a utility earned well in excess of its authorized rate of return.

Not all courts, however, have adopted the "extraordinary loss or gain" exception to the retroactivity rule. A number of courts have held to a strict construction of the rule and have concluded that commissions have the power to set rates prospectively only. In *South Carolina Electric & Gas Co. v. Public Service Commission*,[128] for example, the court reversed a commission order requiring a utility to refund a one-time fuel savings that it had experienced.[129] In response to the commission's argument that these savings were "extraordinary," the court stated:

> Semantics aside, the Commission's action constituted retroactive rate-making. . . .
>
> The result reached here may initially appear unjust to the retail customer and unduly generous to [the utility]. This is not the case. The crux of this issue is the firm principle that rate-making is prospective rather than retroactive. The Commission has no more authority to require a refund of monies collected under a lawful rate than it would have to determine that the rate previously fixed and approved was unreasonably low, and that the customers would thus pay the difference to the utility.[130]

Likewise, in contrast to several other decisions,[131] other courts have held that a commission cannot grant relief for extraordinary losses or gains caused by unusually severe weather.[132] Finally, still another court has reversed a commission's order requiring the flow-through of tax refunds received by the utility.[133]

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127. Nos. 84-73-M.P., 84-232-M.P. & 84-343-M.P. at 2-4 (R.I. Mar. 11, 1986) (LEXIS, States library, RI file). It should be noted, however, that the Rhode Island Supreme Court is the most liberal in its application of the "extraordinary" exception to the rule against retroactive ratemaking.

128. 272 S.E.2d 793 (S.C. 1980).

129. The commission ordered the utility to refund more than $7,000,000 to its customers as a consequence of the interchange of power during the first six months of 1976 and 1977. The interchange of power was the sale and purchase of energy between the utility and other energy producers. *Id.* at 794.

130. *Id.* at 795. The court noted, however, that the commission could consider these extraordinary gains in setting the test year's operating expenses. *Id.* The court did not explain how this procedure was consistent with the retroactivity rule.

131. *See supra* notes 108-16 and accompanying text.

132. In Artesian Water Co. v. Public Service Commission, No. 82-A-DE-14 (Del. Super. Ct. Mar. 28, 1984) (LEXIS, Del library, Super file), the court affirmed a commission order rejecting a water company's request for recovery for a loss of revenues caused by a drought. In *In re* Elizabethtown Water Co., 527 A.2d 354 (N.J. 1987), the court affirmed the reversal of a commission order postponing a water company's rate increase to offset over-earnings from prior years resulting from past, weather-related rate increases. As a result of an extreme drought, severe restrictions were placed on water usage in the utility's service territory. These restrictions prompted the commission to increase rates to stabilize the utility's earnings. When the drought eased, higher usage returned, and the utility experienced over-earnings. *Id.* at 365. Despite these unusual circumstances, the court found that the rate postponement order violated the rule against retroactive ratemaking. *Id.* at 357-65.

133. Niagara Mohawk Power Corp. v. Public Serv. Comm'n, 388 N.Y.S.2d 157 (App. Div. 1976).

2. *Application of the Retroactivity Rule in the Context of Nuclear Plant Cancellation Cases*

This "extraordinary loss" exception to the retroactivity rule has taken on special significance in the context of large capital investments, such as nuclear plants, which have gone awry. As with the other cases considering this exception, these decisions are not uniform.

In one recent case, for example, a court applied the retroactivity rule to deny recovery for one-time costs of a canceled nuclear plant.[134] In that case, *Citizens Action Coalition v. Northern Indiana Public Service Co.*,[135] the court reversed the commission's decision allowing Northern Indiana Public Service Company (NIPSCO) to amortize sunk costs of its abandoned Baily N-1 nuclear plant. The court rejected NIPSCO's argument that these costs were operating expenses because they were in actuality a capital loss, but held that even if it accepted NIPSCO's characterization, NIPSCO had incurred these expenses before the test year. Invoking the venerable rule against retroactive ratemaking, the court noted, "[O]ld losses cannot be recouped through future rates."[136]

Implicitly rejecting this same argument, the court in *Attorney General v. Department of Public Utilities*[137] took a different position, allowing Boston Edison to recover as a cost of service the costs associated with the Pilgrim II nuclear plant. In that case, the commission had approved cost recovery, finding that:

> [w]hat is at issue here are the costs of a failed project that must be characterized as an extraordinary loss. In particular, a loss of the magnitude here has never been considered before by the department. An assessment of the interests involved must be undertaken from first principles. Without such a de novo approach, the rules developed to reflect and generalize other assessments of the relevant interests in other settings might distort the proper balancing called for under these circumstances. *In other words, an extraordinary loss of this size requires separate, independent, and unique rules that properly reflect the just balance of the affected interests.*[138]

On review the court, without explicitly addressing the retroactivity issue, affirmed the commission's decision, deferring to the commission's exper-

134. For a general discussion of the responses by commissions to utility requests to recover costs of canceled plants, see GELLHORN & PIERCE, *supra* note 51, at 116-25. In terms of the ratemaking formula, such costs can be considered an expense item, and the commission must decide whether these expenses were prudent. On the other hand, such costs can be considered part of the rate base, and the commission must determine whether the canceled plant is "used and useful." *Id.* at 120.

135. 472 N.E.2d 938 (Ind. Ct. App. 1984), *aff'd*, 485 N.E.2d 610 (Ind. 1985), *cert. denied*, 476 U.S. 1137 (1986).

136. *Citizens Action Coalition*, 472 N.E.2d at 947. In affirming the court of appeals decision, the Indiana Supreme Court did not address the retroactive ratemaking argument, but merely held that the expense was not for a used and useful service. *Citizens Action Coalition*, 485 N.E.2d at 614.

137. 455 N.E.2d 414 (Mass. 1983).

138. *In re* Boston Edison Co., 46 Pub. Util. Rep. 4th (PUR) 431, 435 (Mass. Dep't of Pub. Util. 1982) (emphasis added).

tise in matters of regulatory policy.[139] A dissenting justice, however, concluded that allowance of the recovery violated the rule against retroactive ratemaking.[140]

D. *Application of the Rule in the Context of Relief for the Period of the Rate Proceedings*

As described earlier,[141] when a utility files a request for a rate increase, the commission usually suspends the proposed rate schedules for an interval of up to one year and holds hearings on the propriety of the new rates. During the suspension period, commissions can grant the utility interim relief. A number of courts have addressed the applicability of the rule against retroactive ratemaking to rates paid during the suspension period or during the period of hearings in a rate investigation or complaint case. In this context, most courts have held that the rule is applicable unless the commission specifically has given the utility and ratepayers adequate notice that the rates collected during the suspension period are subject to revision. If the commission has given such notice, the commission can set rates retroactively.

1. *Setting of Rates from a Date Earlier Than the Date of the Final Order*

In several cases, commissions have claimed the authority to set rates in a final order retroactive to the date of the initiation of the rate proceeding. Traditionally, most courts have rejected such claims in summary fashion, relying on a 1943 United States Supreme Court case that addressed the retroactive ratemaking issue only tangentially. In that case, *Public Utility Commission v. United Fuel Gas Co.*,[142] a gas transmission company sought an injunction in federal court against the Ohio commis-

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139. *Department of Pub. Util.*, 455 N.E.2d at 425.

140. *Id.* at 431. This justice indicated that there was an exception to the rule if the expenses were "extraordinary." In this case, though, he found that the circumstances surrounding Pilgrim II were not extraordinary. *Id.* at 431-32; *see also* Missouri *ex rel.* Union Elec. Co. v. Public Serv. Comm'n, 765 S.W.2d 618, 622-23 (Mo. Ct. App. 1988) (in affirming commission decision to disallow recovery of cancelled nuclear plant costs, court suggested commission has discretion to engage in retroactive ratemaking as to "extraordinary" expenses).

141. *See supra* notes 39-45 and accompanying text.

142. 317 U.S. 456 (1943). Courts have also relied on the 1932 decision in Cheltenham & Abington Sewerage Co. v. Pennsylvania Public Utilities Commission, 25 A.2d 334 (Pa. 1942), to disallow the fixing of rates from the beginning of the rate proceeding. In that case, the court rejected a claim that the commission could grant reparations to ratepayers for unreasonably high rates paid from the date of the institution of a commission investigation of the rates. The court noted that the prior rates were "commission-made" rates:

> The rates so fixed could not be other than commission-made rates for that agency fixed the rate base and after estimating an amount allowable for expenses of operation prescribed the gross annual revenue which the utility could collect. . . . The company consequently was entitled to rely upon the declaration of the commission as to what was a lawful and reasonable rate until a change was made by the commission acting in its quasi legislative capacity.

Id. at 336. Accordingly, the court held that the commission only had authority to grant relief from the time that it found the prior rates to be unreasonable. "The [utility] then knew that the commission after full hearing had determined that the rates were too high." *Id.* at 337.

sion's assertion of jurisdiction over it.[143] The case originated in the commission on the complaint of a utility against a city ordinance setting rates. The commission found that it could not determine the justness and reasonableness of the rates in the absence of proof of the reasonableness of the rates the transmission company charged the utility. Accordingly, it ordered the transmission company to appear and present evidence as to the reasonableness of its rates.[144] The company then successfully sought an injunction in federal court.[145]

As the case wended its way through the federal courts, Congress passed the Natural Gas Act of 1938.[146] The commission argued that adoption of that act did not preempt its jurisdiction in the complaint case because it had the power to fix the rates for sales from the transmission company to the utility retroactively to the date of the original city rate ordinance.[147] The Court, through Justice Frankfurter, disagreed and affirmed the issuance of the injunction. Acknowledging that the Ohio courts had never addressed the retroactivity issue and that he would rather leave the task of formulating local law to the state courts, Justice Frankfurter nevertheless found that it would not serve the public interest to delay the case any longer and set about construing the Ohio statute.[148] He noted that the Ohio complaint statute provided:

> If, after . . . hearing, the Commission finds that the rate or charge is unjust, unreasonable, or otherwise unlawful, it must "fix and determine the just and reasonable rate, fare, charge, toll, rental or service *to be thereafter* rendered, charged, demanded, exacted, or collected for the performance or rendition of the service, and order the same substituted therefor."[149]

Accordingly, he held that the statute "gives the Commission power to prescribe such rates prospectively only" and would not allow it to set rates for sales from the transmission company to the utility retroactively to the initiation of the rate proceeding.[150] Dissenting, Justices Black, Douglas, and Murphy characterized this construction of Ohio law as "dubious."[151]

Despite the dissenters' characterization of the *United Fuel* opinion, most courts have relied on it to prohibit either the fixing of rates back to

143. 317 U.S. at 459.
144. *Id.* at 458-59.
145. *Id.* at 460-61.
146. Ch. 556, § 1, 52 Stat. 821 (1938) (codified as amended at 15 U.S.C. §§ 717a-717z (1988)).
147. 317 U.S. at 461.
148. *Id.* at 462.
149. *Id.* at 464 (citing OHIO GEN. CODE §§ 614-23).
150. *Id.* at 464.
151. *Id.* at 471 (Black, J., dissenting). The dissenters argued that if Ohio law prohibited the fixing of rates as of the date the proceeding began, then the federal courts should have abstained as a matter of equity from tying the commission's hands and barring it from making a final order. *Id.* They further noted that the fact that the commission had vigorously fought the case for four years after the Natural Gas Act had been passed indicated that it did not suppose that it was powerless to fix rates retroactively to the date the transmission company became a party. *Id.* at 473.

the beginning of the suspension period or the initiation of other types of rate proceedings. In *Pacific Telephone & Telegraph Co. v. Public Utility Commission*,[152] for example, the California Supreme Court reversed that part of a rate reduction order that mandated refunds from the beginning of a commission investigation proceeding into the rates of a telephone company. Citing *United Fuel* and statutory language similar to the Ohio statute, the court rejected the commission's argument that the rule against retroactive ratemaking applies only to periods prior to the initiation of a rate case.[153] Similarly, the Texas Court of Appeals in *Public Utility Commission v. General Telephone Co.*[154] relied on *United Fuel* in concluding that the commission did not have authority to set rates retroactively to a date after the start of the proceeding but within the suspension period.[155]

As with most applications of the retroactivity rule, however, several courts have found the rule inapplicable for the period of the rate proceeding. In *Peoples National Gas Division of Northern Natural Gas Co. v. Public Utility Commission*,[156] for example, the court approved the commission's imposition of a surcharge on consumers for usage during the pendency of a rate case. In that case, a utility's suppliers increased its fuel costs to a utility, and the utility sought a "pass-on" rate increase for its fuel costs and a surcharge to cover its losses during the time of the proceeding. The court held that the surcharge did not violate the retroactivity rule because the utility was not seeking an increase to recoup operating expenses incurred prior to any filing of new tariffs, but was only requesting relief for the period during which the commission was considering the new tariffs.[157]

In another case, *Lederk Laboratories v. Gioia*,[158] the court approved

152. 401 P.2d 353 (Cal. 1965).

153. *Id.* at 364.

154. 777 S.W.2d 827 (Tex. Ct. App. 1989) (writ dismissed w.o.j. 1991).

155. *Id.* at 830. In that case, the utility filed an application for a change in rates on February 17, 1984. *In re* GTE Southwest, 106 Pub. Util. Rep. 4th (PUR) 194, 208 (Tex. Pub. Util. Comm'n 1989). The commission suspended the filed rates until May 24, 1984, and the utility agreed to a continuance of the suspension for the entire period of the proceedings. *Id.* at 301. In its final order on February 23, 1989, the commission ordered the utility to reduce its rates effective January 1, 1987. *General Tel. Co.*, 777 S.W.2d at 829. The utility successfully obtained a temporary injunction of that part of the order that made the reduced rate retroactive. *Id.* On appeal, the court held that, because of the rule against retroactive ratemaking, the utility had a probable right to relief, and the district court did not abuse its discretion in granting the injunction. *Id.* at 830-31; *see also* Miami v. Florida Pub. Serv. Comm'n, 208 So. 2d 249, 259-60 (Fla. 1968) (relying on *United Fuel*, court held that rates cannot be set retroactively to the beginning of the test year).

156. 590 P.2d 960 (Colo. 1979).

157. *Id.* at 962. Although the court in that case never addressed the holding in *United Fuel*, it did refer to the relevant statutory language relied on in *United Fuel* that a commission sets rates "to be thereafter observed." *Id.* The court found that this language was not applicable because it only applied to rates set after complaint cases challenging existing rates, not proceedings in which new tariffs are filed. *Id.* Further, the court noted that this was not a general rate case where the utility sought to increase its profits or its allowed rate of return, but rather a case in which the utility only sought a rate increase to cover higher fuel costs. *Id.* at 961.

158. 456 N.Y.S.2d 844 (App. Div. 1982).

a commission order allowing the imposition of a surcharge for the period of the case in which it was considering rate design issues. In that case, on April 30, the commission issued an order in the revenue requirement phase of a case allowing a utility to increase its rates pending an investigation of rate design issues.[159] On May 30 it entered an order adopting a new rate structure incorporating a new summer rate, effective May 1, three times higher than the rate for the rest of the year.[160] Recognizing that there would be delay in implementation of this new rate, the commission allowed the imposition of a surcharge to permit the utility to recoup its May losses.[161] On review the court found the retroactivity rule inapplicable, holding that "there has not been any actual redetermination of rates pursuant to a condition subsequent, but merely the imposition of charges upon [the utility's] customers that they would have been obliged to pay had the new rate design been implemented on its effective date."[162]

2. *Setting of Interim Rates Subject to Refund*

In most jurisdictions, utilities can seek interim relief during the pendency of the rate proceeding.[163] In recent years, requests for interim relief have burgeoned as utilities have complained about the potential loss of revenue between the filing of their rate requests and the final order at the end of the case.[164] As might be expected, issues concerning the appli-

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159. *Id.* at 845.

160. *Id.*

161. *Id.* at 845-46.

