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THE HAWAII PUBLIC UTILITIES COMMISSION

by  
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**STATE OF HAWAII**

## PREFACE

The regulation of privately-owned public utilities by government is a process which produces questions, problems, and controversies. A private company exists, among other reasons, to earn money for its owners. The interests of those owners, therefore, are not always identical with those of the persons who purchase a company's products. A utility is a very special kind of company which operates under conditions of monopoly or controlled competition. The regulating effect of the market mechanism, which provides the consumer with some protection in his dealings with most businesses, is not available in the utility field. The government must serve, in the absence of the market, as the regulator.

The regulatory commission has evolved, in both state and federal governments, as the agency responsible for regulating privately-owned public utilities. Its task is not an easy one, for the competition of interests among investors, customers, the public, and others is very real, and few useful definitive standards exist which may be applied with ease. The imposition of arbitrary controls would be simple. If, however, care and conscience are to be exercised in determining what is the public interest and how it may best be protected, the task of regulating becomes a difficult and frequently thankless undertaking. Those with a particular stake in the process will often think that their interests have been inadequately considered.

This report is concerned with the regulation of public utilities in Hawaii by the Hawaii Public Utilities Commission and the methods employed by the Commission in identifying and protecting the public interest. Improvements in the regulatory organization and process will not reduce the amount of conflict accompanying regulation, but they should result in more adequate protection of the public in a field in which the State is the principal defender of the public interest.

The report has been prepared by the Legislative Reference Bureau, State of Hawaii, at the request of the House Committee on Public Utilities of the First State Legislature. The valuable assistance provided to the Bureau by the Hawaii Public Utilities Commission, and particularly by Mr. Jack E. Conley, Director, Mr. Alvin E. Pierce, Chief Engineer, and Mr. William H. Wright, Chief Auditor, is gratefully acknowledged. Tom Dinell of the Bureau's staff conducted the study and wrote the report.

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## I. THE NATURE OF PUBLIC UTILITIES AND PUBLIC UTILITY REGULATION

Regulation of business is the result of conscious and deliberate decisions of legislative bodies that certain businesses must be regulated because they are "affected with a public interest" to such a degree that excesses which are inimicable to that interest must be avoided. Whether a business should be regulated or not is, in large measure, a matter of judgment as are the questions of how much it should be regulated and in what manner. The courts assume responsibility for reviewing the reasonableness of legislative decisions on these questions.

Regulation of business is not automatic, but one group of businesses which is constantly subjected to regulation when privately-owned, is the public utilities. When public utilities are government-owned and operated as in Europe or as in the United States with respect to water supply agencies, the problems associated with regulation of privately-owned utilities do not arise since ultimately the decisions as to rates and related matters are political. When utilities are privately-owned, however, it becomes necessary to resolve what may be the conflicting interests, at least in the short-run, among the public, investors, and consumers. This report is concerned with the problems encountered and processes employed in the resolution of such conflicting interests.

### The Nature of Public Utilities

It is far less complicated to prepare a list of public utilities

than to identify and describe the characteristics which differentiate them from other types of enterprises, but even the process of enumeration is not simple. Most lists of public utilities, however, would include enterprises which: (1) produce and distribute energy such as electricity and gas; (2) facilitate communications using telephone and telegraph lines; (3) provide for transportation of persons and goods by offering common carrier services on railroads, highways, streets, waterways, and in the air; and (4) furnish water and provide for the disposal of waste. This list might easily be expanded, depending upon one's definition of a public utility, to include transportation of oil and gas through pipelines and the transmission of radio and television programs. Furthermore other types of enterprises, such as grain storage, fire insurance underwriting, and milk production and distribution, have been termed public utilities. It may be maintained that all businesses which are government operated or regulated are, at least to some extent, public utilities, but such a definition so broadens the scope of the term as to limit its usefulness.

It is difficult, as noted earlier, to establish objective criteria which may be used in distinguishing public utilities from other types of enterprises. It has been said that public utilities are "affected with a public interest." This is true, but many businesses including banking and newspaper publishing are affected with this same interest. Public utilities are sometimes described as being natural monopolies, and while this is true of public utilities concerned with the production and transmission of energy or the transmission or facilitation of communications or the provision of water or sewage disposal services, it is not true of the common carriers which transport goods and people. Furthermore there are



many enterprises which are not public utilities which appear to occupy monopolistic or near-monopolistic positions in the production and distribution of certain materials or goods. Public utilities are often identified by the fact that they have been granted franchises and certificates of convenience and necessity by governments which non-utility corporations have not received, and that they have received special privileges such as the power of eminent domain, the right to use public rights-of-way, and the privilege of exclusively occupying a market, privileges which are not granted to non-utilities. All this is true, but this becomes circuitous reasoning when one claims that since an enterprise has been granted privileges which are only granted to public utilities, it must be a public utility.

Perhaps it is more useful to list the characteristics which a public utility may possess, recognizing that all utilities do not possess all these characteristics and that non-utilities often possess some of them. First, the nature of most public utility operations, and particularly the necessity for an expensive network of transmission lines and the requirement for providing continuous service, makes monopolization or at least limited and controlled competition more efficient than unregulated competition. Second, public utility businesses generally require large capital investments partly because they have to provide either plant or reservoir capacity to serve maximum demand. Third, public utilities usually provide necessary services or commodities for which there is an urgent and generally constant demand. Fourth, public utilities serve a large number of customers directly, most of whom have no alternative but to deal with the utility and few of whom would be in a position to bargain with a

utility company on anything approaching equal terms.

When an enterprise possesses all or some of these characteristics, a legislative body may determine that it is desirable to regulate this enterprise and courts may agree that such regulation is a legitimate exercise of the police power of the state or of the interstate and foreign commerce powers of the federal government. This regulation takes the form of imposing a complex of rights and duties on the public utility company. The utility assumes the duties of: (1) serving without discrimination all who desire its services; (2) providing adequate, safe, and continuous service at rates set by a governmental regulatory body; and (3) not abandoning its service or any portion thereof without permission. The utility, in return for assuming these obligations, enjoys the right to: (1) provide a particular service in a designated area in which it has no competition or in which competition is regulated; (2) charge rates which are designated to provide an adequate return on invested capital; and (3) use public rights-of-way and exercise the power of eminent domain if the conduct of its business so requires.

#### The Growth of Regulation

Only a few of the types of public utilities which exist today were known prior to the industrial revolution. Those that did, such as the water viaduct system in Rome, were frequently state-owned. The matter of regulation did not arise until utilities became both common and privately-owned. The concept that certain private businesses are affected with a public interest, however, and therefore may be regulated, has its antecedent in medieval times when on occasion "just" prices were set rather than

permitting sellers to charge all that the traffic would bear; in fourteenth and fifteenth century England when persons engaged in common callings (i.e. innkeeping, ferrying, barbering) that dealt with the public thereby assumed legal obligations, especially that of serving all who desired service; and in the era of mercantilism when certain trading companies were granted franchises or charters giving them exclusive rights to develop and exploit designated colonial areas.

The prevailing economic philosophy in England and the United States during the early nineteenth century was based on the assumption that free competition would promote the satisfaction of individual and public needs. It was during this same period that the processes of production were being transferred from the consumer to private enterprise and from the local tradesmen to the centralized company. A greater number of people became increasingly dependent on the operation of certain private businesses for services and commodities which were becoming essential in their daily lives.

