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Service Charge in Rate Making

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The regulation and control of public utilities has become one of the most important functions of government. Each year witnesses marked extension of the uses of public utility products and a consequently greater dependence of the public upon the service of these important agencies. The public utility affects the entire community of the territory in which it operates and the operation thus becomes a matter of public consequence. In dedicating private property to a public use, the owner is deemed to have granted to the public an interest in that use. Public regulation and control necessarily follow as a protection to the interest so granted.

The duty of the public utility is to provide reasonable service at fair rates and without unreasonable discrimination. The law has long recognized the need of proper classification of customers, based upon the manner of use of utility products. This has been specially true of the electric industry. The amount of current used, the time of its use and the regularity of such use have been considered important in the matter of rate making.

The history of the gas business has been less fortunate. A flat rate per thousand cubic feet of gas has been accepted as fair by both the public and the utilities for so many years that recent efforts to determine gas rates with some regard to facts long accepted in electric rate-making has met with much resisance. Students of rate making agree that there are certain elements of expense which are practically the same for each customer without regard to the amount of the utility product used. The expenses of reading and maintenance of meters, bookkeeping, billing, collecting and other office expenses and, also, fixed charges on a portion of the investment of the company are included in the item of "customer's costs". A further classification of "demand costs," which vary according to the maximum hourly or twenty-four hour use of gas, carry almost all of the company's fixed charges not allocated as customer's cost. Then follows the actual commodity costs which include fuel, oil, labor, supplies and expense items.
which vary directly with the amount of the gas or electricity produced.

The Public Utility Commissioners of all the states have been requested from time to time to approve so-called two-part or three-part rates for gas. The effort to eliminate old schedules, with a stated charge for each measured unit, regardless of the requirements or consumption of a particular customer, has met with much opposition, but the newer form of rate schedules are becoming more prevalent.

The introduction of two-part rate schedules consisting first of a service charge which assumes to cover the customer cost and, possibly, some part of the fixed charge of the company and a commodity charge which varies with the product consumed or used by each individual customer marks an important step in utility development.

The experience of the Niagara Falls Gas & Electric Light Company of Niagara Falls, New York, is typical of the evils of rates based solely upon a fixed charge per measured unit. Prior to 1912, this company's flat rate for gas was $1.30 per thousand. At this rate the company was unable to meet its bond interest. In 1912 the rate was increased to $1.55 per thousand cubic feet. In 1917 the rate was increased to $1.87 per thousand cubic feet. In 1921 to $2.30 and in 1924 to $2.45. These increases were granted by the Public Service Commission of the State of New York. In each application for rates during said period, the petitioning company had asked for a service charge rate rather than a horizontal advance of the old rate schedule. Each increase allowed by the Commission resulted in a curtailment of gas sale, an increase in the number of customers sold at a loss and an increased deficit to the company.

Upon the issuance of the last horizontal increase, the U. S. Light & Heat Corporation brought its suit in equity in the District Court of the United States for the Western District of New York against the Gas Company, the City of Niagara Falls, and the said Public Service Commission as defendants. An individual consumer intervened as party plaintiff, and plaintiff sought to enjoin the Gas Company from obeying the orders of the Commission, and to restrain the company from complying with Chapter 898 of the Laws of 1923 of the State of New York, and en-
joining the Public Service Commission from enforcing such Chapter 898. Section 6 of said Chapter 898 Acts 1923 expressly prohibited a service charge in gas rates.

The report of the Special Master appointed to take testimony and report to the court in this case, contains the following language:

"It is claimed by the Plaintiff and defendant Gas Company that the right to furnish gas at a reasonable and fair price on the part of the defendant Gas Company, and the right to purchase gas at a fair and reasonable price on the part of the plaintiff, is each a property right. It is also claimed by the plaintiff and the defendant Gas Company that without a service charge in its rate structure the defendant Gas Company cannot furnish gas to the plaintiff, or any consumer at a fair and reasonable price. That without a service charge in its structure any rate that might be fixed by the Public Service Commission would be inadequate to bring the defendant Gas Company a fair return upon its capital invested, or to pay the expenses of operation and is therefore confiscatory. It is also claimed by both the plaintiff and defendant Gas Company that with a statute precluding a service charge a large proportion of the consumers are forced to pay a sum in excess of the value of the service rendered to them in gas supplied, and that a large percentage of its consumers receive the service and gas under cost to the defendant Gas Company and that therefore a rate structure without a service charge is unconstitutional in that it fails to give the consumers equal protection of law.