162. *Id.* at 846. In still another case, Moore v. Georgia Public Service Commission, 249 S.E.2d 549 (Ga. 1978), the court held that the rule against retroactive ratemaking did not prohibit a utility's billing at a new rate for service provided before the effective date of the rate. In that case, the new rate became effective on September 2, but was applied to service as far back as July 28. *Id.* at 550. Although the dissenting judge found that this arrangement violated the retroactivity rule, the majority held to the contrary. *Id.* at 552. *But see* Providence Gas Co. v. Burke, 475 A.2d 193, 196-97 (R.I. 1984) (requiring that bills reflect the rates at the time services rendered).

In Texas Association of Long Distance Telephone Cos., 798 S.W.2d 875, 884 (Tex. Ct. App. 1990), *writ denied*, the court held that the commission did not violate the retroactivity rule by establishing an effective date for a rate order after the date of the order determining the level of revenues but before the approval of the final tariffs.

163. Some state enabling acts specifically provide for the granting of interim rates and for a mechanism for commission review of the interim order at the end of the case. *See, e.g.*, ARK. CODE ANN. § 23-4-408 (Michie 1987); CONN. GEN. STAT. § 16-19(d) (1989); MINN. STAT. § 216B.16(3) (1990). In a number of states, however, even though no statutory authority exists for interim rate relief, courts have recognized the "inherent power" of a commission to grant such relief. Colorado Mun. League v. Public Utils. Comm'n, 591 P.2d 577, 584 (Colo. 1979); State *ex rel.* Laclede Gas Co. v. Public Serv. Comm'n, 535 S.W.2d 561, 564-67 (Mo. Ct. App. 1976); *see* Chesapeake & Potomac Tel. Co. v. Public Serv. Comm'n, 330 A.2d 236, 240 (D.C. 1974).

Because statutory provisions for interim relief provide mechanisms for review of the interim order, the issue of the application of the retroactivity rule to interim rate orders only arises in jurisdictions with no specific interim rate statutes. *See* Petition of Minn. Power & Light Co., 435 N.W.2d 550, 554-56 (Minn. Ct. App. 1989) (rejecting retroactive ratemaking argument where specific statutory provision provided for refund "[i]f, at the time of its final determination, the commission finds that the interim rates are in excess of the rates in the final determination").

164. *See Laclede Gas Co.*, 535 S.W.2d at 566 (recognizing the inherent power of a commission to grant interim relief because of the "ravaging inflation of the past few years"); Stefan H. Krieger,

cation of the retroactivity rule have arisen in these cases.

The most common issue in this area is whether the commission has the power to review the interim order in its final determination and to grant retroactive relief for the interim period. Most courts recognize the power of commissions to grant such relief. In *Pueblo Del Sol Water Co. v. Arizona Corp. Commission*,[165] for example, the commission, in granting the application of one utility to transfer substantially all of its assets to another utility, ordered interim rate relief, subject to refund, pending a hearing on the new rates to be charged in the consolidated system.[166] The utility objected, arguing that once a commission sets rates, these rates are final and any change would constitute retroactive ratemaking.[167] The court rejected this argument, holding that retroactive ratemaking occurs only when a commission attempts to change rates after they have been set in a "formal" hearing, not when they are imposed pending a formal hearing.[168]

Several courts have indicated, however, that in order for a commission to grant retroactive relief in the final order for the interim period, it must explicitly designate its original interim order as conditional. For instance, in *Friends of the Earth v. Public Service Commission*,[169] the court recognized that the commission could grant refunds for amounts collected during the interim period, but noted:

> Where a conditional interim rate order is issued the [commission] has not fully exercised its rate making power until such interim rates

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An Advocacy Model for Representation of Low-Income Intervenors in State Public Utility Proceedings, 22 ARIZ. ST. L.J. 639, 640-41 n.8 (1990).

165. 772 P.2d 1138 (Ariz. Ct. App. 1988); *see also* Southern Bell Tel. & Tel. v. Bevis, 279 So. 2d 285, 286-87 (Fla. 1973) (in response to a retroactive ratemaking argument, the court noted, "we have never held the commission powerless to make interim increases contingent on the outcome of a full hearing, and thus refundable if the full hearing discloses that the interim increase was improvidently granted"); Consumers Power Co. v. Public Serv. Comm'n, 448 N.W.2d 806, 810 (Mich. Ct. App. 1989) (rejecting retroactivity challenge to commission order allowing the collection of rates under bond pending resolution of case in which it would be decided whether the utility could offset its taxable income with interest on its investment in a nuclear plant).

One court has also rejected the argument that the power of the commission to order refunds ceases when the suspension period ends. *In re* Wilmington Suburban Water Corp., 367 A.2d 1338 (Del. Super. Ct. 1976) (rates collected under a bond).

166. *Pueblo*, 772 P.2d at 1138.

167. *Id.* at 1140.

168. *Id.*

In Chesapeake & Potomac Telephone Co. v. Public Service Commission, 330 A.2d 236 (D.C. 1974), the commission did not grant direct interim relief but provided that the utility could obtain relief for the interim period after the commission entered the final order. In that case, at the end of the revenue requirement phase of the case, the utility requested interim rate relief. *Id.* at 237-38. The commission denied the request but fashioned its own plan under which the utility would be entitled, after the completion of the rate design phase of the case, to collect a surcharge to permit the company to earn the rate of return authorized in the first phase of the case for the interim period. *Id.* at 238. The utility appealed the denial of immediate interim relief and argued that the commission's plan amounted to retroactive ratemaking. The court rejected this claim, acknowledging that the utility would use future rates to pay for past services but finding that the commission's order was a practical solution to "the increasingly vexing rate regulation problem of regulatory lag." *Id.* at 241-42.

169. 254 N.W.2d 299 (Wis. 1977).

are re-evaluated in the final order. By conditioning the interim order on the possibility that a refund may be required, the [commission] may be deemed to have retained with the consent of the utility the power to issue an order relating back to the interim order for purposes of such re-evaluation. *However, where the interim order is unconditional, we think the attempt to require refunds in the final order is indistinguishable from an attempt to require refund of rates collected under a previous order setting permanent rates.*[170]

A less common issue in the context of interim rate relief concerns interim rate decreases. In *Commonwealth Gas Pipeline Corp. v. Anheuser-Busch Co.*,[171] for example, a utility filed tariffs for a rate decrease, and the commission ordered that the presently effective tariffs should be considered interim rates, subject to refund, until the end of the case.[172] In its final order, the commission granted a refund for services provided during the interim period, which effectively granted retroactive relief for services provided under previously approved tariffs. In response to the utility's retroactive ratemaking argument, the court noted that by seeking a rate decrease, the utility had admitted that its present rates were unjust and unreasonable and held that the interim order and subsequent refunds were proper.[173]

Even where the utility had not made any representations about the unreasonableness of its present rates, one court has found that the commission has the authority to decrease rates for the interim period below the previously approved levels. In *North Carolina ex rel. Utility Commission v. Nantahala Power & Light Co.*,[174] decided after the passage of the Tax Reform Act of 1986, the commission entered an order requiring utilities to collect federal income tax and related gross receipts tax on a provisional rate basis and to place all tax revenues collected in excess of the amounts of tax under the Act in a deferred account pending a final decision in the case.[175] In its final order, the commission ordered a utility to refund from the deferred account a portion of its previously collected

170. *Id.* at 309 (emphasis added) (note omitted). In that case, the commission had not placed a refund condition in its original interim order. The commission and utility, however, agreed to a *nunc pro tunc* modification of the order to include a refund provision. *Id.* at 309. In South Central Bell Telephone Co. v. Tennessee Public Service Commission, 675 S.W.2d 718 (Tenn. Ct. App. 1984), the court disapproved of a commission's attempt to grant a rate refund because it found that the commission had authority to grant temporary rate orders, not "conditional" orders. In that case, a telephone company sought a rate increase, part of which was based upon the anticipated action of the Federal Communications Commission (FCC) which would increase depreciation expenses of $27,000,000 a year. *Id.* at 719. The commission granted a rate increase subject to a refund after the FCC's final action. *Id.* As a result of subsequent FCC action, the commission ordered the company to grant ratepayers a refund. On appeal the court held that the commission had no authority in its original order to reserve the right to change rates retroactively. *Id.* at 719-20. The court held, however, that because the company requested the original order and took no exception to it, it was estopped from contesting it. *Id.* at 720-21.

171. 355 S.E.2d 605 (Va. 1987).

172. *Id.* at 607.

173. *Id.* at 609.

174. 388 S.E.2d 118 (N.C. 1990).

175. *Id.* at 119-20.

revenue.[176] On appeal, the court rejected a retroactive ratemaking challenge, holding that an order requiring that a utility refund monies in a deferred account to ratepayers is not the same thing as ordering adjustments to future rates to rectify undue past profits.[177]

3. *Creation of Deferred Accounts for New Expenses*

Besides interim rate relief, utilities have proposed another mechanism to obtain rate relief during the pendency of rate hearings: the creation of an account to defer expenses that the previous tariffs did not account for but that the utility will incur during the hearing period until the final rate order. In its final order the commission can allow the utility to recover these expenses.[178] Utilities frequently propose such deferred accounting when they cannot meet the requirements for interim rate relief and have a large nuclear plant coming into service.[179] The retroactivity issue that arises in these cases is whether the commission has the authority in its final order to allow recovery of past expenses, which the utility recorded in the deferred account, but which the commission did not allow under the previously approved tariffs.

The courts that have addressed this issue have found no retroactive ratemaking problem. In *Business & Professional People for the Public Interest v. Illinois Commerce Commission*,[180] for instance, the commis-

176. *Id.* at 127.

177. *Id.*

A final retroactive ratemaking issue in the context of interim rates concerns the data examined by the commission in reviewing the interim rates in the final order. If the interim period is outside of the test year, the question arises whether the commission must use interim period data in its review of the interim order or whether it can apply the final order's determination retroactively to adjust the interim rate award. The courts that have addressed this issue are divided. *Compare* Glacier State Tel. Co. v. Alaska Pub. Util. Comm'n, 724 P.2d 1187, 1192-93 (Alaska 1986) (requiring commission to base rate of return for interim period on market conditions at time award granted) *with* Petition of Minn. Power & Light Co., 435 N.W.2d 550, 557 (Minn. Ct. App. 1989) (noting, "[t]o require the Commission to consider a separate cost study for interim rates would set dangerous precedent").

178. *See, e.g.*, *In re* Commonwealth Edison Co., 103 Pub. Util. Rep. 4th (PUR) 80 (Ill. Comm. Comm'n 1989) (approving request for deferred accounting of costs associated with Braidwood II nuclear plant); El Paso Elec. Co., 116 Pub. Util. Rep. 4th (PUR) 351 (Tex. Pub. Util. Comm'n 1990) (approving request for deferred accounting of costs associated with Palo Verde Nuclear Generating Station) (abstract). *But see* City of El Paso v. Public Util. Comm'n, No. 3-90-007-CV, 1991 WL 155113, at *13 (Tex. Ct. App. Aug. 14, 1991) (reversing on statutory grounds commission's approval of deferred accounting procedures for Palo Verde).

179. For the costs associated with the Braidwood II nuclear plant, for example, Commonwealth Edison sought approval of deferred accounting treatment of the plant's costs, rather than interim rate relief. To obtain interim relief, Edison would have had to establish an obvious revenue deficiency, inability to attract capital at reasonable costs, and an erosion of earnings that seriously impaired its ability to meet its financial requirements. *See* Commonwealth Edison Co., No. 82-0026, 1982 Ill. PUC 33, at ** 3-5 (Ill. Comm. Comm'n Nov. 19, 1980). In approving accounting treatment for the costs of Braidwood II, the commission used a much more lenient standard of financial hardship. *Commonwealth Edison Co.*, 103 Pub. Util. Rep. 4th (PUR) at 91.

180. 205 Ill. App. 3d 891, 563 N.E.2d 877, 150 Ill. Dec. 750 (1st Dist. 1990); *see also* Toward Util. Rate Normalization v. Public Util. Comm'n, 750 P.2d 787 (Cal. 1988). In the California case, a utility sought the establishment of an "adjustment account" that was to be debited with the investment-related costs of a nuclear plant, such as depreciation and a return to investors. *Id.* at 788. The stated purpose of the account was to eliminate the problem of retroactive ratemaking if the commis-

sion approved a utility request to defer depreciation costs and to accrue financing costs on a nuclear plant from the time the plant went into service until the time of a final rate order that placed the plant in the rate base.[181] Consumer intervenors challenged this order in court on retroactive ratemaking grounds. The court affirmed the commission's decision, noting that the commission decision was merely an "accounting," and not a "ratemaking," order because it did not decide the issue whether the costs associated with the plant were reasonable for ratemaking purposes. Moreover, the court held that the commission in its final rate order could consider the past plant costs recorded in the deferred account.[182] It reasoned that retroactive ratemaking only applies to adjustments in past rates; because the commission had not taken into account the expenses of the particular nuclear plant in past rates, the commission was free to consider the deferred expenses in setting future rates.[183]

E. *Application of the Rule in the Context of Cost Adjustment Clauses*

As an alternative to the traditional ratemaking process, some commissions—either under specific statutory authorization or under their inherent regulatory powers—have approved utility cost adjustment clauses that allow utilities to adjust their charges for specific expense categories without the necessity of full-blown rate hearings. Examples of such cost adjustment clauses are energy cost adjustment clauses (EACs) that allow electric and gas utilities to adjust their rates for changes in fuel costs from their suppliers[184] and "Operation and Maintenance Indexing Systems" to adjust rates for changes in operation and maintenance ex-

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sion allowed the utility to include the plant in the rate base. *Id.* The court held that because none of the parties, and only an amicus, raised a retroactive ratemaking challenge to the order, the issue had not been preserved for review. *Id.* at 788-89 n.1. The court noted, however, that "[i]f the prohibition against retroactive ratemaking is to remain a useful principle of regulatory law and not become a device to fetter the commission in the exercise of its lawful discretion, the rule must be properly understood." *Id.* at 789 n.1 (quoting Southern Cal. Edison Co. v. Public Util. Comm'n, 576 P.2d 945 (Cal. 1978)).

181. 205 Ill. App. 3d at 894, 563 N.E.2d at 880, 150 Ill. Dec. at 753.

182. *Id.* at 895, 533 N.E.2d at 880-81, 150 Ill. Dec. at 753-54.

183. *Id.* at 896, 533 N.E.2d at 880-81, 150 Ill. Dec. at 753-54. Subsequent to this decision, the Illinois Supreme Court came to a similar conclusion, holding that the recovery of deferred charges does not violate the rule against retroactive ratemaking because these charges "are not intended to correct an error made in a prior rate order which had included [the] plant in rate base. . . . [These] charges are merely one aspect of the reasonable and prudent costs of the plants which should be included in rate base." Business & Professional People for the Pub. Interest v. Illinois Commerce Comm'n, Nos. 71602, et al., 1991 Ill. LEXIS 124, at *84-85 (Sup. Ct. Dec. 16, 1991). Nevertheless, the court held that the commission's test year rules barred the recovery of deferred depreciation and decommissioning expenses because such recovery mismatched expenses for the recovery period with revenue data from the test year. *Id.* at *75-81. In effect, then, the court found that although the retroactivity rule did not apply, the commission's own rules barred retroactive recovery of these expenses. The court held out the possibility, however, that the commission could change its test year rules to allow recovery of these expenses, as long as it offset any such recovery by decreases in other operating expenses or increases in revenues during the deferral period. *Id.* at *79-80, *85-91.

184. NARUC REPORT, *supra* note 11, at 436-37 (Table 13). For electric utilities, these EACs are usually called "fuel adjustment clauses"; for gas utilities, they are termed "purchased gas adjustment clauses."

penses.[185] By far the most frequently used adjustment clauses are EACs. Applications of such clauses became widespread during the "energy crisis" of the 1970s as the pressures of ever-increasing energy costs continually brought utilities to their commissions for rate increases.[186] To relieve commissions from the burden of these cases and to address the perceived financial needs of utilities, commissions approved inclusions of EACs in utility tariffs.[187] Given that fuel can constitute a substantial part of a utility's operating expenses,[188] a utility can pass a significant portion of its increased costs through the EAC.