Various approaches to consumer protection were tried in different states at different times during the years prior to the establishment of regulatory commissions. A consumer who believed he had not received reasonable service at reasonable rates could take his case to the courts, but this procedure was never particularly effective since such proceedings were expensive, the courts were ill-equipped to discharge the function, and the solution was always corrective rather than preventive. The first major legislative attempt to regulate utilities was through the granting of special charters which included some restrictive clauses. The charters, especially the early ones, were generally not well-drawn; they

failed to provide for continuing administration and were enforceable only in the courts. The next recourse was to general incorporation laws, which provided for uniformity, but they did not provide for continuing regulatory administration. Finally, legislatures themselves set rates.

There were some railroad commissions in the United States prior to the Civil War, but they served as advisors to state legislatures. The first state railroad commission with mandatory power to prescribe rates was established in Illinois in 1874, in large part as a result of the efforts of the Granger movement. Other states in the middle West and elsewhere soon established such commissions. While many of the mandatory commissions were not very successful in achieving their objectives, they nevertheless served as the pattern for later commissions and utility regulations, both state and federal. The federal government entered the field of railroad regulation 1887 with the establishment of the Interstate Commerce Commission.

Beginning in the early 1900's, and led by New York and Wisconsin, states began to establish new commissions with broader powers or to extend the powers of existing railroad commissions in order that public utilities other than railroads might be regulated. By 1913 half the states had general public service or utility commissions while today every state has one or more such regulatory agencies. The jurisdiction and responsibilities of such commissions have been increased and their procedures modified during the past half century, but the basic concept remains the

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same, namely; regulation of those enterprises considered by the legislature to be public utilities is a task for an independent commission.

#### Regulation and the U. S. Supreme Court

The Supreme Court declared in 1877 that a business could be so affected with a public interest as to be a proper subject of regulation.

When ... one devotes his property to a use in which the public has an interest, he, in effect, grants to the public an interest in that use, and must submit to be controlled by the public for the common good to the extent of the interest he has thus created. He may withdraw his grant by discontinuing the use; but, so long as he maintains the use, he must submit to control.<sup>1</sup>

Thus, the operation of the grain storage business in Chicago, which was subject to central control and pricing, was determined to be such a use. Railroads were declared to be "affected with the public interest" in a decision also rendered in 1877.<sup>2</sup>

Subsequent decisions extended this basic utility concept to other businesses. In an 1894 decision, the Court confirmed that a legislature has wide discretion in determining what businesses constitute public utilities.<sup>3</sup> Except for the period from 1920 until the middle thirties, the Court has tended to support this recognition of legislative prerogative.

The courts, in addition to defining what may be regulated, have

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<sup>1</sup>Chief Justice Waite in *Munn v. Illinois*, 94 U. S. 113 (1877).

<sup>2</sup>*Chicago, Burlington and Quincy R. R. Co. v. Iowa*, 94 U. S. 155 (1877).

<sup>3</sup>*Brass v. North Dakota*, 153 U. S. 391 (1894).

from time to time assumed responsibility for defining how the regulatory power should be exercised. This has been most obvious in the field of rate regulation, the first and most critical aspect of utility operations which states undertook to regulate. In the Munn case the Supreme Court implied that rates set by a legislature would not be subject to judicial review.<sup>4</sup> In later cases the Court opened the way for judicial review and finally in one case nullified the rates set by the Texas railroad commission.<sup>5</sup> In 1898 in Smyth v. Ames the Court listed the factors which should be considered in setting rates.<sup>6</sup> The decision did not specify a particular formula, but it later came to be interpreted as the fair-value rule.

Commissions initially favored original cost in determining the fair value of the rate base but in time reproduction cost became a dominant element in rate cases. The Court in 1926 resolved these differences by recognizing that reproduction costs were to be the primary basis used in determining fair value.<sup>7</sup> The Court went to great length to define fair value and to specify precise methods which were to be followed in determining that value. In subsequent cases the Court appeared to depart from this decision. Finally in 1944, in the Hope case, the Court discarded both previously set standards as to value and set courses of procedure to be used in ascertaining value.<sup>8</sup>

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<sup>4</sup>Munn v. Illinois, 94 U. S. 113 (1877).

<sup>5</sup>Reagan v. Farmers' Loan and Trust Company, 154 U. S. 362 (1894).

<sup>6</sup>Smyth v. Ames, 169 U. S. 466 (1898).

<sup>7</sup>McCardle v. Indianapolis Water Company, 272 U. S. 400 (1926).

<sup>8</sup>Federal Power Commission v. Hope Natural Gas Co., 320 U. S. 591 (1944).

The validity of rates is still subject to judicial review, but the courts no longer dictate the standards regulators must use and the techniques they must follow. Jurisdiction over these matters has been returned to the legislatures.

#### The Scope of Regulation Today

The jurisdiction of state regulatory commissions has increased in terms of the number and types of utilities regulated, the depth of control exercised in setting rates, and the phases of utility operations which are controlled. Today it is common for state regulatory commissions to have jurisdiction over electric, gas, telephone, railroad, bus, trucking, public transit, airline, water carrier, water supply, and sewage disposal companies. A commission will have broad jurisdiction over some classes of companies while it may have only limited jurisdiction over others. In regulating a public utility's earnings and expenses, a commission will frequently prescribe a uniform accounting system, establish depreciation rates, determine the value of the utility's property, decide the proper rate of return, rule as to the legitimacy of specific expenditures, establish the rate structure, and approve tariff regulations. Commissions commonly have jurisdiction over the capital structure of utilities; their approval is often a necessary prerequisite to the issuing of new stocks or bonds or to the refunding of existing debt. Similar jurisdiction exists with respect to corporate structure, the commission reviewing and approving any proposed reorganization, merger, or separation. Commissions also are commonly assigned responsibility with respect to: (1) the level and adequacy of services provided

by the utilities under their jurisdiction; (2) the safety of utility operations; (3) the issuance of certificates to companies desiring to enter a regulated field or approval of the surrender of such a certificate or of the suspension or termination of operations by such a company; and (4) the insuring of adequate planning for future growth by the utilities.



## II. PUBLIC UTILITIES AND REGULATORY JURISDICTION AND AUTHORITY IN HAWAII

A public utility, as defined in Hawaii law, means any person who owns, controls, operates or manages plant and equipment which are utilized directly or indirectly for public use in: (1) transportation of passengers or freight; (2) conveyance or transmission of telephone or telegraph messages, or the furnishing of facilities for the transmission of intelligence by electricity; (3) the production, transmission, and delivery of light, power, heat, water, gas, or oil; and (4) the storage or warehousing of goods.<sup>1</sup> Excluded are: (1) taxi and point-to-point cabs; (2) water carriers engaged in contract business; (3) common carriers transporting freight over the highways except between inadequately served points or along inadequately served routes; (4) warehousing businesses unless the public utilities commission finds regulation to be necessary in the public interest; (5) utilities owned by the state or the counties; and (6) utilities in interstate and foreign commerce except as the United States permits such regulation.

### Public Utilities Operating in Hawaii

Most of the commonly accepted public utilities operate in Hawaii, most of them are subject to the jurisdiction of the public utilities commission, and most of them possess franchises, charters, or certificates of public convenience and necessity granted or issued by the State.

The main differences between utilities in the Islands and in the Mainland are in the transportation field. Hawaii has no passenger railroad service, but it does support the two very large intrastate airlines.

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<sup>1</sup>Section 104-1, Revised Laws of Hawaii 1955, as amended.