"Hamann is a consumer of the gas manufactured and distributed by the defendant Gas Company. He claims that the price of gas at the rates fixed by the Public Service Commission was so excessive when adapted to his purposes as a householder that he has been forced to cut down his volume of consumption, and to substitute other heating agencies which are not as efficient. That by reason of the meter rate in force he has been obliged to pay materially in excess of the reasonable value of the service received by him, due to the fact that the rate was arbitrarily loaded for the purpose of requiring him and all other consumers similarly situated, i.e.
whose consumption was sufficient to return a profit to the Gas Company, to pay toward or make up the deficit caused by those consumers whose consumption was so small that a deficit as to them resulted, and that by reason thereof his property was taken without reasonable compensation, and without due process of law, and that he was denied the equal protection of the laws, all in violation of his Constitutional rights."

The report continues—"It clearly appears from the testimony that when a Gas Company is operating under a meter rate, a large percentage of the company's consumers do not take enough service or pay enough money to reimburse the company for those services which the company renders to all customers. * * * * * It also appears that under the meter rate system there is another class of customers who pay the Gas Company enough money and take enough service to reimburse the company for the service but not enough to fully reimburse the company for more services and the other outlay that the company makes for those customers, and pay the company a fair return upon the investment."

The evidence submitted to the Special Master showed that under flat rates, 38% of all the customers of gas companies in the United States do not pay to the company sufficient money to reimburse the company for the cost of service to such customers. An additional 31% do not pay into the company enough money to reimburse the company for the cost of service, its fixed charges and a fair return upon the company investment. The remaining customers are compelled, therefore, to pay their own proportion of the operation and investment cost with fair return, but also to carry the deficit arising from the discriminatory flat rate.

Upon the recommendation of the Special Master the court (Judge Hazel) found for the plaintiff; finding specifically that the statutory inhibition against a service charge (Chapter 898 New York Laws of 1923) is an arbitrary attempt to exercise police power and is illegal and void because in contradiction of Article 1, Section 10, Sub-division 1 of the Federal Constitution and the Fourteenth Amendment thereto.

The development of the electric industry has been more pronounced than that of the gas business, due, largely, to the fact that electric rate making has always recognized a specific demand
charge and through more or less scientific allocation of all costs has enabled electric companies to successfully compete with other forms of energy.

The application of a service charge in a gas rate schedule results not only in a less discriminatory rate as between users, but enables an operating company to so reduce its commodity rates as to increase its sales, which condition in turn occasions further reduction in rates to all.

The gas history of two Indiana cities of approximately the same population fairly explains the merits of the two-part rate. At the end of the war, each city had a gas rate of $1.55 per thousand cubic feet. There were lower steps based upon large consumption, but the schedule affecting all but industrial users was, as to each city, the flat rate above stated. The company operating in these cities proposed an optional two-part rate consisting of $1.00 per month service charge and $1.00 per thousand cubic feet of gas. One of said cities accepted the new optional schedule. The other insisted upon a horizontal reduction of rates, and its gas rate was reduced to $1.45 per thousand cubic feet of gas—a flat rate. After about three years of operation under the new rates, it was observed that under the two-part rate the business of the company showed an increase of more than 15% in the amount of gas sold, and that the average rate of gas sold had approximated $1.32 per thousand.

In the city operating under the flat rate of $1.45 per thousand cubic feet of gas, the business of the company showed practically no growth and the average rate for gas was about 13 cents per thousand more than was collected in the city of the service charge rate.

This comparison of the results of operation explains the recent activity of gas companies to sell the idea of a two-part or three-part rate to the public and to the Commissions. Through the lower commodity rates, resulting from this form of schedule, the gas industry may more fully enter the competitive field as against other heating agencies. Due largely to the advantages of these newer forms of gas rate schedules, the gas business has “come back,” is sure of its future in a sense not anticipated ten or fifteen years ago.