The specific formula for calculating the energy cost adjustment can vary between different jurisdictions; even within a given jurisdiction, different utilities may use different adjustment methodologies.[189] The most widely used method involves taking total allowable fuel costs in a given period and comparing the resulting fuel cost per kilowatt hour to a base figure of fuel cost contained in the EAC.[190] The utility passes the increase or decrease above the base unit price on to the ratepayer in a future period either through a charge or credit on the bill.[191] After the end of a given period, usually a year, the commission holds hearings to reconcile fuel cost recoveries collected through the EAC.[192] The purpose of these "true-up" proceedings is to determine whether the amounts passed through to customers were in accordance with the EAC.[193] At the end of those proceedings, the commission can allow a pass-through under the EAC of either a refund to ratepayers or a surcharge to the utility.

EACs raise several retroactive ratemaking issues. First, by their very nature—comparing fuel costs with a base price and adjusting for past overcharges or undercharges in future bills—they appear to allow utilities to set rates by looking at past losses or gains. Second, by allowing for refunds or surcharges through the reconciliation process, EACs allow commissions to engage in what otherwise would be considered retroactive ratemaking.[194] Most courts, however, have found no

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185. *See* Attorney Gen. v. Public Serv. Comm'n, 349 N.W.2d 539 (Mich. Ct. App. 1984). Utilities have proposed other kinds of adjustment mechanisms without much success. *See, e.g.*, Connecticut Light & Power Co. v. Department of Pub. Util. Control, 516 A.2d 888 (Conn. Super. Ct. 1986) (rejecting proposal for adjusting utility's rate of return on equity).

186. Roger D. Blair & David L. Kaserman, *Automatic Fuel Adjustment Clauses: Issues and Evidence*, PUB. UTIL. FORT., Nov. 25, 1982, at 27, 28.

187. Krieger, *supra* note 164, at 640-41 n.8.

188. *See* Blair & Kaserman, *supra* note 186, at 28 (automatic adjustment clauses for gas and electricity accounted for 58% of revenue increases in 1974 and 1975, rising to 76% in 1976 and 82% in 1977).

189. MICHAEL SCHMIDT, AUTOMATIC ADJUSTMENT CLAUSES: THEORY AND APPLICATION 126-38; Robert H. Sarikas, *What Is New in Adjustment Clauses*, PUB. UTIL. FORT., June 19, 1975, at 32, 33-35.

190. SCHMIDT, *supra* note 189, at 61. The EAC specifies what constitutes "fuel costs" for purposes of the clause. Traditionally, most fuel clauses provided that utilities were to pass all "costs of fuel" through to consumers. Recently, commissions have narrowed this definition. *Id.* at 63.

191. *Id.* at 61.

192. *Id.* at 84.

193. *Id.*

194. In those states which have statutes allowing for EACs, there is no problem that the EAC

retroactivity problem with EACs.

1. Retroactive Nature of EACs

As to the first issue—adjustments allowed by EACs based on the comparison of past fuel costs with a base price—courts have not construed such a procedure as retroactive ratemaking. The seminal case addressing this issue is *City of Norfolk v. Virginia Electric & Power Co.*[195] In that case, the court noted that "[t]he Commission does not have the power to redetermine rates for a past period at a different level from those actually filed in accordance with filed schedules because that would be to make retroactive rates."[196] It found, however, that in approving the EAC, "the Commission did not fix rates retroactively, but on the contrary, it authorized and prescribed a fixed mathematical formula to be inserted in the schedules of the Company which will serve as a 'guide, direction, or rule of action' for determining future rates."[197] Accordingly, courts following this reasoning hold that because the EAC is a fixed rule that looks to past costs only to set future rates, it does not actually permit a utility to recoup past losses through present rates.[198]

Consistent with this reasoning, several courts have rejected utility attempts to impose surcharges for fuel costs, which the utility had not collected yet through the EAC, after an EAC formula has been changed. In *North Carolina ex rel. Utility Commission v. Edmisten*,[199] for example, the court reversed the commission's approval of the imposition of a surcharge after the legislature terminated all EACs. Under the EAC procedure, each month the utility had recorded fuel costs in its books as "unbilled revenues" which it would recover within the next two months under the EAC.[200] When the legislature terminated EACs as of September 1, 1975, the utility sought and received a base rate increase to recover

violates a statutory prohibition on retroactive ratemaking because of the specific legislative authorization.

195. 90 S.E. 140 (Va. 1955); *see also* Colorado Energy Advocacy Office v. Public Serv. Co. of Colo., 704 P.2d 298, 305 (Colo. 1985); People's Counsel v. Public Serv. Comm'n, 472 A.2d 860, 866-67 (D.C. 1984); Consumer Protection Bd. v. Public Serv. Comm'n, 449 N.Y.S.2d 65, 66-67 (App. Div. 1982).

196. *Virginia Elec. & Power Co.*, 90 S.E.2d at 148.

197. *Id.*

198. *See, e.g.*, *People's Counsel*, 472 A.2d at 867; *Consumer Protection Bd.*, 449 N.Y.S.2d at 67.

In the rate design context, one court has taken a similar approach in overruling a retroactivity objection to a "ratchet" provision in a utility's tariff. Amax Zinc Co. v. Illinois Commerce Comm'n, 124 Ill. App. 3d 4, 463 N.E.2d 902, 79 Ill. Dec. 348 (5th Dist. 1984). In that case, the commission approved a ratchet mechanism in a utility's tariff to tie the monthly billing for demand cost to the customer's highest consumption in a previous given period. *Id.* at 4-10, 463 N.E.2d at 903-06, 79 Ill. Dec. at 349-52. Noting that "[t]he ratemaking process is lacking in precision and is not an exact science," the court rejected the retroactive ratemaking argument because, although the rate design looked to past usage, the rates were only applicable to future services. *Id.* at 11, 463 N.E.2d at 908, 79 Ill. Dec. at 354.

199. 232 S.E.2d 184 (N.C. 1977).

200. *Id.* at 191.

increased fuel costs as of that date and a surcharge to recover fuel expenses that it had recorded for the months of July and August 1975.

The court held that the utility had no right to the surcharge because the EAC did not allow recovery of past costs, but merely used the past costs as estimates for future fuel costs. The court wrote:

> The [EAC] was, like the basic rate increase procedure, simply the orthodox use of a test period. Instead of the usual twelve months test period, used in general rate cases with reference to all expense experience of the utility, the [EAC] used a one month test period with reference to coal expense alone. When approved on 19 December 1973, it applied instantly to all kilowatt hours sold that day. It used the most recently available coal cost data (November) experience to determine the cost of coal per kilowatt hour to be anticipated in December. Like other test period data, the data was used as the most accurate measure of the cost of coal per kwh on 19 December 1973 and throughout that month. Similarly, for kwh sold in January 1974, the coal cost per kwh in December was used, and the charge per kwh, if any, was instantly effective as to every kwh sold in January. It was likewise as to each subsequent month to and including July and August 1975.[201]

The court did not question the propriety of accounting for the fuel costs as "unbilled revenues," but merely observed that these accounting entries were not designed to "recover" from present users the fuel costs of the previous month.[202]

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201. *Id.* at 196-97.

202. *Id.* at 197; *see also* Detroit Edison Co. v. Michigan Pub. Serv. Comm'n, 331 N.W.2d 159 (Mich. 1982). In *Detroit Edison*, the utility's original EAC allowed the utility to record "deferred fuel" expense on its books to be collected two months hence. *Id.* at 165. On February 3, 1975, the commission adopted a new EAC and eliminated the two-month lag. Because the utility had recorded over $26 million in fuel expenses for December 1974 and January 1975, it sought a surcharge to collect that amount. *Id.* at 166.

On a tie vote, the court affirmed the court of appeals decision disallowing any surcharge, holding that the past costs were only used as an estimate of future costs:

> We think the concern that Edison has not been able to recover all of its costs misses the point. Certainly it is true that in this case Edison's total [EAC] charges were less than its excess fuel costs. However, that is simply one of the risks that any utility operating under our regulatory system takes. Rates are set on the basis of estimates of costs, typically based on a "test year" or other period, which is sometimes adjusted on the basis of predictions as to future trends and events that will affect costs. . . . *But the essential principle of the rule against retroactive ratemaking is that when the estimates prove inaccurate and costs are higher or lower than predicted, the previously set rates cannot be changed to correct for the error . . . .*

Id. at 164 (footnotes omitted) (emphasis added).

Courts also have used the fixed formula rationale to reject attempts to challenge the EAC formula retroactively. *See, e.g.*, First Hartford Corp. v. Central Me. Power Co., 425 A.2d 174 (Me. 1981); National Fuel Gas v. Public Serv. Comm'n, 469 N.Y.S.2d 171 (App. Div. 1983). In *First Hartford Corp.*, consumers challenged the application of an EAC to pass-through costs of more expensive power when the utility shut down a nuclear plant for repairs and maintenance. *First Hartford Corp.*, 425 A.2d at 175. The court rejected the consumers' claims for refunds, holding that the EAC was a rate approved by the utility, and rates collected under it could not be retroactively adjusted. *Id.* at 177-81. In *National Fuel Gas*, a utility sought a change in its EAC to allow interest accruals on undercollections of fuel costs and sought retroactive recoupment of interest accruals for a one-year period. The court held: "While petitioner is correct in its contention that a[n] [EAC] is

2. *Reconciliation Proceedings*

The second retroactive ratemaking issue raised by EACs is the procedure allowed in most states for periodic reconciliation proceedings to reconcile the amounts passed through and to grant relief for over- or undercollections. One court has found that such a procedure violates the rule against retroactive ratemaking. In that case, the commission approved an EAC-type tariff that required the utility to file by December 15 of each year new rates based on forecasted sales and energy costs for the coming year; unless suspended, those rates went into effect on February 1 of the next year.[203] The terms of the tariff required the utility to file data concerning actual sales and energy costs each year. If the historical data reflected overcollections, the EAC tariff required the utility to credit customers' bills in the coming year; if they showed undercollections, the utility could add a surcharge to the bills.[204] The court found that the tariff constituted retroactive ratemaking because it allowed customers to pay for past deficits of the utility and the utility to refund to customers a portion of its previously earned profits.[205]

Most courts, however, have held that reconciliation proceedings do not violate the retroactivity rule because the utility commissions have not approved the amounts collected under EACs in "general" ratemaking proceedings.[206] In *Public Service Commission v. Delmarva Power & Light*

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not retroactive . . . where the formula to compute the clause changes, the change approved . . . must be limited to future rates only . . . ." *National Fuel Gas*, 469 N.Y.S.2d at 172.

203. *In re* Central Vt. Pub. Serv. Corp., 473 A.2d 1155, 1156 (Vt. 1984).

204. *Id.* at 1157.

205. *Id.* at 1160; *cf.* North Carolina *ex rel.* Util. Comm'n v. Thornburg, 353 S.E.2d 413, 416-17 (N.C. 1987) (holding that rule against retroactive ratemaking prohibits "true-ups" under statutory EAC procedure which did not make explicit provision for "true-ups").

One court has used this same reasoning to reject a "return on common equity" adjustment clause. Connecticut Light & Power Co. v. Department of Pub. Util. Control, 516 A.2d 888 (Conn. Super. Ct. 1986). In that case, the commission entered a rate order a year before the utility planned to request the inclusion of a nuclear plant in its rate base. In its order, the commission provided that in each month when the utility's return of equity exceeded 15.9%, the company should place a commensurate amount of funds in a reserve account for use as an offset in the next rate case. *Id.* at 891-92. The court reversed this order, noting, "[o]nce rates are set by a regulating agency in accordance with statutory guidelines, the revenues realized belong to the company. The amount, if any, remaining after paying taxes, and operating expenses . . . is the company's compensation for use of its property." *Id.* at 896.

206. *See, e.g.*, Southern Cal. Edison Co. v. Public Util. Comm'n, 576 P.2d 945 (Cal. 1978) (refunds permitted for overcollections caused by favorable weather conditions which allowed use of inexpensive fuels); Gulf Power Co. v. Florida Pub. Serv. Comm'n, 487 So. 2d 1036 (Fla. 1986) (refunds allowed for imprudent management decision to pay excessive fuel costs); Business & Professional People for the Pub. Interest v. Illinois Commerce Comm'n, 171 Ill. App. 3d 948, 525 N.E.2d 1053, 121 Ill. Dec. 746 (1st Dist. 1988) (refunds allowed for imprudent prediction of nuclear plant's operating capacity); Indiana Gas Co. v. Utility Consumer Counselor, No. 93A02-8906-Ex-289, 1991 WL 149798, at *7-8 (Ind. Ct. App. Aug. 8, 1991) (refunds allowed for overearnings); Public Serv. Comm'n v. Delmarva Power & Light Co., 400 A.2d 1147 (Md. Ct. Spec. App. 1979); Equitable Gas Co. v. Pennsylvania Pub. Util. Comm'n, 526 A.2d 823 (Pa. Commw. 1987) (refund based on imprudent decision of utility to use more expensive fuel source); Metropolitan Edison Co. v. Pennsylvania Pub. Util. Comm'n, 437 A.2d 76 (Pa. Commw. 1981) (refund allowed because utility had paid more for coal than contract price and coal did not meet contract specifications); *cf.* Maine Pub. Advocate v. Public Util. Comm'n, 476 A.2d 178 (Me. 1984). In *Maine Public Advocate*, under a previous

Co.,[207] for instance, the commission initiated an investigation of EACs for all public utilities in the state. As part of this proceeding, the commission determined that one utility had not included test generation of nuclear stations in its calculation of its fuel adjustment that resulted in a higher fuel cost for the EAC.[208] The commission ordered a refund of the overcollections.[209] The court approved the commission's order, distinguishing between base rate cases and EAC proceedings:

> All the parties to this case agree that retroactive rate making is impermissible, but we think the controversy in this case is to be distinguished from the Commission's function in approving rates to be charged in a base rate hearing proceeding.
>
> As we have indicated, the theory of permitting the filing of [EACs] with the . . . Commission is to permit a more rapid recognition and recovery of fluctuating fuel costs without the requirement of lengthy and complex hearings. As these [EACs] contemplate complex formulas which must be tested against mathematical calculations from designated figures each month, we conclude that implicitly, the Commission must retain jurisdiction over such charges in order to assure that the charges made are fair and reasonable to the customer as well as to the company.[210]

F. Application of the Rule in the Context of Rate Order Reversals After Judicial Review

As described above, after the commission enters a final rate order, the utility or any other affected party can appeal the decision to a court, but the commission-ordered rates go into effect unless the appellant ob-

order, the commission allowed the utility to include certain revenue from the sale of its surplus electricity in a power exchange as revenue in its general rate cases and to include certain costs related to its purchases in the exchange as a "cost of fuel" in its EAC. *Id.* at 180. Subsequently, the commission decided to include both the revenue and costs from the power exchange transactions in the calculation of the EAC and decreased the amount of available revenue in the utility's general rate case. *Id.* On appeal the court reversed the commission's decision modifying the EAC, and the commission granted a retroactive adjustment to the EAC to compensate the utility. *Id.* at 181. On retroactive ratemaking grounds, however, it rejected a claim that this adjustment should be offset by the rate increase attributable to the decrease in revenues calculated in the general rate case. *Id.* at 181-82.

The court found no problem with the retroactive adjustment to the EAC to remedy the error of the commission in modifying the EAC. It did find, however, that the commission was correct that it could not amend by way of the EAC what it perceived to be an error in the calculation of the base rate. Accordingly, by distinguishing between retroactivity on the EAC level and the "general" rate case level, the court allowed the utility—at least until the next general rate case—to exclude the revenue from the power exchange from both the EAC and its base rates. *Id.* at 182-83.

207. 400 A.2d 1147 (Md. Ct. Spec. App. 1979).

208. *Id.* at 1149.

209. *Id.* at 1149-50.