Current Utility Operations. Hawaii has two classes of utilities concerned with the transmission of energy--electric and gas. There are seven electric utility companies and one gas company. Electricity is available in all populated localities and gas in pipelines is available in some areas of Oahu, Hawaii, and Maui. There are a number of utilities providing communication services including a telephone company and several telegraph or cable companies; and, if one considers them as public utilities, a number of radio and television stations. In the transportation field, Hawaii is served by two intrastate airlines, four bus transit lines, two railroads which provide limited service to waterfront areas, one intrastate water carrier, many freight and household goods trucking firms, and a large number of taxi and point-to-point cab operators. Most domestic water is supplied by municipal water utilities, but there are also three privately owned water companies (and a fourth to be added soon). Sewage disposal is also almost exclusively a governmental operation except in a few subdivisions, but more private sewage disposal systems are expected in the future. Irrigation has not been considered a public utility in Hawaii, though irrigation facilities are operated by both private companies and the government.

#### Legal Authority for Public Utility Company Operations

Public utility companies usually must possess a charter, a franchise, or a certificate granted or issued by a government having jurisdiction over the area in which they desire to operate before they may provide service to the public.<sup>2</sup> Franchises are privileges which a government chooses to grant

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<sup>2</sup>For a more detailed discussion of franchises and licenses, especially Hawaiian franchises, please see: State of Hawaii, Attorney General, Public Utility Franchises (Honolulu, 1961) and copy of memorandum from Herman Doi, special deputy attorney general to Shiro Kashiwa, attorney general, which is included in the publication.

to private individuals or corporations and are subject to the conditions and limitations which the granting government may impose. Governmental licenses, on the other hand, are temporary permits issued by an administrative agency pursuant to the police power of the state to permit an individual or corporation to do what otherwise would not be legal. It is not an exclusive privilege. A certificate of public convenience and necessity may be a limited franchise or a license.

Franchises, Charters, and Certificates of Hawaii's Public Utilities.

All of Hawaii's electric utility companies and its gas company operate under franchises granted by the legislatures of the Republic and the Territory and ratified by Congress, as is indicated in Table 1. Honolulu Rapid Transit received its first franchise from the Territory of Hawaii while Hawaiian Telephone, Oahu Railway and Land Company, and Kahului Railroad received their initial charter from the Kingdom. Certificates of public convenience and necessity have been issued by the public utilities commission to several companies which provide bus transportation services and around-the-island tours on Oahu. Although airlines and water companies are defined as public utilities in section 104-1, Revised Laws of Hawaii 1955, they operate without state franchises or certificates.

Taxi and point-to-point operators are issued permits by their respective county governments. Common carrier truck operators at present are not certified by the State though legislation is pending which would make them subject to such regulation. Water companies are subject to regulation

Table 1

LEGAL AUTHORITY FOR VARIOUS PUBLIC UTILITY COMPANIES OPERATING  
IN THE STATE OF HAWAII  
1961

<u>Utility Companies</u>	<u>Source of Authority</u>			
	Charter- Kingdom of Hawaii	Franchise- Legislature of Republic or Territory	Certificate of Public Convenience and Necessity-Public Utilities Commission	Referred to in Statutes only
<u>Electric</u>				
Hana Light and Power		x		
Hawaiian Electric		x		
Hilo Electric		x		
Kauai Electric		x		
Lahaina Light & Power		x		
Maui Electric		x		
Molokai Electric		x		
<u>Gas</u>				
Honolulu Gas				
Hilo Division		x		
Honolulu Division		x		
Isle Gas		(a)		
<u>Telephone</u>				
Hawaiian Telephone	x			
<u>Motor Carriers</u>				
Gray Line - Around-the-Island Tour			x	
Honolulu Rapid Transit				
Metropolitan		x		
Around-the-Island Tour			x	
Kaneohe Transportation			x	
Leeward Bus (Leeward & Windward)			x	
Tradewind - Around-the-Island Tour			x	
Wahiawa Transport System			x	
<u>Railroads</u>				
Kahului Railroad	x			
Oahu Railway & Land	x			
<u>Airlines</u>				
Aloha				x
Hawaiian				x
<u>Water</u>				
East Kauai				x
Kohala Ditch				x
Waianae Development				x

Source: Public Utilities Commission.

<sup>a</sup> Pipeline operations on Maui considered to be authorized under the Honolulu and Hilo division franchises.

but are not required to possess a franchise or certificate. Telegraph or cable companies are interstate operators not licensed or franchised by the State. Similarly, radio and television stations do not receive their basic license from the state government.

Effect of Statehood on Franchises. Some question has arisen as to whether the franchises granted prior to Hawaii becoming a State and ratified by the United States are still valid. The state constitution provides that laws approved or ratified by Congress should continue in effect until altered or repealed by the State, but the Admission Act provides that territorial laws enacted by Congress shall expire August 21, 1961. A special deputy attorney general has concluded that franchises granted by the legislature of the Territory or Republic qualify as "territorial laws enacted by Congress" and therefore will expire August 21, 1961, unless the state legislature acts sooner; that these franchises are not federal franchises; and that "the legislature should act so that the conflict between the provisions of the Constitution and the Admission Act may be resolved".<sup>3</sup>

#### Jurisdiction of the Public Utilities Commission

The commission has comprehensive jurisdiction over the operations of some classes of utilities and limited jurisdiction over others. The extent of its jurisdiction by type of utility is summarized in Table 2. It has jurisdiction with respect to rates, service, accounts, and securities of the electric, gas, and telephone utilities, but it has no control over telegraph companies or radio or television stations all of which are federally regulated. Interstate and foreign telephone and telegraph service

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<sup>3</sup>Ibid.

Table 2

REGULATION OF PUBLIC UTILITY OPERATIONS BY THE HAWAII PUBLIC  
UTILITIES COMMISSION AND FEDERAL AGENCIES  
STATE OF HAWAII  
1961

Type of Utility	<u>Hawaii Public Utility Commission</u>				Federal Agency
	<u>Rates</u>	<u>Service</u>	<u>Securities</u>	<u>Accounts</u>	
<u>Energy</u>					
Electric	x	x	x	x	
Gas	x	x	x	x	
<u>Communications</u>					
Telephone	x	x	x	x	FCC <sup>a</sup>
Telegraph					FCC <sup>a</sup>
<u>Transportation</u>					
Metropolitan Transit	x	x	x	x	
Rural Transit	x	x	x	x	
Around-the-Island Tours	x	x		x	
Railroads			x		ICC
Airlines			x		CAB, FAA
Water Carriers			x		FMB
Household Goods Movers					ICC
Freight Motor Carriers					
<u>Water and Sewage</u>					
Water	x	x	x	x	
Sewage					
Irrigation					

Source: Public Utilities Commission.

<sup>a</sup>Interstate and foreign communications only.

Federal agency abbreviations:

FCC = Federal Communications Commission  
ICC = Interstate Commerce Commission  
CAB = Civil Aeronautics Board  
FAA = Federal Aviation Agency  
FMB = Federal Maritime Board

and radio and television broadcasting are regulated by the Federal Communications Commission.

In the field of transportation, the commission's jurisdiction varies with the type of transportation involved. It has jurisdiction over the financial transactions of the two intrastate airlines, including the authorization of new bonds or stocks and the purchase and sale of capital assets, but the Federal Aviation Agency controls commercial air transportation operations and the Civil Aeronautics Board sets rates and issues certificates. The C.A.B. contends that the air space between the islands is international air and that therefore planes operating between the islands are interstate commerce. According to the C.A.B. its jurisdiction over interisland air operations is not in any way affected by the provisions of the Admission Act, but it is willing to relinquish jurisdiction over air operations between points on a single island. The Supreme Court of Hawaii recently upheld the refusal of the state commission to establish rates for a new corporation which desired to operate an interisland air bus service, but several substantive questions have not yet been answered.<sup>4</sup>

The Federal Maritime Board exercises jurisdiction over intrastate water carrier operations but this responsibility will be assumed by the State as of August 21, 1961, or earlier if the State acts during the interim. The regulatory function, which the F.M.B. desires the State to assume, will probably be assigned to the public utilities commission. The F.M.B. would retain control over interstate and international water commerce.

The Interstate Commerce Commission regulates Hawaii's two terminal railroads and will continue to do so in accordance with the provisions of

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<sup>4</sup>Supreme Court of Hawaii, in the matter of Island Airlines, Inc., October Term 1960, No. 4212, February 27, 1961.

the federal railroad act; however, the state commission has power to investigate railroad operations. The rates, service, accounts, and securities of all the transit and around-the-island tour companies are regulated by the state commission.

The Interstate Commerce Commission exercises some control over household goods moved in interstate commerce. The provisions of the interstate commerce act relating to motor carrier operations in interstate and foreign commerce between points within the state became applicable in Hawaii upon statehood. The Interstate Commerce Commission has issued a certificate of exemption and order, however, which exempts from regulation motor carriers operating solely in Hawaii.<sup>5</sup> The opinion was not unanimous, three commissioners entering a vigorous dissent.

Commission jurisdiction over private water companies extends to regulation of rates, service, and accounts but does not include issuance of securities. It does not, however, regulate sewage disposal companies.

#### The Authority of the Public Utilities Commission

The authority of the public utilities commission is described in chapter 104 of the Revised Laws of Hawaii 1955, as amended, as are the procedural limitations which the commission must observe in exercising that authority. The powers granted to the commission are extremely broad. The legislature has not attempted to establish substantive standards or guides, as distinguished from procedural, which the commission must follow in making determinations. The law simply expresses a general intent that rates

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<sup>5</sup>Interstate Commerce Commission, Certificate of Exemption and Order and Discussion and Conclusions, Ex Parte No. MC-59 (Washington, D. C.; January 23, 1961).



be "just and reasonable", implies that other regulations should also meet this criterion, and grants considerable authority to the commission so that it may proceed with the task of regulating.

General Authority. The law grants the commission general supervision over all public utilities. It has the power to adopt its own rules of procedure. Public utilities are required to furnish the commission all information which it may require, including a complete inventory of their property. The commission may institute actions in its own name, the name of the State, or of a complainant, before the Interstate Commerce Commission, other governmental agency, or a court. If the commission determines ". . . that in any way [a utility] is doing what it ought not to do, or not doing what it ought to do," the commission is to notify the utility in writing, include the matter in its annual report, and give any other publicity to the matter that it sees fit.<sup>6</sup>

Investigatory Power. The commission has the power to investigate each public utility, and specifically: (1) the safety and accommodation of the public; (2) the safety of working conditions; (3) the conditions of employment with respect to hours and wages; (4) the utility's rate structure; (5) its capital and corporate structures; (6) all of its financial transactions; (7) its relations with other enterprises; (8) its compliance with laws and rules; and (9) "all matters of every nature affecting the relations and transactions between it and the public or persons and corporations."<sup>7</sup> It may investigate such matters on its own initiative, at the request of a utility, or upon a sworn written complaint filed with the commission. Further, it has the obligation to investigate the amounts charged for domestic

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<sup>6</sup> Section 104-14, Revised Laws of Hawaii 1955.

<sup>7</sup> Section 104-6, Revised Laws of Hawaii 1955.

water when the water is obtained as a result of a state lease.

Authority with Respect to Rates and Rate Base. The commission is given authority to fix all rates, fares, charges, classifications, rules and practices of public utilities, and each utility is obligated to abide by the approved tariffs and regulations. The rates are to be "just and reasonable" and provide "a fair return on the property of the utility actually used or useful for utility purposes."<sup>8</sup> Further, "rebates and unreasonable discrimination between localities" are prohibited.<sup>9</sup> The commission is also authorized, on its own initiative or at the request of a utility, to value the property of any utility. No mention is made of any particular basis which should be employed in making the valuation. Utilities must publish their rates, fares, classifications, charges, and rules in such manner as the commission requires. Further, the commission has authority to prescribe the accounting system to be employed by utility companies and to regulate the return they receive on their property.

Authority with Respect to Securities. All regulated utilities must obtain the approval of the commission before issuing stocks, bonds, notes, or any other evidence of indebtedness which will be outstanding for more than one year. Such indebtedness may only be entered into for purposes of acquiring property, constructing facilities, refunding debt, or reimbursing the company for moneys actually expended for capital purposes.

Authority with Respect to Corporate Structure. A public utility may not acquire capital stock in any other Hawaii public utility without first

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<sup>8</sup> Section 104-15, Revised Laws of Hawaii 1955, as amended.

<sup>9</sup> Ibid.

obtaining the approval of the commission. Neither may a utility merge nor consolidate with any other utility or sell or otherwise dispose of any of its property or franchises or permits without the prior approval of the commission.

Authority with Respect to Common Carriers. Several sections in chapter 104 deal specifically with common carriers operating on public highways. Such carriers, except those which transport freight, are required to obtain a certificate of public convenience and necessity before furnishing public service. They must also provide surety bonds or liability insurance to pay final judgments which may be awarded as a result of death or injury to a passenger or loss of or damage to property.

Prescribed Commission Procedures. The law prescribes the procedures to be followed by the commission and grants the commission or individual commissioners the power to administer oaths, compel attendance of witnesses, require production of exhibits, examine witnesses, and punish for contempt.

All hearings must be public, and utilities and complainants have the right to be represented by counsel. The commission, however, is not bound by strict rules of common law relating to evidence. The commission may not approve an increase in utility rates without holding a public hearing on the island on which the utility is located. The law specifies the manner in which notice of such a request for a rate increase and hearing on that increase shall be given. Further, reasonable notice must be given by the commission to a utility which is being investigated. Appeals from the decisions of the commission are made to the state supreme court.

### III. THE ADMINISTRATION OF THE PUBLIC UTILITIES COMMISSION

Once the State assumes responsibility for regulating the activities of those businesses which it has designated as public utilities, the question of what constitutes the most effective way to discharge this responsibility arises. Increasingly, since the turn of the century, jurisdiction over the activities of privately-owned public utilities has been assigned to commissions which usually operate somewhat independently of both the executive and the legislative branches of government. Because these commissions have the power to issue orders to utilities, they are able to prevent abuses before they occur, and because these commissions are continuing bodies, they are able to exercise day-to-day control over utilities.

The widespread acceptability of the commission approach is evidenced by the fact that 49 states, the District of Columbia, and Puerto Rico all have such commissions.<sup>1</sup> A few states divide the responsibility for regulating utilities among several commissions. The federal government has also created commissions--Interstate Commerce Commission, Federal Communications Commission, Federal Power Commission, Civil Aeronautics Board, and Federal Maritime Board--to regulate interstate public utility operations.