210. *Id.* at 1153. The California Supreme Court was more forthright in its rejection of a retroactive ratemaking challenge to a refund order after a commission investigation of amounts collected under an EAC: "If the prohibition against retroactive rate making is to remain a useful principle of regulatory law and not become a device to fetter the commission in its lawful discretion, the rule must be properly understood." Southern Cal. Edison Co. v. Public Util. Comm'n, 576 P.2d 945 (Cal. 1978).

tains a stay of the commission order.[211] In most jurisdictions, if the court reverses the commission order further appeals may be taken, and if the reversal is upheld, the court remands the case to the commission either for further proceedings or the entry of a new order.[212] Frequently, both the judicial review and remand process can be quite lengthy.[213] As a result, a number of retroactive ratemaking issues have arisen in the context of judicial review of commission rate orders: first, whether the prevailing appellant has a right to retroactive relief for the period between the commission order and the initial reversal; second, whether the appellant has a right to relief for the period after the initial reversal, either on further judicial review, during the remand proceedings, or both; and third, whether the commission can consider evidence concerning the period after the original order in issuing its remand order. As with the other areas in which courts have considered the retroactive ratemaking doctrine, the decisions in the judicial review context are divergent and contradictory, at times even within the same jurisdiction.

1. *Retroactive Relief for the Period Between the Commission Order and the Initial Reversal*

As to the first issue—whether a prevailing appellant can obtain retroactive relief for the period between the commission order and the initial reversal either in the form of a surcharge for a utility or a refund for a ratepayer—the cases are almost evenly split. One line of cases holds that the rule against retroactive ratemaking bars any relief for this period.[214] A good example is a seminal decision in the area: *Mandel Brothers, Inc. v. Chicago Tunnel Terminal Co.*[215] There, the Illinois Commerce Commission granted an underground railway system an increase in rates for

211. *See supra* note 67 and accompanying text.

212. *See supra* notes 65-68 and accompanying text.

213. In Independent Voters of Illinois v. Illinois Commerce Commission, 117 Ill. 2d 90, 510 N.E.2d 850, 109 Ill. Dec. 782 (1987), for example, the commission entered the original rate order in 1971. In 1973 the Illinois Supreme Court reversed the commission order, holding that the commission improperly had allowed certain costs of the utility as operating expenses. Illinois Bell Tel. Co. v. Illinois Commerce Comm'n, 55 Ill. 2d 461, 303 N.E.2d 361 (1973). The commission reopened proceedings on remand in 1975, and did not enter its order on remand until 1982. Independent Voters of Ill. v. Illinois Commerce Comm'n, 139 Ill. App. 3d 957, 487 N.E.2d 963, 94 Ill. Dec. 86 (2d Dist. 1985). The Illinois Supreme Court did not decide the appeal of the remand order until 1987, 16 years after the original rate decision.

214. *See* Alabama Gas Corp. v. Wallace, 308 So. 2d 674 (Ala. 1975); State v. Alabama Pub. Serv. Comm'n, 307 So. 2d 521 (Ala. 1975); Public Serv. Comm'n v. Diamond State Tel. Co., 468 A.2d 1285 (Del. 1983); Utah Power & Light Co. v. Idaho Public Util. Comm'n, 685 P.2d 276 (Idaho 1984); Independent Voters of Ill. v. Illinois Commerce Comm'n, 117 Ill. 2d 90, 510 N.E.2d 850, 109 Ill. Dec. 782 (1987); Mandel Bros., Inc. v. Chicago Tunnel Terminal Co., 2 Ill. 2d 205, 117 N.E.2d 774 (1954); Mountain States Tel. & Tel. Co. v. New Mexico Corp. Comm'n, 563 P.2d 588 (N.M. 1977); Keco Indus. v. Cincinnati & Suburban Bell Tel. Co., 141 N.E.2d 465 (Ohio), *cert. denied*, 355 U.S. 182 (1957); New England Tel. & Tel. Co. v. Public Util Comm'n, 358 A.2d 1 (R.I. 1976); Security Alarms & Servs., Inc. v. Tennessee Pub. Serv. Comm'n (Tenn. Ct. App. Sept. 13, 1984) (LEXIS, Tenn library, App file). *See generally* Poor, *supra* note 36.

215. 2 Ill. 2d 205, 117 N.E.2d 774 (1954).

shipments of coal in the Chicago Loop.[216] A shipper that had participated in the commission proceedings successfully appealed the increase and then sought reparations in the commission for payments made during the period of the appeal.[217] The commission denied the requested relief, and on appeal the court affirmed. The court reasoned that the relevant statutory scheme allowed reparations only if the rates charged by the utility were "excessive"; because the commission had approved the rates charged during the period of the appeal as just and reasonable, they were not excessive, and the shipper thus had no claim to reparations.[218]

Other courts have applied the *Mandel Brothers* reasoning to deny claims on behalf of all ratepayers to refunds after reversal of a rate order[219] and to reject claims for surcharges after successful appeals by utilities from adverse commission rulings.[220] In addition to denying statutory reparations, other courts have relied on the *Mandel Brothers* rationale to reject claims for equitable restitution after reversals of rate orders. They reason that although equity requires restitution when a party has obtained property without lawful authority, the rates collected pursuant to a commission order are by definition lawful.[221]

In all of these cases, the prevailing appellant—whether utility, ratepayer, or intervenor group—argued that the judicial reversal itself rendered the initial commission order invalid from the very beginning. The courts adopting the *Mandel Brothers* view, however, reject this argument on retroactive ratemaking grounds. They start with the premise that only commissions, not the courts, can engage in ratemaking.[222] Accordingly, only commissions can rectify mistakes in their own orders. Moreover, because ratemaking is solely prospective in nature, a commission can remedy its original order only prospectively in the remand order.[223] Otherwise, in the words of one court, "potential havoc . . . would be

216. *Id.* at 206, 117 N.E.2d at 774.

217. *Id.* at 206-07, 117 N.E.2d at 774.

218. *Id.* at 209-11, 117 N.E.2d at 776-77.

219. Alabama Gas Corp. v. Wallace, 308 So. 2d 674 (Ala. 1975); State v. Alabama Pub. Serv. Comm'n, 307 So. 2d 521 (Ala. 1975); Independent Voters of Ill. v. Illinois Commerce Comm'n, 117 Ill. 2d 90, 510 N.E.2d 850, 109 Ill. Dec. 782 (1987); Security Alarms & Servs., Inc. v. Tennessee Pub. Serv. Comm'n (Tenn. Ct. App. Sept. 13, 1984) (LEXIS, Tenn. library, App. file).

220. Public Serv. Comm'n v. Diamond State Tel. Co., 468 A.2d 1285 (Del. 1983); Utah Power & Light Co. v. Idaho Public Util. Comm'n, 685 P.2d 276 (Idaho 1984); Mountain States Tel. & Tel. Co. v. New Mexico Corp. Comm'n, 563 P.2d 588 (N.M. 1977); *cf.* Bristol County Water Co. v. Hersch, 386 A.2d 1103, 1108 (R.I. 1978) (affirming denial by commission of reimbursement in next rate order for errors in previous order). One court, however, held that the retroactivity rule would not bar recovery if there was an extraordinary deprivation of the due process rights of the utility, e.g., the utility's inability to receive a fair return. New England Tel. & Tel. Co. v. Public Util. Comm'n, 358 A.2d 1, 22 (R.I. 1976).

221. Independent Voters of Ill. v. Illinois Commerce Comm'n, 117 Ill. 2d 90, 98-99, 510 N.E.2d 850, 854-55, 109 Ill. Dec. 782, 786-87 (1987); *see also* Security Alarms & Servs., Inc. v. Tennessee Pub. Serv. Comm'n (Tenn. Ct. App. Sept. 13, 1984) (LEXIS, Tenn library, App file) at *3.

222. *Diamond State Tel. Co.*, 468 A.2d at 1298.

223. *See, e.g.*, *id.* at 1297-1300; *Utah Power & Light Co.*, 685 P.2d at 281-85; *Mountain States Tel.*, 563 P.2d at 604 ("[r]etroactive remedies, which are in the nature of reparations rather than

wreaked in . . . [the] intricate statutory scheme [of public utilities regulation]."[224]

Furthermore, these courts assert that under the relevant statutes the only means to avert this retroactive ratemaking problem is the issuance of a stay of the commission order.[225] In the case of a utility appealing the denial of a rate increase, a stay would allow it to implement its originally-filed rate increase; in the case of a ratepayer appellant, the stay would prevent the collection of rates under the commission order.[226] In that way, a successful appellant would not need a retroactive remedy upon the reversal of the order. The courts note that the appellants in those cases did not seek or obtain stays, and therefore had no relief for the period between the commission order and the reversal.[227]

In contrast to the *Mandel Brothers* line of cases, another group of decisions holds that the rule against retroactive ratemaking does not pro-

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rate-making, are peculiarly judicial in character, and as such are beyond the authority of the Commission to grant").

224. *Utah Power & Light Co.*, 685 P.2d at 282; *see also* Keco Indus. v. Cincinnati & Suburban Bell Tel. Co., 141 N.E.2d 465 (Ohio 1957). The *Keco* court stated:

> It may seem inequitable to permit the defendant to retain the difference in the rates collected under the . . . order of the commission . . . but absolute equity in a particular case must sometimes give way to the greater overall good. In adopting a comprehensive scheme of public utility rate regulation the Legislature found it impossible to do absolute justice under all circumstances.

Keco Indus., 141 N.E.2d at 469 (quoting unreported lower court opinion of Hoy, J.).

225. *Alabama Gas Corp. v. Wallace*, 308 So. 2d at 681; *Utah Power & Light Co.*, 685 P.2d at 284-85; *Mandel Bros.*, 2 Ill. 2d at 211, 117 N.E.2d at 777. In *Utah Power & Light Co.*, in which the utility appealed a commission order, the court noted:

> [i]t is clear that the legislature envisioned protecting individual ratepayers by providing that the higher rates collected following a stay of a [commission] order be put aside and that if the petitioning party does not prevail upon appeal those rates will be refunded *to the individual ratepayers from whom collected.*

685 P.2d at 284-85.

226. Poor, *supra* note 36, at 746.

227. *Mandel Bros.*, 2 Ill. 2d at 211, 117 N.E.2d at 777.

Under most statutory schemes, to obtain a stay of a commission order a party must show that it will be irreparably harmed in the absence of a stay. *See, e.g.*, ILL. REV. STAT. ch. 111 2/3, para. 10-204 (1989). Some appellants have argued that because of the rule against retroactive ratemaking, equity always requires a stay of the commission rate order because denial of the stay will always irreparably harm the appellant. Courts are divided on this issue. *Compare* South Cent. Bell Tel. Co. v. Louisiana Pub. Serv. Comm'n, 555 So. 2d 1370, 1374 (La. 1990) (holding that a utility will suffer irreparable harm if a court does not enjoin a commission rate order because the rule against retroactive ratemaking will preclude the utility from ever recouping potential losses) *with* City of Chicago v. People of Cook County, 133 Ill. App. 3d 435, 449, 478 N.E.2d 1369, 1379-80, 88 Ill. Dec. 643 (1st Dist. 1985) (holding that the inability of ratepayers to obtain retroactive relief if a court reverses a rate order does not automatically entitle them to the stay of the commission order). One commentator, E. King Poor, poses the dilemma for a commission if both the utility and ratepayers seek a stay. It would be impossible for the commission, Poor argues, both to stay its rate order and to allow the utility's filed rates to go into effect. Poor, *supra* note 36, at 746. Of course, the commission would not face that dilemma if the court allowed retroactive ratemaking after reversal of a commission order.

Also, under most statutes a nongovernmental appellant must post a bond to obtain a stay. *See supra* note 67. Most ratepayer groups are financially unable to meet this requirement. *See* Mountain States Tel. & Tel. Co. v. Arizona Corp. Comm'n, 604 P.2d 1144, 1146 n.2 (Ariz. Ct. App. 1979); Ellis B. Levin, *Illinois Public Utility Law and the Consumer: A Proposal to Redress the Imbalance*, 26 DEPAUL L. REV. 259, 269 (1977).

hibit retroactive relief for the appeal period.[228] In rejecting the retroactivity rule, the courts have used varied rationales. In some cases, the courts have held that the rule does not apply because judicial reversal of the commission order renders it void *ab initio*.[229] As one court has held, "[t]he premise underlying such a refund obligation is that rates which are found to be excessive are then *considered* to have been illegal from the outset, and are not considered to have been illegal only as of the date on which the court has found them to be so."[230]

Other courts have held that the retroactivity rule is inapplicable because the original order is not final for ratemaking purposes until after full judicial review.[231] For instance, one court, in approving the granting of refunds, noted:

> "Retroactive rate making occurs when, . . . the utility is required to refund revenues collected, pursuant to the then lawfully established rates, for such past use." . . . The key phrase here is "lawfully established rates." A rate has not been lawfully established simply because the Commission has ordered it. If the Commission makes an error of law in its order from which there is a timely appeal the rates put into effect by that order have not been "lawfully established" until the appellate courts have made a final ruling on the matter.[232]

Similar to this reasoning, still other courts have rejected a retroactivity challenge to relief after reversals on the grounds that meaningful judicial review requires the right to retroactive relief.[233] As one court stated, "[i]t defies common sense to believe that the Legislature intended" to

228. Some cases adopt this view in the context of retroactive relief for consumers. Mountain States Tel. & Tel. Co. v. Arizona Corp. Comm'n, 604 P.2d 1144 (Ariz. Ct. App. 1979); Mountain States Tel. & Tel. Co. v. Public Util. Comm'n, 502 P.2d 945 (Colo. 1972); Pennwalt Corp. v. Michigan Public Serv. Comm'n, 311 N.W.2d 423 (Mich. Ct. App. 1981); Public Serv. Comm'n v. Southwest Gas Corp., 662 P.2d 624 (Nev. 1983); Appeal of Granite State Elec. Co., 421 A.2d 121 (N.H. 1980); North Carolina *ex rel.* Util. Comm'n v. Nantahala Power & Light Co., 332 S.E.2d 397 (N.C. 1985); North Carolina *ex rel.* Util. Comm'n v. Conservation Council of N.C., 320 S.E.2d 679 (N.C. 1984). Other cases have accepted this approach in the context of utilities collecting surcharges after the reversal. Railroad Comm'n v. High Plains Natural Gas Co., 628 S.W.2d 753 (Tex. 1981); Southwestern Bell Tel. Co. v. Public Util. Comm'n, 615 S.W.2d 947 (Tex. Civ. App. 1981). Finally, some cases have found the retroactivity rule inapplicable in the context of reversals of rate design decisions. California Mfrs. Ass'n v. Public Util. Comm'n, 595 P.2d 98 (Cal. 1979); *In re* Application of Haw. Elec. Light Co., 594 P.2d 612 (Haw. 1979). In the rate design area, the retroactive relief consists of refunds to some customers and surcharges to others.

229. *Southwest Gas Corp.*, 662 P.2d at 627-28; *Nantahala Power & Light Co.*, 332 S.E.2d at 472.

230. *Nantahala Power & Light Co.*, 332 S.E.2d at 472.

231. *California Mfrs. Ass'n*, 595 P.2d at 103 (relying on prior case which held that retroactivity rule did not apply to reviews of energy cost adjustments); *Nantahala Power & Light Co.*, 332 S.E.2d at 472 (holding that the refunds were not "collectible for past service, but for service rendered in the locked-in period of this docket"); *Conservation Council of N.C.*, 320 S.E.2d at 685.

232. *Conservation Council of N.C.*, 320 S.E.2d at 685 (citation omitted).