The widespread use of the commission approach to utility regulation

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<sup>1</sup>Rhode Island has a public utilities division within a department of business regulation which is headed by a public utilities administrator. Quasi-judicial matters are ruled on by an administrative commission composed of the administrator and his two subordinate bureau chiefs--the superintendents of the bureaus of regulation and of rates and tariffs.

belies the amount of controversy which surrounds it. The recent Landis report is only the latest in a series of criticisms which have been made concerning the operation of regulatory commissions.<sup>2</sup> Much of the criticism of commissions centers about their independence from the executive branch of government and the consequent difficulty in developing coordinated, long-range government policies relating to energy, communications, and transportation. Commissions are also often criticized for being dominated by the industries they regulate, being dilatory in processing cases, and for improperly merging legislative, executive, and judicatory functions. They have also been criticized for failing to recognize the affirmative role of the profit motive in utility development.<sup>3</sup>

Hawaii, like its sister states, has assigned the task of regulating its public utilities to a semi-autonomous, multi-member body--the public utilities commission. This section of the report is concerned with describing the organization, staffing, financing, and workload of that commission.

#### Organization and Staffing

When Hawaii gained statehood, it was necessary to reorganize the executive department into not more than twenty principal departments as provided in the State Constitution. There was some debate, at the time reorganization was considered, as to whether placing the commission within a department would be compatible with the purposes of the commission or whether it would

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<sup>2</sup>James M. Landis, Report on Regulatory Agencies to the President-Elect (Washington, D. C.: Government Printing Office, December 1960).

<sup>3</sup>See N. Y. Chamber of Commerce, Public Regulation of Utility Enterprise, (New York: 1960) and Report of the President's Committee on Administrative Management (Washington, D. C.: Government Printing Office, 1937).

not be better to make the commission a separate department. Although other boards and commissions in the State were concerned with regulating private business, the public utilities commission was clearly the largest and possibly the most important of these agencies. The legislature finally decided to create a department whose primary function would be to regulate the activities of private businesses which are affected with a public interest to such a degree as to require governmental control, and the public utilities commission was made a division of that department.

Relationship of the Commission to the Department of Treasury and Regulation. Placement of the public utilities commission within the department of treasury and regulation for administrative purposes means that all communications of the commission to the governor or the legislature and all requests for funds are transmitted through the treasurer, who is director of the department. The treasurer also: (1) reviews and approves personnel transactions, other than appointments of the commissioners themselves; (2) assigns office space; (3) approves purchases; and (4) passes on rules and regulations adopted by the commission. The treasurer's authority over the commission is limited to those activities mentioned above. He is specifically prohibited from controlling the quasi-judicial functions of the commission.

The actual working relationships between the commission and the department are still in the process of evolving. The commission since its inception has operated independently and understandably finds being within a department, even if only for administrative purposes, somewhat of a burdensome arrangement offering it few advantages. The department, on the

other hand, has not entered into the business of the commission other than to implement the Reorganization Act provision relative to administrative responsibilities.

Thus the commission in all substantive matters continues to operate as a relatively independent agency, with the notable exceptions that it is now accountable to the executive branch in a way in which it was not before.

The Commission. The commission consists of five members, appointed by the governor with the advice and consent of the senate for 4-year overlapping terms. No commissioner may now serve more than eight consecutive years under the provisions of the Hawaii State Government Reorganization Act of 1959. Two members are appointed from Oahu, one from Maui, one from Hawaii, and one from Kauai. One of the two Oahu commissioners is designated as chairman. Commissioners serve part-time, receiving \$10 per day while actually engaged in performing their official duties, provided that the total amount paid in any one year does not exceed \$1,000. They may also receive reasonable traveling expenses. Commissioners may not hold any interest in or receive any remuneration from a public utility company. The commission meets regularly on the third Wednesday and Thursday of each month and holds such other meetings as it may deem necessary.

Alaska, which established its commission in 1960, and Hawaii are the only states in which commissioners receive per diem rather than a salary and in which all commissioners serve part-time only. In Vermont the chairman serves full-time and the commissioners part-time. Other states employ full-time commissioners, though in some states, commissioners may and do accept outside employment which does not conflict with their responsibilities as members of a regulatory agency in terms of the nature

and demands of the work,

The commission appoints a director who is in charge of the commission's staff. The general practice has been for the commissioners to keep themselves apart from most internal administrative matters and to deal with staff members on important questions through the director. The commission, however, and not its director, is in the last analysis responsible for the management of the agency.

Commissioners, for the most part, have served for relatively long periods as shown in Table 3. The present commissioners have rendered a total of over 60 years of service. There has been a tendency for commissioners to rely on certain members for advice in particular areas. Thus, for example, each neighbor island commissioner is considered to have special knowledge with respect to utilities on his island, while each of the five commissioners is considered to be an expert in finance, engineering, transportation, accounting, or utility management. There appears to have developed, as a matter of habit and convenience rather than law, some tendency for division of labor within the commission.

Commissioners appear to be selected from a very limited group of occupations, businesses, and professions, as a review of the data in Table 3 indicates. Except for the appointment of two commissioners from Kauai, who served for relatively short periods, all the commissioners since 1946 have been businessmen, financiers, or bankers (13), attorneys (2), or engineers (2). There has not been one college professor, labor union official, social service agency director, physician, or company employee other than a member of top-management. The theory appears to be that those acquainted



Table 3

DATA ON EMPLOYMENT AND TERMS OF OFFICE OF  
COMMISSIONERS OF THE PUBLIC UTILITIES COMMISSION, BY COUNTY  
1946 to 1961

OAHU

Name	Occupation, Business or Profession	Member		Chairman	
		From	To	From	To
Valentine B. Libbey	Engineer	May 1933	April 1947	February 1937	April 1947
Arthur H. Rice, Jr.	President, A.H. Rice, Ltd. (Stocks & Bonds)	June 1939	June 1946		
John E. Parks	Attorney	November 1946	November 1947	June 1947	November 1947
James M. O'Dowda	Manager, Honolulu Motors, Ltd.	April 1947	December 1951	December 1947	June 1950
J. Harold Hughes	Attorney	January 1948	June 1953	July 1950	June 1953
Jesse H. Kopp	Engineer, Grace Bros., Ltd., Paving Division	January 1952	November 1954		
Robert T. Williams, Sr.	President, Williams' Equipment Co.			June 1953	April 1957
Roger S. Ames	President, Budget Finance Co.	June 1955	October 1958	May 1957	October 1958
James M. O'Dowda	Manager, Tidewater Oil Co. (Hawaii)	May 1957	Present	October 1958	Present
Vincent J. Moranz	President, Hawaiian Savings & Loan	October 1958	April 1960		
Roger S. Ames	President, American Pacific Life Insurance	October 1960	Present		

Table 3 (continued)

MAUI

<u>Name</u>	<u>Occupation, Business or Profession</u>	<u>Member</u>	
		<u>From</u>	<u>To</u>
Fred G. Manary	Engineer, Hawaiian Commercial & Sugar Co. (Retired 8/60)	May 1935	Present

HAWAII

Walter E. Eklund	Manager, Hilo Motors, Ltd.	July 1942	April 1947
Leo G. Lycurgus	Manager, Hilo Hotel, Ltd.	April 1947	Present

KAUAI

Randolph A. Crossley	Manager, Hawaiian Fruit Packers	April 1945	April 1947
Manuel A. Aguiar, Jr.	Rancher	April 1947	September 1948
Anthony C. Baptiste, Jr.		December 1948	December 1950
Edward K. Robinson	Manager, Waimea Branch, First National Bank of Hawaii	April 1951	June 1953
Masaru Shinseki	President, Kauai Finance Factors	June 1953	Present

Source: Public Utilities Commission,

with business are best qualified to regulate business. It may also be that people in only these types of occupations, businesses, and professions from which commissioners have been selected can afford and are willing to give up the amount of time necessary to serve as part-time commissioners.