233. *See* Pennwalt Corp. v. Michigan Pub. Serv. Comm'n, 311 N.W.2d 423, 425 (Mich. Ct. App. 1981) (holding that "[a] judicially mandated refund is the result of statutorily authorized review of the Commission's orders and does not constitute retroactive rate-making"); *Conservation Council of N.C.*, 320 S.E.2d at 686; Southwestern Bell Tel. Co. v. Public Util. Comm'n, 615 S.W.2d 947, 955-56 (Tex. Ct. App. 1986).

deny ratepayers refunds after reversal "while allowing utilities to retain the proceeds of rates that were illegally charged."[234]

Finally, several courts have held that retroactive relief is available as a form of equitable restitution.[235] In *Mountain States Telephone & Telegraph Co. v. Arizona Corp. Commission*,[236] for example, the court explicitly rejected the *Mandel Brothers* approach and held that the rule against retroactive ratemaking applies only to retroactive changes in rates made by the agency on its own initiative or on a collateral attack, not to refunds resulting from statutorily authorized review.[237] The court, however, rejected the "artificial" reasoning that the commission order was void from the beginning and held that a refund is necessary only if equitable principles required the return of the monies collected.[238] In that particular case, the court held that equity required a refund because the utility had never shown that the rates collected under the original commission order were ever just and reasonable.[239]

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234. *Conservation Council of N.C.*, 320 S.E.2d at 686.

235. Williams v. Washington Metro. Area Transit Comm'n, 415 F.2d 922 (D.C. Cir. 1968) (en banc); Mountain States Tel. & Tel. Co. v. Arizona Corp. Comm'n, 604 P.2d 1144 (Ariz. Ct. App. 1979); Appeal of Granite State Elec. Co., 421 A.2d 121, 123 (N.H. 1980); Railroad Comm'n of Tex. v. High Plains Natural Gas Co., 628 S.W.2d 753, 754 (Tex. 1981).

236. *Mountain States Tel.*, 604 P.2d at 1146.

237. *Id.* at 1146-47; *see also* Mountain States Tel. & Tel. Co. v. Public Util. Comm'n, 502 P.2d 945, 949 (Colo. 1972); Appeal of Granite State Elec. Co., 421 A.2d 121, 122 (N.H. 1980).

In refusing to accept the *Mandel Brothers* doctrine, these courts explicitly reject the *Mandel Brothers* court's reliance on the United States Supreme Court's decision in Arizona Grocery Co. v. Atchison, T. & S.F. Ry., 284 U.S. 370 (1932). In that case, the Interstate Commerce Commission found that rates it had approved previously were unreasonable and awarded reparations to certain shippers. The Court affirmed the district court's reversal of the commission's order, holding that under the Interstate Commerce Act:

> Where the Commission has, upon complaint, and after hearing, declared what is the maximum reasonable rate to be charged by a carrier, it may not at a later time, and upon the same or additional evidence as to the fact situation existing when its previous order was promulgated, by declaring its own finding as to reasonableness erroneous, subject a carrier which conformed thereto to the payment of reparation measured by what the Commission now holds it should have decided in the earlier proceeding to be a reasonable rate.

284 U.S. at 390. Justices Holmes and Brandeis dissented, relying on a circuit court of appeals' opinion that distinguished between the flexibility of the federal regulatory system in comparison with the rigidity of the state system. *Id.* (relying on the concurring opinion of Judge Hutcheson in Eagle Cotton Oil Co. v. Southern Ry. Co., 51 F.2d 443, 445-47 (5th Cir. 1931)). Citing the majority opinion in *Arizona Grocery Co.*, the *Mandel Brothers* court held that reparations were not available after reversal of a commission order because where a commission has approved rates, the commission cannot subsequently find them to be unreasonable. 2 Ill. 2d at 209, 117 N.E.2d at 775-76.

The courts that reject *Mandel Brothers* agree that *Arizona Grocery Co.* forbids an agency from reviewing its own past determination of reasonableness of rates. They decide, however, that *Arizona Grocery Co.* is not relevant to a situation where a commission is asked to grant reparations after a court has reversed a prior order. *See, e.g.*, *Mountain States Tel.*, 604 P.2d at 1147.

238. *Id.* at 1147. In recognizing a right to equitable restitution, the court relied on Justice Cardozo's opinion in Atlantic Coast Line Railroad v. Florida, 295 U.S. 301 (1935). In that case, the Court held that amounts collected under an invalid Interstate Commerce Commission order should be refunded unless to do so would be unjust in the particular circumstances of the case. In that particular case, the Court denied restitution because the original order merely lacked requisite findings that the commission provided in the second order. *Atlantic Coast*, 295 U.S. at 311-12.

239. *Mountain States Tel.*, 604 P.2d at 1147-48.

As to the assertion in the *Mandel Brothers* line of cases that the statutory stay provisions are the only means to avert the adverse effects of the retroactivity rule, one court has noted that stays are

2. *Retroactive Relief for the Period Between the Reversal and the Order on Remand*

As to the second retroactive ratemaking issue raised by judicial review proceedings—relief for the period after reversal—the courts are again divided. One court, the Ohio Supreme Court in *Cleveland Electric Illuminating Co. v. Public Utilities Commission*,[240] has taken a purist antiretroactivity approach and suggested that a prevailing appellant is entitled to no relief for rates collected during the remand period. In that case, a utility successfully appealed a commission rate order, and on remand the commission held that, upon reversal of its order, the rates in effect prior to the issuance of the rate order were reinstituted as a matter of law.[241] The court reversed this holding and stated:

> [T]he statutes make clear that public utilities are required to charge the rates and fees stated in the schedules filed with the commission pursuant to the commission's orders; that the schedule remains in effect until replaced by a further order of the commission; that this court's reversal and remand of an order of the commission does not change or replace the schedule as a matter of law, but is a mandate to the commission to issue a new order which replaces the reversed order; and that a rate schedule filed with the Commission remains in effect until the commission executes this court's mandate by an appropriate order.[242]

In dicta the court recognized that this holding might pose a problem to consumers who would have to pay unlawful charges during the remand period, but noted that there was no way that "an immediate and perfect modification of utility rates can be achieved."[243]

Although agreeing with *Cleveland Illuminating* that the reversed rates remain in effect during the remand period, the court in *Independent Voters of Illinois v. Illinois Commerce Commission*,[244] held that judicial review would be meaningless unless successful appellants obtained relief for the remand period.[245] In response to the retroactive ratemaking argument, the court attempted to distinguish its own *Mandel Brothers* decision, asserting, "[t]he refund here is a result of a direct, statutorily authorized review of the Commission order. This case was remanded to the Commission . . . to correct the erroneous portion of the rates, not for original rate-making."[246] The court simply ignored the fact that the *Mandel Brothers* case also concerned a request for a refund after a statu-

permissive only and are not required for full judicial review. Pennwalt Corp. v. Michigan Pub. Serv. Comm'n, 311 N.W.2d 423, 425 (Mich. Ct. App. 1981).

240. 346 N.E.2d 778 (Ohio 1976).

241. *Id.* at 780.

242. *Id.* at 786.

243. *Id.* The court did note, however, that the commission had a duty to act promptly on remand and that the commission had authority to implement a temporary rate on remand. *Id.*

244. 117 Ill. 2d 90, 510 N.E.2d 850, 109 Ill. Dec. 782 (1987).

245. *Id.* at 104-05, 510 N.E.2d at 857-58, 109 Ill. Dec. at 789-90.

246. *Id.* at 105, 510 N.E.2d at 857-58, 109 Ill. Dec. at 789-90.

torily authorized review of a commission order; the only difference between the two cases was that *Mandel Brothers* sought relief for the period before the reversal.

Rejecting both the approach of *Cleveland Illuminating* and *Independent Voters of Illinois*, the court in *City of Los Angeles v. Public Utilities Commission*,[247] held that upon reversal of a rate order, the only lawful rates that the utility could collect during the remand period were the rates in existence prior to the reversed commission order. In reaching this decision, the court held that the approach taken in *Independent Voters of Illinois* itself constituted retroactive ratemaking. It reasoned that if it allowed the commission on remand to redetermine what rates were reasonable as of the date of its prior order and then to fix new rates for the purpose of refund, the commission would be establishing rates retroactively.[248] Accordingly, the court remanded the case to the commission to set rates prospectively.[249]

3. *Relevant Data for Consideration on Remand*

The final retroactive ratemaking issue in the judicial review context concerns the data that the commission may consider in rendering its remand decision. As the courts in *Cleveland Electric Illuminating* and *City of Los Angeles* have held, a strict construction of the retroactive ratemaking doctrine should prevent the commission on remand from entering anything except a prospective order. If the commission were to reconsider its prior, erroneous order, and issue a new order—either reaffirming the original order and denying any claims for refunds or surcharges or modifying it and granting refunds or surcharges—it would be fixing rates retroactively.[250] In essence, under this reasoning, after reversal the commission should be considering the case as if it were a newly-filed proceeding.

In those jurisdictions, however, that allow the commission on remand to modify its original order and base its refund or surcharge calculation on this modified decision, the issue arises whether the commission

247. 497 P.2d 785 (Cal. 1972)

248. *Id.* at 804.

249. *Id.* at 806. In Business & Professional People for the Public Interest v. Illinois Commerce Commission, 136 Ill. 2d 192, 555 N.E.2d 693, 144 Ill. Dec. 334 (1989) (as modified on denial of rehearing), the utility suggested a fourth approach to the issue of relief during the period between the reversal and the order on remand. In that case, the utility argued that once a court reverses a rate order, the *originally-filed* tariffs go into effect until a new rate order. Looking solely to the mechanics of the ratemaking process, the utility reasoned that because the suspension period had passed and the commission order was void, the only legal rates were those it originally had filed. *Id.* at 245-46, 555 N.E.2d at 717-18, 144 Ill. Dec. at 358-59.

The court correctly rejected this argument, finding that it "would lead to an incongruous result": the court's reversal of the commission's lower rates on a consumer intervenors' appeal would result in the implementation of *higher* rates. *Id.* at 246, 555 N.E.2d at 718, 144 Ill. Dec. at 359. Indeed, the utility's argument in *Business & Professional People for the Public Interest* is an excellent illustration of the absurd results that flow from a purely mechanical view of the ratemaking process.

250. *See supra* notes 240-43 & 247-49.

in rendering its remand decision and concomitant refund or surcharge order can consider any evidence concerning the period after the original order. As may be expected, courts are divided on this issue.

Several courts have held that the rule against retroactive ratemaking bars any consideration of evidence on remand concerning the period after the original commission order.[251] In *Muncie v. Public Service Commission*,[252] for example, on the appeal of the original order, the court reversed the order, finding that the commission had erred in computation of the utility's income tax expense, and remanded to the commission for a redetermination of this expense and calculation of refunds to consumers.[253] On remand the utility sought to introduce evidence of its actual operating experience during the pendency of the appeal and remand periods, and the commission certified this issue to the court. The court held that such evidence was not relevant to the remand proceeding. The court noted that once the commission had redetermined the utility's income tax expenses and modified its original order, the only evidence the commission needed to determine the size of the refund was the amount of service provided prior to the remand order.[254] Moreover, it asserted, if the commission used evidence of the utility's actual operating experience in determining the remand order or the refund calculation, it would be engaging in unlawful retroactive ratemaking.[255]

In contrast, the court in *People ex rel. Hartigan v. Illinois Commerce Commission*[256] held that the commission could consider the utility's actual operating experience in rendering its remand order. In that case, the Illinois Supreme Court reversed the commission's original order including the costs of a nuclear plant in the rate base.[257] On remand, although all the parties to the case agreed that the proper basis for calculating any refund amount was the actual revenue collected by the utility, the commission asserted that the utility was entitled to offset these revenues by the actual expenses it incurred during the remand period—not just the expenses forecasted in the original order.[258] The court rejected the retroactive ratemaking challenge to the commission's position, holding that the commission's proposal was not retroactive ratemaking "but rather a matching of the relevant expenses to revenue for the period in question."[259] It noted that improper retroactive ratemaking would occur

251. Mountain States Tel. & Tel. Co. v. Public Util. Comm'n, 502 P.2d 945 (Colo. 1972); City of Muncie v. Public Serv. Comm'n, 396 N.E.2d 927 (Ind. Ct. App. 1979); Parker v. South Carolina Pub. Serv. Comm'n, 342 S.E.2d 403 (S.C. 1986).

252. 396 N.E.2d 927 (Ind. Ct. App. 1979).

253. Indiana has a statute requiring refunds after reversals. IND. CODE ANN. § 8-1-3-6 (Burns 1988).

254. *Muncie*, 396 N.E.2d at 928.

255. *Id.* at 929.

256. 202 Ill. App. 3d 917, 561 N.E.2d 711, 149 Ill. Dec. 341 (1st Dist. 1990), *petition for leave to appeal allowed*, 136 Ill. 2d 553, 567 N.E.2d 341, 153 Ill. Dec. 383 (1991).

257. *See supra* notes 17-29 and accompanying text.

258. *Hartigan III*, *supra* note 17, at 957, 561 N.E.2d at 735, 149 Ill. Dec. at 365.

259. *Id.* at 957, 561 N.E.2d at 735, 149 Ill. Dec. at 365.

only if the utility sought a surcharge when its actual expenses were higher than its actual receipts.[260]

G. *Summary of the Application of the Rule in Different Contexts*

This survey of the applications of the rule against retroactive ratemaking during the last three decades shows that the decisions, to say the least, are muddled. Although most courts still continue to pay fervent homage to the doctrine, elevating it to a fundamental principle of ratemaking,[261] in practice they frequently allow ratemaking that permits utilities to recoup past losses and consumers to receive refunds of excess utility profits. At the same time that courts warn of the potential havoc that would ensue if the judiciary rejected the doctrine,[262] they either ignore the rule, misconstrue it, or create ad hoc exceptions to it.

As the above review of cases shows, this kind of decision making is widespread. Some courts have allowed commission changes in accounting methodology to reflect the "reality" of a financial transaction, even when the modifications retroactively reduce profits properly accounted for on the utility's books.[263] Others have permitted retroactive modifications to remedy "procedural" mistakes in prior orders—even years after the original order.[264] Several courts have recognized an "extraordinary" occurrence exception to the retroactive ratemaking doctrine to allow the utility to recover for unusual losses and to allow ratepayers to receive credit for unusual utility gains.[265] Still other courts have accepted the concepts of interim rate relief with the possibility of refunds at the time of the final order and deferred accounting to permit utilities to recover past expenses not recognized in the previous case.[266] Other courts have approved of energy adjustment clauses which, without the requirement of a full rate case, allow utilities to change their rates to reflect past changes in the price of fuel and provide for reconciliation proceedings to adjust retroactively the amounts collected under these clauses.[267] Finally, some courts have authorized refunds to ratepayers or surcharges to the utility—for the period of the pendency of an appeal and the remand proceedings—when a rate order has been reversed.[268]

This survey also demonstrates that many of these exceptions to the retroactivity rule have arisen from a recognition of the unique problems

260. *Id.*

261. *See, e.g.*, Citizens Utils. Co. v. Illinois Commerce Comm'n, 124 Ill. 2d 195, 205-11, 529 N.E.2d 510, 515-17, 124 Ill. Dec. 529, 534-36 (1988); *In re* Elizabethtown Water Co., 527 A.2d 354, 360-61 (N.J. 1987); Bristol County Water Co. v. Hersch, 386 A.2d 1103, 1108 (R.I. 1978).

262. *See* Utah Power & Light Co. v. Idaho Pub. Utils. Comm'n, 685 P.2d 276, 282 (Idaho 1984).

263. *See supra* notes 78-97 and accompanying text.

264. *See supra* notes 98-103 and accompanying text.

265. *See supra* notes 108-27 & 134-36 and accompanying text.

266. *See supra* notes 163-83 and accompanying text.

267. *See supra* notes 195-202 & 206-10 and accompanying text.