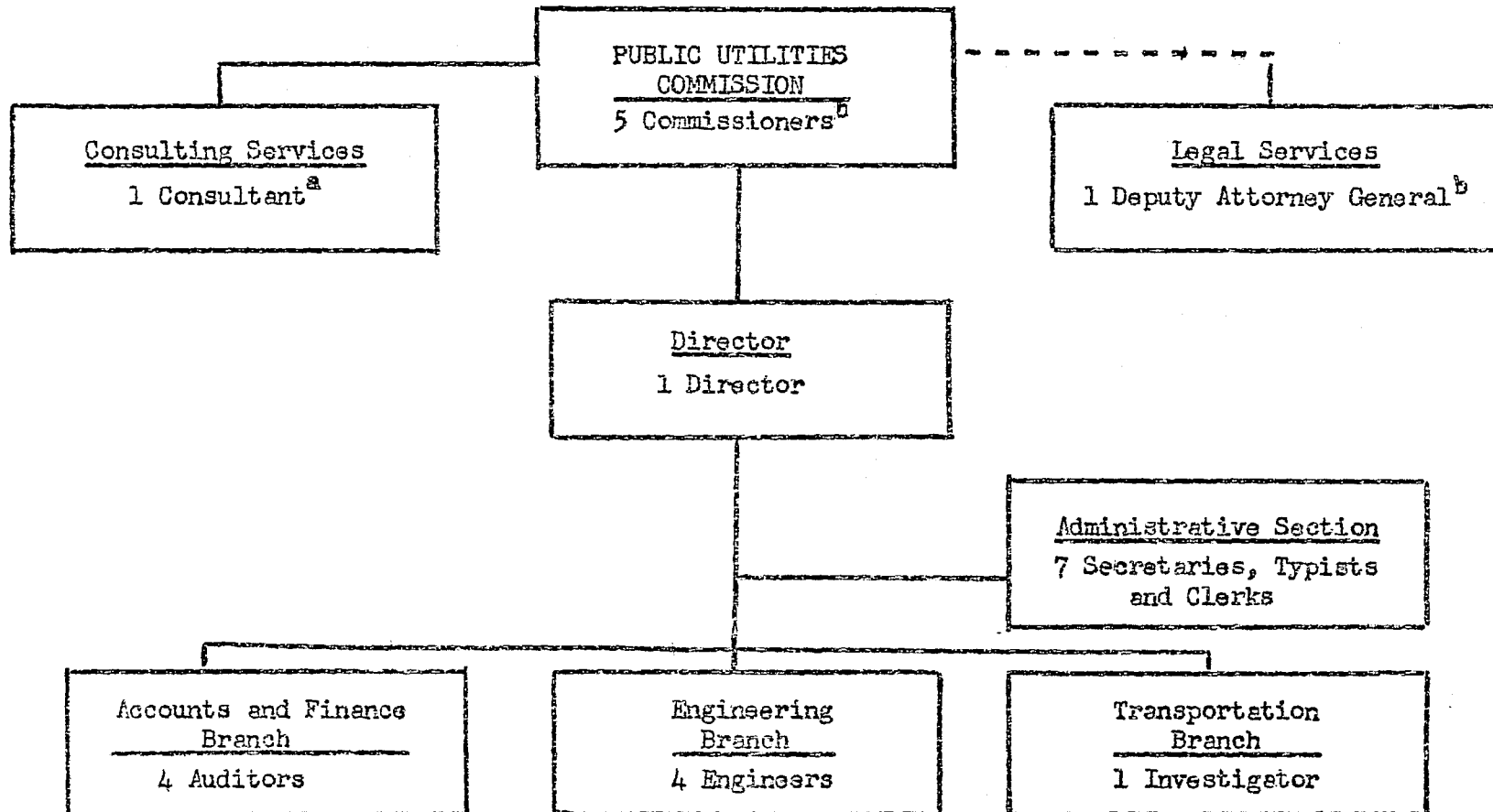
#### The Staff and Its Functions

The commission's staff, which serves under the director, is organized into an administrative section, an accounts and finance branch, an engineering branch, and a transportation branch as shown in the chart on the following page. All members of the commission's full-time staff, except the director, presently serve in civil service positions. The director's position was exempt prior to reorganization and its present status is not entirely clear.

The director is responsible for directing the work of the staff and for the commission's relations with other governmental officials and agencies and with utility companies and private organizations. During a case, the director supervises the staff's work in preparing the state's presentation, arranges the hearing schedule, and advises the commissioners, upon request, during a hearing. An administrative secretary takes the minutes of commission meetings and maintains commission records though formal hearings are recorded by a court reporter. The administrative section provides the usual clerical, fiscal, and personnel services.

The accounts and finance branch performs a group of related functions. It is responsible for: (1) insuring that utilities follow the prescribed accounting and reporting procedures; (2) examining operating results; (3) developing data on rate bases, rates of return, cost of money, financial

Chart  
ORGANIZATION AND AUTHORIZED  
STAFF OF THE PUBLIC UTILITIES COMMISSION  
STATE OF HAWAII  
1961



<sup>a</sup> Retained by the Commission.

<sup>b</sup> Serve part-time.

requirements, and related matters; (4) investigating applications for approval of issuance of securities, changes in corporate structure, and sale and transfer of properties; (5) examining certain utility operating expenditures; and (6) investigates complaints.

The engineering branch is also concerned with money matters but more from the viewpoint of technical engineering considerations. Thus the division is involved in appraisals, rate base valuations, depreciation, cost of service and similar studies, and revenue and expenditure forecasting. Construction standards, safety, line extensions, plant and distribution system improvements and expansions, purchase power contracts, service complaints, and fuel oil clauses also are under the jurisdiction of this branch. It also investigates and resolves complaints concerning interference with radio and television reception.

The transportation branch reviews applications for certificates of public convenience and necessity filed by motor vehicle common carriers, enforces the terms of such certificates, and investigates complaints concerning carriers.

Legal Services. Legal services are provided by the attorney general who assigns one of his deputies to serve the commission on a part-time basis. Ordinarily, the deputy is able to devote about half his time to commission matters, but during hearings he works exclusively for the commission.

The deputy is responsible for presenting the staff's case and for cross examining utility company witnesses in proceedings before the public utilities commission. He plays a significant role in determining prior to and during the actual hearing the approach the staff will use in presenting its case. During a hearing he disputes statements of the

privately-owned utility company which are believed to be incorrect or misleading and advises the commission on points of law when such questions arise.

Consulting Services. The public utilities commission retains the services of a utilities consultant, Mr. Roy Wehe of San Francisco, who is paid a retainer for providing a limited number of days of counsel and advice. When important cases arise, however, he is requested to assist in preparing the staff's case and in presenting that case before the commission. He frequently appears as a witness for the State and often participates in the questioning of company witnesses.

#### Office Space

The Commission is housed on the first floor of the Hawaiian Life Building. The quarters include adequate space for staff members as well as a hearing room for the commissioners. The offices have been rented for five years, February 1958 through January 1963, for \$1,400 per month. It was not required at the time that the lease was signed that it be reviewed, negotiated, or approved by the division of public works (now a part of the department of accounting and general services). It is possible to cancel the lease at the end of a fiscal year if no appropriation is made for quarters. Such an action would presume, of course, that space was available in a state office building.