268. *See supra* notes 228-39 and accompanying text.

of modern public utility regulation. Several of the cases recognizing the "extraordinary" occurrence exception to the rule, for example, arose in the context of the reorganization of the Bell system and the cancellation of nuclear plants.[269] As the commission stated in one of the nuclear plant cases, "[a]n assessment of the interests involved must be undertaken from first principles. Without such a de novo approach, the rules developed to reflect and generalize other assessments of the relevant interests in other settings might distort the proper balancing called for under these circumstances."[270] Courts have approved other exceptions to the doctrine—such as interim rate order and energy adjustment clauses—in the context of commission attempts to deal with the issue of regulatory lag and the specter of continuous rate proceedings.[271] Moreover, the exception for refunds or surcharges after reversals of rate orders has been allowed to provide for "meaningful judicial review" at a time of increased and lengthy judicial examination of rate cases.[272]

This review of the cases, however, also shows that the courts have been inconsistent in their application of the retroactivity rule and its exceptions. For instance, while some courts have allowed commission changes in accounting methodology even if these modifications alter the treatment of prior gains or losses realized by the utility, others have found that the rule against retroactive ratemaking prohibits such modifications.[273] Similarly, courts have differed in their treatment of commission corrections of errors in prior orders,[274] extraordinary gains or losses,[275] retroactive relief for the suspension period of a case,[276] and the ability of commissions to make retroactive adjustments to amounts collected under energy adjustment clauses during reconciliation proceedings.[277] Finally, in the context of reversals of commission orders on judicial review, courts have developed divergent constructions of the doctrine, some forbidding any retroactive relief for the appeal and remand periods, some allowing recovery for the entire period, and others allowing it for only part of the period.[278]

Even in the same jurisdiction, courts render seemingly contradictory interpretations of the rule. In Illinois, for example, one of the leading outposts for a strict construction of the rule, the supreme court has held

269. *See supra* notes 121-23 & 134-36 and accompanying text.

270. *In re* Boston Edison, 46 Pub. Util. Rep. 4th (PUR) 431, 435 (Mass. Dep't of Pub. Util. 1982).

271. *See* Blair & Kaserman, *supra* note 186, at 28; Sarikas, *supra* note 189, at 33. *See generally* Elizabeth Warren, *Regulated Industries' Automatic Cost of Service Adjustment Clauses: Do They Increase or Decrease Costs to the Customer?*, 55 NOTRE DAME L. REV. 333 (1980).

272. Independent Voters of Ill. v. Illinois Commerce Comm'n, 117 Ill. 2d 90, 94, 510 N.E.2d 850, 858, 109 Ill. Dec. 782, 785 (1987).

273. *See supra* notes 72-77 and accompanying text.

274. *See supra* notes 98-107 and accompanying text.

275. *See supra* notes 108-40 and accompanying text.

276. *See supra* notes 141-77 and accompanying text.

277. *See supra* notes 203-10 and accompanying text.

278. *See supra* notes 211-60 and accompanying text.

that although the rule prohibits the commission from granting retroactive relief for the period of the appeal to the trial court, after that court reverses a rate order, the doctrine does not bar the commission from allowing such relief for the period after the trial court reversal until the commission enters a remand order.[279] If the rule is an absolute limitation on the authority of the commission, it is difficult to understand how the magical moment of trial court reversal can expand this power. On the other hand, if the rule is not absolute and courts can create exceptions to meet a policy concern such as meaningful judicial review, it is hard to discern why courts should not permit retroactive relief for the entire period of the appeal.[280]

A few courts properly have begun to consider the policies underlying the rule when applying it. In Rhode Island, for example, the court developed the extraordinary occurrence exception to the rule by determining that it would not adversely affect the functions of the rule.[281] Likewise, the California Supreme Court, in allowing the refunds of overcollections under an energy cost adjustment clause, examined the policies of the rule. It noted, "If the prohibition against retroactive ratemaking is to remain a useful principle of regulatory law and not become a device to fetter the commission in the exercise of its lawful discretion, the rule must be properly understood."[282] Even these few courts, however, have limited this policy analysis to only a few discrete areas.

IV. Critique of the Current Applications of the Rule Against Retroactive Ratemaking

Given the varied constructions of the rule against retroactive ratemaking and its inconsistent and, at times, ad hoc application by the courts, it is necessary to determine whether the rule still has any validity. In this section of the article, I will provide such a critique. I will examine the purported bases for the rule against retroactive ratemaking and will evaluate the soundness of each of them, especially in view of the modern regulatory process. In addition, I will analyze whether the current applications of the rule are consistent with the stated bases.

A. *Purported Statutory Prohibition of Retroactive Ratemaking*

Although most public utility commission enabling acts do not spe-

279. Independent Voters of Ill. v. Illinois Commerce Comm'n, 117 Ill. 2d 90, 510 N.E.2d 850, 109 Ill. Dec. 782 (1987).

280. Similarly, one of the Illinois appellate courts has held that the rule against retroactive ratemaking does not prohibit a commission, upon reversal of a rate order, from considering the utility's experience during the appeals and remand period in determining the amount of the refunds to ratepayers. People *ex rel.* Hartigan v. Illinois Commerce Comm'n, 202 Ill. 3d 917, 956, 561 N.E.2d 711, 735, 149 Ill. Dec. 341, 365 (1990). Such a procedure clearly involves looking at the past profits of the utility to determine retrospectively the reasonableness of the rates for the appeals and remand period.

281. Narragansett Elec. Co. v. Burke, 415 A.2d 177, 178 (R.I. 1980).

282. Southern Cal. Edison Co. v. Public Util. Comm'n, 576 P.2d 945, 945 (Cal. 1978).

cifically prohibit retroactive ratemaking, courts have found that these statutory schemes, taken as a whole, impliedly bar such ratemaking.[283] Their reasoning invariably begins with the premise that commissions have only the powers delegated to them by the legislature.[284] They then refer to the provision of the enabling act that allows for the filing of complaints by affected parties against existing rates. With minor modifications in terminology depending upon the jurisdiction, this section provides:

> Whenever the commission *after* a hearing, finds that the rates . . . demanded, observed, charged, or collected by any public utility *for or in connection with any service* . . . are . . . unreasonable, . . . the commission shall determine and fix by order, the just, reasonable, or sufficient rates . . . *to be thereafter* observed and *in force*.[285]

Pointing to the "thereafter" language and relying on the Supreme Court's construction of similar language in the Ohio statute in *Public Utility Commission v. United Fuel Gas Co.*,[286] they then conclude that the legislature intended to give the commission power to prescribe rates prospectively only.[287]

In further support of this construction of the legislature's intent, courts rely on provisions in enabling acts that prohibit a utility from charging more or less than the rate approved by the commission, that penalize utilities for such conduct, or that allow the commission to grant reparations only if the utility has charged an unreasonable or excessive rate.[288] From these provisions, courts infer that the legislature intended the granting of retroactive relief only in the limited circumstances when a

283. *See, e.g.*, Pacific Tel. & Tel. Co. v. Public Util. Comm'n, 401 P.2d 353, 364-68 (Cal. 1965); *In re* Elizabethtown Water Co., 527 A.2d 354, 359 (N.J. 1987).

284. *See, e.g.*, *Pacific Tel. & Tel. Co.*, 401 P.2d at 365.

285. *See, e.g.*, CAL. PUB. UTIL. CODE § 728 (West 1975); COLO. REV. STAT. § 40-3-111 (1990); DEL. CODE ANN. tit. 26, § 309 (1989); FLA. STAT. ANN. § 366.06(2) (West 1991); IDAHO CODE § 61-502 (1976); MASS. ANN. LAWS ch. 159, § 14 (Law. Co-op. 1979); N.H. REV. STAT. ANN. § 378:7 (1984); N.J. STAT. ANN. § 48:2-21 (West 1969); N.Y. PUB. SERV. LAW § 114 (McKinney 1989); N.C. GEN. STAT. § 62-136 (1989); OR. REV. STAT. § 757.279 (1987); S.D. CODIFIED LAWS ANN. § 49-10-34 (1983); TENN. CODE ANN. § 65-5-201 (1982); TEX. REV. CIV. STAT. ANN. art. 1446(c), § 42 (Vernon Supp. 1991); UTAH CODE ANN. § 54-4-4 (1953); WASH. REV. CODE ANN. § 80.28.020 (1991).

286. 317 U.S. 456 (1943); *see supra* notes 142-51 and accompanying text.

287. *See, e.g.*, *Pacific Tel. & Tel. Co.*, 401 P.2d at 364.

288. *See, e.g.*, Mandel Bros., Inc. v. Chicago Tunnel Terminal Co., 2 Ill. 2d 205, 209, 117 N.E.2d 774, 776 (1954). For examples of statutes that provide such prohibitions on the power of utilities to make charges different from the approved rates; see ARIZ. REV. STAT. ANN. § 40-374 (1956); ARK. CODE ANN. § 23-4-107 (Michie 1987); COLO. REV. STAT. § 40-3-105 (1990); D.C. CODE ANN. § 43-529 (1990); IDAHO CODE § 61-310 (1976); ILL. ANN. STAT. ch. 111 2/3, paras. 9-240, 9-252 (Smith-Hurd 1988); IND. CODE ANN. § 8-1-2-44 (Burns 1988); IOWA CODE ANN. § 476.5 (West 1990); KAN. STAT. ANN. § 66-109 (1985); KY. REV. STAT. ANN. § 278.160(2) (Michie/Bobbs-Merrill 1989); ME. REV. STAT. ANN. tit. 35A, § 309 (West 1964); MASS. ANN. LAWS ch. 159, § 14A (Law. Co-op. 1979); MISS. CODE ANN. § 77-3-35 (1972); MO. ANN. STAT. § 393.140(11) (Vernon 1991); MONT. CODE ANN. § 69-3-305 (1989); N.M. STAT. ANN. § 62-8-5 (1978); N.C. GEN. STAT. § 62-139 (1989); OR. REV. STAT. § 757.310 (1989); 66 PA. CONS. STAT. ANN. § 1303 (1979); R.I. GEN. LAWS § 39-2-2 (1956); S.D. CODIFIED LAWS ANN. § 49-10-14 (1983); TENN. CODE ANN. § 65-5-110 (1982); TEX. REV. CIV. STAT. ANN. art. 1446(c), § 46

utility assesses a rate that is different from the approved tariff.[289]

As noted by the *United Fuel* dissenters, this construction of the enabling acts is "dubious." The provisions that require commissions to fix the rates that utilities will charge "thereafter" are silent on the issue of what factors the commission can consider in setting those rates. Indeed, most enabling statutes, when the legislatures originally adopted them sixty or seventy years ago, made no reference to "test years" or any of the specific components of the ratemaking formula, but gave commissions broad discretion in determining the factors to be considered in setting rates. In fact, in most other rate-setting contexts, courts have recognized the legislative intent to allow the commission such wide authority.[290] It is difficult to understand why legislatures would have delegated such broad powers to commissions, but would have simultaneously limited that authority with off-hand wording in a provision merely describing the process for the entry of a rate order. The most probable reason, then, for the inclusion of the "thereafter" language in the enabling statutes is the simple fact that after the commission enters a rate order, a utility cannot mechanically collect rates in the past. Contrary to the *United Fuels* reasoning, the statutory schemes evidence no legislative intent prohibiting commissions from looking to the past in setting rates.

Similarly, the provisions requiring utilities to collect the filed rates and limiting reparations cases to claims against utilities for excessive charges do not address the powers of the commission in fixing rates. These sections limit the power of *utilities* to discriminate between customers or customer classes in the collection of rates or to adjust their rates without commission approval based on their own notions of reasonableness. By their very language, these provisions do not deal with the rate-setting authority of the commission. It does not follow that because

(Vernon Supp. 1991); UTAH CODE ANN. § 80.28.080 (1991); W. VA. CODE § 24-3-2 (1986); WIS. STAT. ANN. § 196.22 (West Supp. 1990); WYO. STAT. § 37-3-102 (1977).

Statutes such as these reflect what has been termed the "filed rate doctrine": utilities cannot charge rates for their services other than those properly filed with their commissions. *See supra* note 8. On the federal level, the Supreme Court recently reaffirmed the need for strict compliance with this doctrine in the context of the Interstate Commerce Act. Maslin Indus. v. Primary, 110 S. Ct. 2759 (1990). In that case, the Court rejected the Negotiated Rates policy of the Interstate Commerce Commission (ICC) which allowed carriers and shippers to negotiate rates lower than those filed with the ICC. Consistent with the views expressed in this article, Justice Stevens, joined by Chief Justice Rehnquist, dissented, noting that the regulatory environment has changed drastically from the beginnings of carrier regulation in the nineteenth century: "Nothing more than blind adherence to language in cases that have nothing to do with the present situation supports today's result." *Id.* at 2780.

289. *See, e.g.*, Pacific Tel. & Tel. Co. v. Public Util. Comm'n, 401 P.2d 353, 363-64 (Cal. 1965); Mandel Bros., Inc. v. Chicago Tunnel Terminal Co., 2 Ill. 2d 205, 209, 117 N.E.2d 774, 775-77 (1954).

290. *See, e.g.*, Office of People's Counsel of D.C. v. Public Serv. Comm'n, 571 A.2d 206, 209-11 (D.C. 1990) (approving expedited procedures for certain rate filings); Northern Ind. Pub. Serv. Co. v. Citizens Action Coalition, 548 N.E.2d 153, 157-61 (Ind. 1989) (recognizing broad authority of commission to grant interest on refunds to ratepayers); Wisconsin Ass'n of Mfrs. & Commerce v. Public Serv. Comm'n, 287 N.W.2d 844, 846-48 (Wis. Ct. App. 1979) (noting wide discretion of commission to determine factors upon which to design rates).

the legislature required utilities to abide by their own tariffs, it intended to create a blanket prohibition on the commission's consideration of past losses or gains of the utility in the setting of rates.

Moreover, some of the recent applications of the rule against retroactive ratemaking are inconsistent with the traditional reading of the enabling acts. If commissions in their rate orders are allowed to consider only losses or gains forecasted to occur "thereafter," then it is difficult to discern how commissions have the authority to correct mistakes in past rate orders, to allow recoveries for past extraordinary gains or losses, to change accounting treatment for past gains or losses, or to grant refunds or surcharges after reversal of a rate order. Admittedly, some courts have not recognized some or all of these powers, but many have, either creating exceptions to the rule or ignoring prior constructions of "thereafter" language for purposes of the particular case.

In summary, a close reading of the relevant enabling statutes discloses no clear legislative intent to forbid retroactive ratemaking. Moreover, a number of courts themselves recognize this fact in allowing such ratemaking in some, but not all, circumstances. Although most courts will not acknowledge it,[291] the rule is simply a judicially-created doctrine. The question then arises whether there are sound regulatory policies to support continued adherence to it.

B. Legislative Nature of Ratemaking Process

Another asserted basis for the rule against retroactive ratemaking is the claim that ratemaking is a "legislative" process, which, by its very nature, must be focused prospectively. As one court has put it:

> Pervading the utility rate making process is the fundamental rule that rates are exclusively prospective in application and that future rates may not be designed to recoup past losses. The rationale of this principle is that the Commission acts in a legislative capacity in exercising its rate making authority; that rate making orders have statutory effect; and that, as such, they are subject to rules ordinarily applied in statutory construction. . . . [T]o accord a rate order retroactive effect, requires "the clearest mandate."[292]

291. *But see* Southern Cal. Edison Co. v. Public Util. Comm'n, 576 P.2d 945 (Cal. 1978); Narragansett Elec. Co. v. Burke, 415 A.2d 177, 178 (R.I. 1980).

As those courts which have created exceptions to the rule tacitly recognize, even if legislatures early in this century intended to restrict all retroactive ratemaking, the regulatory process has changed so drastically over time that the restriction should not be absolute. The retroactivity rule is part and parcel of the "file and suspend" ratemaking process developed early in this century. *See supra* notes 39-45 and accompanying text. Legislatures premised that entire process on the belief that courts could resolve rate cases within six months to a year. Today, that is simply not the case. The courts that have adopted a more liberalized approach to the rule have recognized this change in circumstances and have decided not to enforce the rule when its basic premise no longer exists.

292. Louisiana Power & Light Co. v. Louisiana Pub. Serv. Comm'n, 377 So. 2d 1023, 1028 (La. 1979) (citations omitted); *see also* Public Serv. Comm'n v. Diamond State Tel. Co., 468 A.2d 1285, 1298-99 (Del. 1983); Mandel Bros., Inc. v. Chicago Tunnel Terminal Co., 2 Ill. 2d 205, 210, 117 N.E.2d 774, 776 (1954).

Leaving aside for the moment the validity of the premise that legislation must be prospective in outlook,[293] the reasoning underlying this purported basis for the rule is usually circular. Courts do not analyze the meaning of "legislative," as opposed to "adjudicative" or some other function, nor do they examine the role of the commission in a particular rate-setting context. Rather, they merely resort to unsubstantiated syllogism: ratemaking is "legislative" in nature; "legislation" must be prospective; therefore, ratemaking must be prospective.[294]

When one closely examines ratemaking procedure in terms of the standard definition of the legislative function, however, it is very questionable whether this process, as it currently operates, is in fact "legislative." Davis makes the classic distinction between "legislative facts" and "adjudicative facts":

> Adjudicative facts are the facts about the parties and their activities, businesses, and properties. Adjudicative facts usually answer the questions of who did what, where, when, how, why, with what motive or intent. . . . Legislative facts do not usually concern the immediate parties but are general facts which help the tribunal decide questions of law and policy and discretion.[295]

Under this definition, past ratemaking may have concerned primarily legislative facts—general policy issues concerning the utility's reasonable rate of return and the reasonableness of rate distinctions made between customer classes. More recently, however, rate cases have begun to focus on clearly adjudicative issues. In the revenue requirement context, for instance, issues frequently arise that concern who did what, where, when, how, why, and with what motive or intent: for example, questions in regard to the prudency of major construction decisions, the reasonableness of particular operating expenses, and utility compliance with specific statutory and regulatory guidelines.[296] Even in the rate design area, which traditionally has been considered legislative in nature, adjudicative issues develop, such as the validity of usage forecasts for particular classes, compliance with particular conservation guidelines, or the relationship between the past usage of different classes and the causes of particular construction decisions.[297]

Acknowledging the changing nature of the ratemaking process, commissions have developed procedures that clearly are not "legislative" in outlook. Certainly, energy cost adjustment clauses with periodic mod-

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293. *See infra* notes 317-23 and accompanying text.

294. *Diamond State Tel. Co.*, 468 A.2d at 1298-99; *Mandel Bros.*, 2 Ill. 2d at 210, 117 N.E.2d at 776; *Louisiana Power & Light Co.*, 377 So. 2d at 1028.

295. KENNETH CULP DAVIS, ADMINISTRATIVE LAW TEXT 160 (3d ed. 1972).

296. *See Hartigan II*, *supra* note 17, at 136-41, 510 N.E.2d at 872-74, 109 Ill. Dec. at 804-06; Kansas Gas & Elec. Co. v. State Corp. Comm'n, 720 P.2d 1063, 1078-80 (Kan. 1986).

297. *See, e.g.*, *Re* Union Elec. Co., 66 Pub. Util. Rep. 4th (PUR) 202, 294-95 (Mo. Pub. Serv. Comm'n 1985) (issue of cost causation for nuclear plant); *Re* National Fuel Gas Distrib. Corp., 82 Pub. Util. Rep. 4th (PUR) 250 (N.Y. Pub. Serv. Comm'n 1987) (proposal for special service classification for customers with independent supply of natural gas).

ifications in rates to reflect changes in fuel costs and annual reconciliation proceedings, interim rate cases with refund mechanisms at the end of the case, or deferred accounting for major investments are not legislative methods of decisionmaking. In fact, several legislatures have recognized the change in the rate-setting process and have required the use of adjudicative rather than rule-making procedures for rate hearings.[298]

Labelling ratemaking as "legislative," then, does not help the analysis. If "legislative" is nothing more than a buzzword for "prospective decision making," the argument that ratemaking is "legislative" in nature and cannot be retroactive is nothing but a tautology. If, on the other hand, "legislative" means a particular kind of decision-making function, the "ratemaking is legislative" basis for the retroactivity rule fails because, as it operates in reality, ratemaking now concerns more than general determinations of policy issues.

C. *Rates as Vested Rights*

Still another basis for the rule prohibiting retroactive ratemaking is the concept that commission-approved rates create "vested rights" for utilities and ratepayers which, under the federal or particular state constitution, courts cannot impair retrospectively.[299] A good example of a decision adopting this approach is *Lightfoot v. Springfield*.[300] In that case, the state commission approved rates for a utility including expenses for fuel from a particular natural gas supplier. Subsequently, the Federal Power Commission (FPC) ordered the supplier to reduce its rates. While the case was on appeal, however, the federal court stayed the reduction pending final review, subject to refund.[301] During the appeal, the utility continued to collect the rates that the state commission previously approved. When the federal court affirmed the FPC decision, certain ratepayers brought a class action against the utility for a declaration that they were entitled to the refund amount. The court rejected this claim:

> In our opinion, the money so unconditionally paid as prescribed by the lawfully promulgated and effective rates became and was the property of the [utility]. . . . [W]hen the established rate is followed, the amount so collected becomes the property of the utility, of which it cannot be deprived by either legislative or court action without violating the due process provisions of the state and federal constitutions.[302]

When commission-approved rates become "vested rights" or cease to be such rights, however, is not always clear. The *Lightfoot* court itself indicated that it could have refunded the commission-approved rates if a

298. *See, e.g.*, ILL. REV. STAT. ch. 111 2/3, para. 10-101 (1989); TEX. REV. CIV. STAT. ANN. art. 6252-13a, § 3(2) (Vernon Supp. 1991).

299. *See* COLO. CONST. art. II, § 11; OHIO CONST. art. II, § 28; TENN. CONST. art. I, § 20.

300. 236 S.W.2d 348 (Mo. 1951).

301. *Id.* at 350.

302. *Id.* at 354.

customer had requested an order from the commission that the utility set apart or impound the rates associated with the supplier's fuel pending the federal court decision.[303] In another case, *Peoples National Gas Division of Northern Natural Gas Co. v. Public Utility Commission*,[304] the court rejected a ratepayer's "vested right" argument against the retroactive assessment of a surcharge allowing the utility to collect for increased fuel costs during the rate suspension period. The court observed that the surcharges did not affect any vested rights because they related to service provided only after the initiation of the rate case, when supposedly the previously approved rates ceased to be vested.[305] In *Narragansett Electric Co. v. Burke*,[306] the court dismissed a "vested rights" challenge to a commission refund order based on its finding that a utility earned well in excess of its reasonable rate of return of 15.2%. The court held that the utility had no vested right to earn in excess of its allowed return on equity.[307] Similarly, the court in *Southwestern Bell Telephone Co. v. Public Utility Commission*,[308] in permitting retroactive relief after judicial reviews of rate orders, noted that no party has a vested right to any particular system of utility rates, but only to "just, fair and reasonable" rates.[309]

Accordingly, given the difficulty of determining the meaning of "vesting," the "vested right" rationale is not helpful to analysis of the rule. If a court determines that retroactive relief is not allowed, it will label the previously approved rates as "vested"; if it decides that retrospective recovery is permitted, it will declare that those particular rates were not vested. As one commentator has noted in relation to retroactive legislation, "the distinction between vested and non-vested rights . . . is of use primarily as a basis on which to classify decisions after they have already been reached on other grounds."[310]

D. *Reliance on Commission-Approved Rates*

Another basis for the rule against retroactive ratemaking is the assertion that utilities and ratepayers have the right to rely on rates estab-

303. *Id.* at 353-54.

304. 590 P.2d 960 (Colo. 1979).

305. *Id.* at 962; *see also* Colorado Energy Advocacy Office v. Public Serv. Co. of Colo., 704 P.2d 298 (Colo. 1985). In that case, the court held that an energy cost adjustment clause did not impair "vested rights" even though the commission determined the rates under the clause in part by recovery of costs which the utility incurred two months earlier. *Id.* at 305. Focusing solely on the collection process of the rates, the court found no retroactive ratemaking because the clause "as imposed applies only to future gas consumption." *Id.*

306. Nos. 84-73-M.P., 84-232-M.P. & 84-342-M.P. (R.I. Mar. 11, 1986) (LEXIS, RI library, RI file).

307. *Id.* at 3.

308. 615 S.W.2d 947 (Tex. Ct. App. 1981).

309. *Id.* at 957.

310. Bryant Smith, *Retroactive Laws and Vested Rights*, 5 TEX. L. REV. 231, 246 (1927); *see* Charles B. Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 HARV. L. REV. 692, 696 (1960).

lished by a commission. Once ratepayers consume a unit of utility service, the argument goes, they are legally obligated to pay for it at the rates fixed by the commission. If a court allowed a commission to alter this rate retrospectively, it would be sanctioning a retroactive change of the contractual agreement relied on by the parties.[311] As one court has noted, "[E]ven when a product is unregulated, the consumer is confident once he purchases a product that the merchant will not claim that he is liable for a retroactive price increase on the product."[312] Similarly, a utility, like a merchant in the unregulated context, is confident that the consumer will not be able to obtain a refund of the amount paid.[313] Moreover, it is argued that, absent the rule, investors could not rely on the rates fixed by the commission, and utilities would find it difficult to attract capital.[314]

The problem with this reliance basis for the retroactivity rule is that it is overly simplistic. As mechanically applied, it easily can be overcome by simply inserting in each rate order a notice to the parties that the approved rates are subject to retroactive alteration.[315] Under such a sys-

311. Appeal of Pennichuck Water Works, 419 A.2d 1080, 1083 (N.H. 1980). *See generally* Hardman, *Administrative Finality*, *supra* note 36; Hardman, *Finality of Filed Rate*, *supra* note 36.

312. *Appeal of Pennichuck Water Works*, 419 A.2d at 1083. In that case, a utility filed a request for an increase in rates on December 29, 1978 and sought a temporary increase to be effective on all bills rendered on or after January 31, 1979. Because the utility billed its customers on a staggered basis, the temporary rate increase would have been applicable to service provided before December 29, 1978. *Id.* at 1081. The court found that this proposal violated the rule against retroactive ratemaking, holding that "the customers of a utility have a right to rely on the rates which are in effect at the time they consume the services provided by the utility." *Id.* at 1083; *see also* Narragansett Elec. Co. v. Burke, 415 A.2d 177, 179 (R.I. 1980) (holding that one of the purposes of the retroactivity rule is to safeguard customers from surprise surcharges dating back over years that they had a right to assume were finished business).

313. *See* Spintman v. Chesapeake & Potomac Tel. Co., 255 A.2d 304, 308 (Md. 1969) (holding that if retroactive refunds were allowed utilities "would . . . never be able to project what should be a reasonable rate because they would have little knowledge of what contingent liabilities may be lurking in the future by way of rebates . . . to dissatisfied customers"); New Haven v. New Haven Water Co., 45 A.2d 831, 838 (Conn. 1946) ("it cannot be that the legislature would intend to require a refund as to rates which the company had no reason to believe would be called into question").

314. Southern Cal. Edison Co. v. Public Util. Comm'n, 576 P.2d 945, 961-62 (Cal. 1978) (Clark, J., dissenting) (criticizing the majority's failure to invoke the retroactivity rule in an energy cost adjustment reconciliation case and lamenting the fact that the decision "means that investors contemplating purchase of bonds issued by California utilities may put only very limited reliance on the balance sheets and profit and loss statements"); Indiana Tel. Corp. v. Public Serv. Comm'n, 171 N.E.2d 111, 124 (Ind. Ct. App. 1960) (en banc); *In re* Elizabethtown Water Co., 527 A.2d 354, 361 (N.J. 1987) ("[i]f the [commission] were permitted to reduce the past earnings of a utility, investor confidence would be undermined and the utility would find [sic] more difficult to obtain the capital needed to maintain service").

315. *See* Louis Kaplow, *An Economic Analysis of Legal Transitions*, 99 HARV. L. REV. 509, 522-23 (1986). The Supreme Court has upheld such a notice procedure. *See* Great N. Ry. v. Sunburst Oil & Ref. Co., 287 U.S. 358 (1932). In that case, the state supreme court in a previous decision had held that a shipper could challenge in the commission a previously approved rate and recover retroactively excess charges. The carrier challenged the constitutionality of this procedure. The Court, through Justice Cardozo, rejected this challenge:

> By implication of law there had been written into the statute a notice to all concerned that payments exacted by a carrier in conformity with a published tariff were subject to be refunded if found thereafter, upon sufficient evidence, to be excessive and unreasonable. The Constitution

tem, no party could assert that it has an entitlement to rely on the established rate.

More importantly, this basis for the rule ignores the realities of the current regulatory process. Some reliability, of course, is essential to the public utility regulatory system. If commissions could retroactively change rates willy-nilly, and ratepayers' bills and utility revenues were continually subject to large fluctuations, serious questions would arise concerning the legitimacy of the ratemaking process.[316] As Munzer has noted in the area of retroactive legislation, however, the model of legal expectations that views statutes as fixed agreements is unsatisfactory in a modern society where conditions are often too complex and unpredictable to allow a legislature to bind itself; legislatures need flexibility.[317] Likewise, in the public utility context, the view that all rates are permanently fixed until prospectively changed is inconsistent with the need for flexibility in the current regulatory system. This is precisely the reason for the widespread use of energy cost adjustment clauses, interim rate increases, bonded rates, deferred accounting procedures, and other conditional ratemaking mechanisms.

Moreover, given the increased number of rate filings, appeals, remands, and reconsiderations in public utility cases, it is difficult to dispute that rates, to some extent, are frequently going to be changing. The important point, then, is that under the current regulatory system, the parties' reliance on commission-approved rates should not be an absolute litmus test for determining retroactivity questions.

Munzer's model for analyzing reliance interests in the retroactive legislation context is very helpful here. He proposes that government must create a proper balance between the need for flexibility in the legislative process and the reliance interests of the affected parties.[318] He asserts that courts can best achieve this balance by protecting only those expectations of the parties that are both rational and legitimate.[319] An expectation is rational, he contends, "if the probability assigned to the predicted event corresponds suitably to the actual likelihood that it will occur, and if the person making the prediction has good grounds for assigning the probability he does."[320] Also, it is rational only if it is adaptive over time and takes into account the divergence of official action

of the United States would have nothing to say about the validity of a notice of that tenor written in so many words into the body of the act.

Id. at 362.

316. For a discussion of the importance of legitimacy in the regulatory process, see Krieger, *supra* note 164, at 669.

317. Stephen R. Munzer, *A Theory of Retroactive Legislation*, 61 TEX. L. REV. 425, 430 (1982). For another critique of the reliance and expectations arguments in the context of retroactive legislation, see Kaplow, *supra* note 315, at 522-27.

318. Munzer, *supra* note 317, at 429-35.

319. This rationality/legitimacy model is based on Munzer's study of retroactive legislation. *Id.* at 427-33. Munzer selects these two criteria because of the "strong claim that they characteristically lead to efficient use of the resources of the legal system." *Id.* at 433.

320. *Id.* at 430.

from the declared rule.[321] An expectation is legitimate, Munzer asserts, if both the underlying justification of the law causing it and the fundamental principles of the legal system support it.[322] If an expectation is neither rational nor legitimate, he concludes, there is no sound policy basis for a mechanical application of a retroactivity rule.[323]

When Munzer's model is applied to the ratemaking setting, the rule prohibiting retroactive ratemaking becomes a flexible tool for regulation. Under this formulation, courts should not invoke the rule to protect mere claims that a particular party relied on prior commission-approved rates. Rather, the court should consider whether the claimant reasonably predicted that those rates would remain fixed until the adoption of new prospective rates and that the prediction remained valid over time. Further, it should examine whether the claimant's expectations were legitimately based on the justification for the rates set forth in the prior rate order. Finally, it should assess whether fundamental principles of the legal system supported the reliance.