#### Financing the Regulatory Program

The costs of operating the public utilities commission are financed from a general fund appropriation made for the purpose. Prior to July 1, 1959, the commission had its own special fund into which were deposited fees paid by public utility companies and from which the commission expended money as required. This arrangement had the advantages, from the commission's viewpoint, of providing it with a great deal of latitude in financial matters

and a minimum of program review, though standard provisions with respect to depositing funds, processing vouchers, and reporting expenditures applied. Now that an annual appropriation is required, the commission must submit a budget request, justify it before the governor and legislature, and expend funds in accordance with a planned program and quarterly allotments.

One disadvantage of general fund financing is that the commission may not have adequate funds available to meet the unusual case in which the cost of consulting and reporting services run extremely high. The commission, in such an instance, can request that the governor make money available from his contingency fund. This difficulty has been avoided in one state by making a special appropriation to the commission which may only be drawn on for special assistance such as consulting and reporting. It is possible to restrict the use of this type of conditional appropriation in a number of ways and still attain the desired flexibility.

Commission Expenditures. Commission expenditures have increased in recent years, as shown in Table 4, due to several factors including a small increase in staff, increases in staff salaries, and much higher expenditures for other current expenses. The expenditures for personal services rendered by commissioners, consultants, reporters, and others vary from year to year depending upon the number of important cases which are heard. The large increase in other current expenses has been primarily for rent and for travel in connection with current cases. A recent case involving the telephone company, for instance, required the holding of public hearings on all the islands, as well as the taking of several trips by the commission's consultant. The cost of regulating public utilities is now over \$150,000 per year. It is doubtful if this cost will be reduced in future years, except possibly for rental of office space. It is more likely that it will increase as the

Table 4

EXPENDITURES OF THE PUBLIC UTILITIES COMMISSION  
STATE OF HAWAII

July 1, 1955 to June 30, 1960

Fiscal Year	Personal Services			Other Current Expenses	Equip- ment	Special Charge	Total Expenditures
	Staff	Commissioner, Consultants, Others	Sub- Total				
1955-56 <sup>a</sup>	\$58,773	\$ 6,507 <sup>c</sup>	\$ 65,280	\$20,448 <sup>d</sup>	\$ 773	—	\$ 86,501
1956-57 <sup>a</sup>	64,462	5,736 <sup>c</sup>	70,198	19,539 <sup>d</sup>	491	\$96,150 <sup>e</sup>	186,378
1957-58 <sup>a</sup>	76,078	11,754 <sup>c</sup>	87,832	41,741 <sup>d</sup>	6,846	—	136,419
1958-59 <sup>a</sup>	79,632	8,950 <sup>c</sup>	88,582	51,059 <sup>d</sup>	8,267	—	147,908
1959-60 <sup>b</sup>	92,428	21,314	113,742	36,586	33	—	150,361

Source: Public Utilities Commission.

<sup>a</sup>Special fund.

<sup>b</sup>General fund.

<sup>c</sup>Includes employee's share of retirement costs. This cost paid from a general fund appropriation in 1959-60.

<sup>d</sup>Includes management cost levy made against special funds.

<sup>e</sup>Non-recurring charge levied against special funds to raise revenue to finance the costs of salary increases (Act 2, Special Session Laws of Hawaii, 1956).



commission's jurisdiction is enlarged and more intensive regulatory administration is desired.

Personal Services. The staff of the commission is not large, compared to the staffs of commissions of other states. Only six states--Delaware, Idaho, Montana, Nevada, Vermont, and Wyoming--had fewer staff employees than Hawaii as of July 1, 1959.<sup>4</sup> Most state commissions, however, regulate a greater variety of utility services and many regulate a larger number of individual companies. For these and related reasons, interstate statistical comparisons need to be employed judiciously.

The commission has seldom been able to fill all of its authorized positions, as a review of the data in Table 5 will indicate. The assistant engineer's position was vacant for three years, primarily, according to the director, because the proffered salary was too low. As of January 1, 1961, however, all 17 authorized positions were actually filled which gave the commission a larger staff than it has had during any of the past 10 years. Several additional positions have been requested in recent years. It has been suggested that it will be necessary to double the staff if the commission assumes jurisdiction over motor vehicle, air, and water carriers.<sup>5</sup>

#### The Commission's Workload

The workload of the commission is not subject to precise measurement. Frequently the amount of time devoted to any particular matter is determined, in large measure, by the pressure of other work. Seldom does the staff have an opportunity to study and report on a question in as much depth as it might like. Tasks which result in the issuance of similar orders often

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<sup>4</sup>National Association of Railroad and Utilities Commissioners, Proceedings, Seventy First Annual Convention (Washington, D. C.: Author, 1960), p. 307.

<sup>5</sup>Letter from Director, Public Utilities Commission, to Senate Committee on Economic Development, Tourism, and Transportation dated March 8, 1961.

Table 5

SIZE OF ADMINISTRATIVE AND TECHNICAL  
STAFF OF THE PUBLIC UTILITIES COMMISSION  
STATE OF HAWAII

July 1, 1950 to June 30, 1960

Fiscal Year	Administrative		Technical		Total	
	Authorized	Actual	Authorized	Actual	Authorized	Actual
1950-1951	8	7.7	6	5.0	14	12.7
1951-1952	9	7.9	6	4.8	15	12.7
1952-1953	9	8.0	6	5.0	15	13.0
1953-1954	9	8.0	6	4.8	15	12.8
1954-1955	9	7.2	6	4.7	15	11.9
1955-1956	9	7.5	6	5.0	15	12.5
1956-1957	9	6.6	8	5.1	17	11.7
1957-1958	8	6.9	8	6.0	16	12.9
1958-1959	8	6.8	9	7.4	17	14.2
1959-1960	8	6.6	9	7.9	17	14.5

Source: Public Utilities Commission.

Note: As of January 1, 1961 the 17 authorized positions were filled. Two floater positions were authorized but not filled due to lack of provision for payment.

require different amounts of staff time. There are no useful standards which specify that a major rate case should require 100 days of staff time, a line extension application 1 day, and a review of an application for a certificate of convenience and public necessity 3 days. The commission has relatively little control over its workload except with respect to investigations which it initiates.

There are a few general indices of workload, however, which are useful in evaluating changes in the total amount of work which the commission must process. Data on meetings held, dockets processed, and decisions and orders issued have been maintained by the commission for a number of years, and are presented in Table 6, for the years 1957 through 1960. There has been an increase in the number of business meetings (also called quorum meetings) and public hearings held by the commission. The increase in number of hearings in 1960 was largely attributable to a major telephone case heard that year. The number of dockets received has varied between 30 and 52 per year and the number of decisions and orders between 35 and 45, except that in 1958 the number was larger because many transportation cases were processed.

Most of the commission's work results in the issuance of orders. If, therefore, the number of orders which require a large amount of staff time has increased greatly, then probably so has the quantity of work which the commission is required to perform. Data are presented in Table 7 on the number of orders, classified by type of order, which the commission issued in the years from 1950 to 1960. Because the amount of work involved in issuing an order varies greatly, orders requiring a similar amount of

Table 6

MEETINGS HELD, DOCKETS PROCESSED AND DECISIONS  
AND ORDERS ISSUED BY THE PUBLIC UTILITIES COMMISSION  
STATE OF HAWAII

1957 - 1960

	<u>1957</u>	<u>1958</u>	<u>1959</u>	<u>1960</u>
I. Meetings held				
Quorum meetings	24	31	46	55
Public hearings	29	56	59	133
II. Dockets processed				
Filed and received	33	52	30	43
III. Decisions and orders issued				
Electric and gas	11	9	9	25
Telephone	3	6	3	2
Transportation	20	35	23	16
Miscellaneous	1	3	1	2
	<hr/>	<hr/>	<hr/>	<hr/>
Total -	35	53	36	45

Source: Public Utilities Commission.