In fact, some courts have adopted this type of analysis in applying the retroactivity rule. In *Richmond v. Public Service Commission*,[324] for example, during the pendency of a utility's rate case, the Federal Power Commission (FPC) conditionally approved a rate increase for the utility's supplier, potentially subject to refund. In its final rate decision, the commission noted the FPC proceeding and, with the consent of the utility, provided for the possibility of refunds to ratepayers if the utility received one from its supplier. The utility did receive a refund, and the commission authorized a rebate to the utility's customers.[325] The utility challenged this order as retroactive ratemaking.[326] The court rejected this argument because the utility did not have a reasonable and legitimate expectation to retain its suppliers' refund. It noted that at the time of the commission's rate order, the utility knew it would have to pay a refund to its customers if it received one from its suppliers. Further, it noted that the utility itself had suggested a refund provision in the order during the commission proceedings. Although the court held that this conduct did not legally estop the utility from raising a retroactivity claim, it questioned the ethics of its behavior. Based on this analysis, it found that the utility could not claim reliance on the finality of the com-

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321. *Id.* at 431-32.

322. *Id.* at 432-33.

323. *Id.* at 433.

324. 406 N.E.2d 1269 (Ind. Ct. App. 1980); *see also* Narragansett Elec. Co. v. Burke, 415 A.2d 177, 179 (R.I. 1980) (finding exception to retroactivity rule when a utility sought to recover past extraordinary losses caused by a severe storm because customers have an expectation that service will be restored promptly when an unexpected storm occurs); *cf.* South Cent. Bell Tel. Co. v. Tennessee Pub. Serv. Comm'n, 675 S.W.2d 718, 720 (Tenn. Ct. App. 1984) (finding that a conditional rate order allowing for later refunds constituted retroactive ratemaking but refusing to reverse commission refund order because utility had consented to rate order).

325. *Richmond*, 406 N.E.2d at 1271-74.

326. *Id.* at 1275.

mission's rate order.[327]

E. Economic Efficiency

The final basis for the rule against retroactive ratemaking is the rule's purported incentive to efficiency. This basis rests on the premise that the rule places upon the utility the risk that in fixing rates the commission erred in estimating expenses and revenues. If the estimated revenues are too high or the estimated costs too low, the utility will suffer the loss and will not recover its allowed rate of return. If, on the other hand, the estimated revenues are lower than those that the utility actually collects or the estimated costs are higher than actual costs, the utility will receive more than its allowed return. Thus, the argument goes, the rule against retroactive ratemaking encourages efficiency because the utility will endeavor to increase profits under the approved rate.[328] If the utility knows that it can recoup past losses retroactively or that ratepayers can obtain refunds of excess profits, it will have little or no incentive to operate efficiently.

As with the reliance rationale for the rule, this basis has some validity. Certainly a procedure that required a utility to set aside amounts earned over its allowed return in a reserve account as an offset for the next general rate increase[329] would create a disincentive for the utility to earn over this return. Likewise, an adjustment clause which allowed a utility to change its rates automatically each month to reflect its failure to earn its allowed return would not encourage utility efficiency.

In the context of modern public utility regulation, however, the significance of this basis for the rule is questionable. Given the widespread acceptance of energy cost adjustment clauses, interim rate increases, and other conditional rate mechanisms that allow utilities to receive automatic relief for increased expenses, it is hard to say that the policy to place the risk incentive on the utility is always a primary goal of the rate-setting process. In approving these procedures, commissions and courts have identified a number of other policies that they consider paramount, such as the financial stability of the utility or the efficiency of the regula-

327. *Id.* at 1274-75.

328. Southern Cal. Edison Co. v. Public Util. Comm'n, 576 P.2d 945, 958 (Cal. 1978) (Clark, J., dissenting); *see also* De Alessi, *supra* note 35. De Alessi defines "retroactive ratemaking" in the very narrow sense of "the authority of a public utility commission to review a utility's rate structure and to reduce a utility's prices retroactively to the date the rate proceedings began." *Id.* at 434 n.3. Without considering the possibility of retroactive rate increases, he argues that the possibility of retroactive rate reductions would decrease utility efficiency because it would result in increased capital expenditures, less technological innovation and product improvement, and reduced incentives to establish cost-related price structures. *Id.* at 439-43. In addition, he asserts that allowance of such reductions would have numerous adverse effects: more interim price changes; higher costs of ratemaking proceedings; increased uncertainty; depletion of capital during inflationary periods; reduction of investors' wealth; the transfer of the risk-bearing function from investors to consumers; and the transfer of the monitoring function from investors to the commission. *Id.* at 443-49.

329. *See* Connecticut Light & Power Co. v. Department of Pub. Util. Control, 516 A.2d 888 (Conn. Super. Ct. 1986).

tory system.[330] No reason exists why courts should ignore countervailing policies when examining other exceptions to the retroactivity rule.

Moreover, retroactive ratemaking does not always create disincentives to efficiency. As the court noted in *Narragansett Electric Co. v. Burke*,[331] for example, a utility does not lose its incentive to operate efficiently if it is allowed to recoup losses caused by an extraordinarily severe storm. Such storms are not part of the normal planning process of the company.[332] Similarly, it is unlikely that a significant disincentive to efficiency would be created if commissions granted refunds when a utility received an extraordinary, and totally unexpected, large gain.[333] The efficiency incentive rationale, therefore, needs to be examined in terms of the economics of the particular transaction involved, the planning processes of the company, and the particular loss or gain experienced by the utility.

Finally, it needs to be recognized that the retroactivity rule can itself create disincentives to some types of efficient conduct. As Kaplow has observed in the context of the policy against retroactive legislation, antiretroactivity rules can decrease incentives for managers to consider the consequences of their conduct:

> [W]hen the government bans a product on the basis of recently completed studies indicating that the product had always been harmful, penalties should also be applied to production prior to the date of the announcement; failure to do so would decrease the incentives for manufacturers to take such risks into account ex ante.[334]

For this reason, he concludes that, from an economic efficiency standpoint, courts should allow the retroactive application of legislation when the justification for a reform suggests that the prior activity was socially undesirable.[335] Likewise, in the public utility context utility managers should not be able to use the rule against retroactive ratemaking to insulate themselves from the consequences of prior undesirable conduct. To take an extreme example, if a commission approved rates based on an unlawful procurement scheme devised by the utility, commissions should not apply the rule to prevent ratepayers from seeking relief for any overpayments.[336] Otherwise, the rule would provide utility managers with an undesirable disincentive to consider the risks of such conduct.

330. *See generally* Krieger, *supra* note 164, at 640-41 n.8.

331. 415 A.2d 177 (R.I. 1980).

332. *Id.* at 179.

333. This would be the case even for refunds for earnings well in excess of rate of return. *See* Narragansett Elec. Co. v. Burke, Nos. 84-73-M.P., 84-232-M.P. & 84-342-M.P. (R.I. Mar. 11, 1986) (LEXIS, RI library, RI file).

334. Kaplow, *supra* note 315, at 551.

335. *Id.*

336. *Cf.* Richter v. Florida Power Corp., 366 So. 2d 798 (Fla. Dist. Ct. App. 1979).

V. NEW FORMULATION OF THE RULE AGAINST RETROACTIVE RATEMAKING

This critique of the bases for the rule prohibiting retroactive ratemaking demonstrates that courts should not apply the rule rigidly. Reliance on the "thereafter" language in most enabling acts misconstrues the broad ratemaking schemes set forth in those statutes. The buzzword formulations that "ratemaking is legislative" and "commission-approved rates create vested rights" ignore the realities of the present regulatory system. Further, although the reliance and economic incentive rationales for the rule have some validity, they certainly do not support strict application of the rule in all contexts.

At the most, this analysis suggests that there should be a rebuttable presumption against retroactive ratemaking, not a complete prohibition. Undoubtedly, the public utility regulatory system can maintain its legitimacy only if parties can reasonably rely on the fact that, in most instances, utility commissions will not alter the prices paid for utility service retrospectively. Moreover, the system will fail to provide proper economic incentives to utilities if commissions regularly allow recoupments of past losses or frequently grant ratepayers recurrent refunds for prior utility gains.

Under our current regulatory system, however, neither of these policies is absolute. As the critique shows, the reliance rationale is relevant only when the party invoking the rule had rational and legitimate expectations that the rates would remain in effect until the commission changed them prospectively.[337] The economic incentive rationale is applicable only if retroactive relief in fact would create disincentives to efficient utility operation.[338] Moreover, the efficiency argument is valid only if the application of the retroactivity rule itself would not create disincentives to efficient and socially desirable conduct.[339] In sum, issues of retroactivity require more than a mechanical appeal to reliance and economic incentive policies but compel an examination of the actual reliance and incentive issues in a particular case.

For these reasons, commissions and courts should apply a presumption against retroactivity but analyze the particular circumstances of the case to determine if the presumption should apply.[340] They should first consider the rationality and legitimacy of the expectations of the parties

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337. *See supra* notes 318-27 and accompanying text.

338. *See supra* note 330 and accompanying text.

339. *See supra* notes 334-36 and accompanying text.

340. If commissions and courts fail to recognize broadened exceptions to the rule against retroactive ratemaking, then state legislatures should address the issue. Recently, Congress has begun to tackle the retroactivity rule in the federal regulatory context. In 1988 Congress passed the Regulatory Fairness Act, Pub. L. No. 100-473, 102 Stat. 2299 (codified as amended in 16 U.S.C. § 824e (1988)). Under the Act, in electric wholesale rate cases initiated on the motion of the Federal Energy Regulatory Commission (FERC) or the complaint of a customer, the FERC, under certain circumstances, can grant refunds for part of the period of the hearings. 16 U.S.C. § 824e(b). The Senate, in its report, noted that the Act was necessary because these cases require two years on an

in regard to previously approved rates. They should then examine the potential effects of retroactive relief on economic incentives for the utility. If it appears that reliance on the prior rates was not rational or legitimate and that a retroactive remedy would not create substantial efficiency disincentives, courts should allow such relief.

A number of examples, based on the decisions discussed in part III, will illustrate the application of such a method. In regard to changes in accounting treatment of previously realized gains or losses, for instance, the proposed methodology supports those decisions that allow for such changes, even if they have a retroactive effect, if the modifications reflect the actual economic reality of the particular transactions. It is hard to argue that a utility or its investors has a rational or legitimate expectation that a commission will maintain its approval of an accounting method that ignores economic reality. Moreover, denial of retroactive relief would create a disincentive for utility managers to develop accounting methods that correctly reflect the economics of the transactions involved.

As to procedural mistakes in commission orders, the proposed method generally would allow retroactive relief. It is difficult to understand how a party could have a rational or legitimate expectation that a court would not rectify clerical error in a commission order. This same kind of analysis also applies to substantive errors if the commission makes the correction shortly after the original order. In the *General Motors Corp. v. Public Service Commission*[341] type situation, for example, where a utility announces the mothballing of a major plant only two months after the rate order, it is hard to identify any legitimate expectation on the part of the utility or its investors that the commission would not alter its order retroactively to take this closing into account. As to the economic incentive policy, the prohibition of retroactive relief would create the undesirable incentive for utilities to withhold disclosure of plant closings before the end of a case.

The proposed methodology also would permit retroactive relief for truly extraordinary gains or losses. As discussed earlier, a legitimate expectation is one supported by the underlying justification of the law inducing it.[342] In the ratemaking process, the parties have a legitimate expectation that the utility will pay for its normal operating expenses, even if they are above those forecasted, and will collect and retain its normal revenues, even if they are below those forecasted. Unusual losses or gains, however, by their very nature have not been recognized in the prior rate proceeding. For this reason, a party cannot legitimately expect that such losses or gains will not be recoverable.[343] As to incentive is-

average, and the FERC previously only had the power to grant prospective relief in those cases. S. REP. No. 491, 100th Cong., 2d Sess. 3-4, *reprinted in* 1988 U.S.C.C.A.N. 2684, 2685.

341. 438 N.W.2d 616 (Mich. Ct. App. 1988); *see supra* notes 104-07 and accompanying text.

342. *See supra* note 322 and accompanying text.

343. This is not to say, however, that extraordinary losses should be recoverable automatically. For example, as to the issue whether a utility can recover costs for a canceled nuclear plant, the

sues, as discussed earlier, because such extraordinary occurrences are not part of the normal planning process, it is doubtful whether retrospective recovery creates efficiency disincentives.[344]

In regard to retroactive relief for the period of the rate proceeding, the proposed analysis indicates that the crucial issue is notice. If, through the entry of an interim order, the commission has given proper notice to both the utility and ratepayers that certain funds may be subject to retroactive recovery, the parties have no rational expectation that such relief is prohibited. Likewise, in the energy cost adjustment clause area, when the clause itself, or a commission rule, clearly sets forth the formula for adjusting costs and provides for periodic reconciliation proceedings, the utility and ratepayers have a rational and legitimate expectation that the commission may modify rates retroactively. In regard to the efficiency incentive policy, the commission will have to determine in each case the importance of that policy when balanced against the need for prompt rate relief.[345]

Finally, as to judicial review, the proposed method supports the granting of retroactive relief for the entire appeal and remand period after the reversal of a rate order. When a rate order is appealed, the rational and legitimate expectation of the parties should be that the court may reverse those rates on review. A rate order in fact is not final until after the entire review process. Moreover, given the fixed periods of appeal and remand, it is difficult to perceive any negative economic incentives created by such an approach. In fact, the contrary position—prohibiting retroactive relief during appeals—gives appellees the incentive to delay the review process.[346]

VI. Conclusion

Over forty years ago, one commentator, in a review of cases applying the rule against retroactive ratemaking, observed:

> In an era when mechanical jurisprudence is moribund, if not dead, in most branches of the law, and especially in the domain of public law where economic and social facts are rarely constant, it has come as something of a shock to many to learn that the inelastic method of deciding cases is in vogue today in such an ever-important field as public utilities.[347]

Since that time, most courts have continued, at least rhetorically, to

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commission must consider the reasonableness of the utility's planning process and the expenses incurred.

344. *See supra* notes 318-27 and accompanying text. If, however, a commission allows a utility to recover such extraordinary losses, it should adjust the utility's allowed rate of return to recognize the decreased risk it faces in the ratemaking process.

345. *See generally* Warren, *supra* note 271.

346. *See* Mountain States Tel. & Tel. Co. v. Arizona Corp. Comm'n, 604 P.2d 1144, 1146 (Ariz. Ct. App. 1979).

347. Hardman, *Administrative Finality*, *supra* note 36, at 78.

maintain their rigid acceptance of the rule. In almost every discussion of retroactivity issues, courts regularly chant a familiar litany: "ratemaking is legislative and accordingly must be prospective in nature"; "retroactive ratemaking would unjustly affect vested rights"; "the rule is necessary to provide stability to the regulatory system." As this article has shown, however, in many instances these very same courts either ignore the literal terms of the rule in particular cases or create ad hoc exceptions to it.

Judicial applications of the rule have become contradictory, and at times inconsistent within the same jurisdiction. In almost all of the contexts in which courts have addressed the rule in the past three decades—changes in commission accounting treatment; corrections of mistakes in commission orders; extraordinary losses and gains; interim rate relief; energy cost adjustment clauses; judicial review—different courts have adopted varying interpretations of the doctrine. Faced with the reality of the current regulatory system, some courts, while maintaining verbal allegiance to the retroactivity rule, attempt to distinguish it away for a particular set of circumstances; other courts, examining the very same situation, continue to apply the rule inflexibly. As a result, courts have given parties and their attorneys little real guidance as to the general applicability of the rule. Litigants themselves (depending upon their interests in the case) either urge the rigid application of the rule or attempt to devise their own ad hoc exceptions to it.

To address these problems, I have presented in this article a new formulation of the prohibition against retroactive ratemaking. Under this formulation, there is only a presumption against retroactivity. When faced with a retroactivity claim, the commission must determine whether the claimant had a rational and legitimate reliance interest in the prior rate. Further, it must examine whether retroactive operation of rates would create efficiency incentives or disincentives to the utility. Under this proposed method, therefore, the commission would engage in the same kind of analysis it undertakes in numerous other areas—from determining the different terms of the revenue requirement formula to devising a rate design. Because it requires some balancing, this proposal will not result in the same kind of ratemaking certainty purported to be created by the current rule. But in the present regulatory system with the often inconsistent and erratic applications of the rule, this alleged virtue of the rule is illusory. The proposed formulation, by providing an overall framework for addressing retroactivity issues, itself has the potential for providing some guidance and stability to the regulation of public utilities.