Table 7

DECISIONS AND ORDERS OF THE PUBLIC UTILITIES COMMISSION  
STATE OF HAWAII  
1950 - 1960

Type of Order	Relative Weight	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960
Major Rate Case Orders	40	12	10	8	6	10	4	3	7	5	6	8
Complicated Orders	20											
Rates		4	4	1	1	1	6	6	1	6	1	-
Depreciation		1	-	-	1	-	1	5	-	6	-	-
Mergers		-	2	-	-	1	-	1	-	-	-	1
Valuations		-	-	-	1	-	-	-	-	1	-	1
Intermediate Complexity Orders	3											
CPCN		22	4	5	3	4	5	3	12	24	10	2
Finance		5	10	11	10	8	5	9	7	7	8	11
Rules and Regulations		2	1	3	3	2	-	1	3	-	1	1
Tariffs		2	1	1	-	-	-	-	-	-	-	-
Simple Orders	1											
Plant Purchase or Sale		3	2	-	5	2	-	1	2	-	5	6
Revised Boundaries		4	2	-	-	-	-	-	-	-	-	-
Purchase Power Agreement		-	-	-	1	-	-	-	1	-	1	4
Investigations		-	-	1	-	-	-	-	-	-	1	5
Line Extensions		-	-	-	-	-	-	1	1	-	1	-
Formal Complaints		-	-	-	-	-	-	-	1	-	1	2
Accounting Procedures		-	-	-	-	-	-	1	-	3	1	-
Special Services		-	-	-	-	-	-	-	-	1	-	1
Easements		-	-	-	-	-	-	-	-	-	-	2
Conversions		-	-	-	-	-	-	-	-	-	-	1
TOTAL		55	36	30	31	28	21	31	35	53	36	45
WEIGHTED TOTAL		680	572	401	354	484	330	522	371	556	327	423

Source: Public Utilities Commission.

Abbreviation:

CPCN = Certificate of Public Convenience and Necessity

time have been placed together. The four groups are: (1) simple orders which require little work; (2) orders of intermediate complexity which, on the average, require about three times as much time as a simple order; (3) complicated orders which, on the average, require about 20 times as much work as a simple order; and (4) major rate case orders which, on the average, require about 40 times as much work as a simple order. The estimates of relative time are rough approximations made by members of the commission's staff.

The data in Table 7 indicate that while the number of orders issued in the various classifications has tended to fluctuate from year to year there is no distinct trend indicating that the commission's work is either increasing or decreasing. The same conclusion applies even if the orders are weighted according to the 1-3-20-40 system described in the prior paragraph and a weighted total calculated.

It is fairly clear that there has not been any distinctive increase in the quantity of work which the commission and its staff process as measured by applications and orders. There have been, however, important changes which affect the amount of time required to process the same quantity of work. First, more comprehensive studies are made than formerly and more materials are prepared for the commission's use in reaching its determinations. One example of this is the cost-of-money studies in rate cases which the staff now prepares. Second, the size and complexity of the operations of the utilities which are regulated have increased greatly. The number of kilowatt hours of electricity sold has more than doubled in the last ten years. Total telephone stations and total calls have also doubled in the same period while the therms of gas sold has increased by about half. This large and rapid growth in utility

services has required great increases in plant investment, new issues of securities, and continual review and adjustment of rates. This has meant, for example, that studies such as depreciation and valuation, which are often part of a rate case, require more time to prepare than in years past when utility operations were not so large and complicated. Further, as the utilities have increased in size, the companies have tended to invest more time and money in preparing and presenting their cases. This has resulted in the commission having to investigate many matters which might not have been issues in former years.

Thus, it is not the quantity of work processed that has increased, but rather the nature of the commission's studies and the size of the utility operations which have changed.

#### IV. THE REGULATION OF PUBLIC UTILITIES

The regulation of private utility companies by the government necessitates the establishment of procedures that make it possible to ascertain the public interest and to guard that interest while at the same time ensuring that the legitimate rights of company owners are also protected. The task of establishing and administering such procedures has been entrusted to regulatory commissions. These commissions have been assigned legislative, executive, and judicial authority to enable them to achieve the purposes of utility regulation.

The commission is a miniature legislature when it adopts general orders which supplement the law and are applicable to all utilities or establishes general guides which it follows in ruling on individual cases. It is a court when it hears and decides individual cases. It is an administrative agency when it investigates utility operations and prepares and presents evidence in hearings. Even within the commission, different parts of the agency serve in different roles at the same time. Thus during a hearing the commission itself is a court but the staff is an administrative agency.

Utility commissions are not the only governmental agencies in which there is a merger of such seemingly diverse functions. It also occurs within administrative agencies headed by a single individual and subordinate to the chief executive. There is nothing inherently incorrect in having a merger rather than a separation of powers as long as adequate safeguards exist to assure that those who require protection are protected. It is important, however, from the viewpoint of regulating public utilities that those concerned with the process of regulation recognize that they operate in several



capacities which require the assumption of differing perspectives if each of the three roles is to be discharged successfully.

#### Regulation Through Legislation

A public utilities commission, like many agencies within the executive branch of the government, is authorized to adopt rules and regulations which supplement the provisions of law. This arrangement has the advantage of permitting those who best understand the intricacies of a particular situation to design, adopt, and enforce the rules which implement general legislative intent. Further, the practice: (1) reduces the volume of detail which a legislature must consider; (2) permits the amendment of rules without having to submit such proposals to a legislative body; (3) contributes to the simplicity of statutory law; and (4) minimizes the need for amendment of the statutes.

General Orders. The public utilities commission is empowered to adopt general orders which are applicable to all utilities or to classes of utilities. General orders, which are listed in Table 8, are adopted only after study by the commission's staff, consultation with the utilities affected, provisions for public hearings, and review and deliberation by the commission. The contents of the orders are noted below.

General order numbers 1 through 4 have been superseded by general order number 7. General order number 5 prescribes the rules of practice and procedure governing commission proceedings. It covers such subjects as formal requirements for pleadings and briefs, investigations, applications, filing, forms, hearings, subpoenas, evidence, briefs and oral arguments, decisions, and rehearings. Order number 6 provides for the adoption, with slight modification, of the rules of the California public utilities commission govern-

Table 8

GENERAL ORDERS OF THE PUBLIC UTILITIES COMMISSION  
STATE OF HAWAII  
1961

Order No.	Subject	Date Adopted
1	Rules and practices to be observed by all motor vehicle common carriers.	January 20, 1933
2	Amendment general order number 1.	February 3, 1933
3	Amendment general order number 1.	September 15, 1933
4	Amendment general order number 1.	October 14, 1942
5	Revised rules of practice and procedure. <sup>a</sup>	February 18, 1953
6	Rule governing overhead line construction.	June 12, 1953
7	Revised rules and practices to be observed by all motor vehicle common carriers.	June 20, 1956
8	Revised uniform system of accounts for electric utilities.	October 27, 1960
9	Revised uniform system of accounts for gas utilities.	October 27, 1960

Source: Public Utilities Commission.

<sup>a</sup>Prior rules adopted by commission December 2, 1920 but not as a general order.

ing the construction of overhead lines. The rules and practices to be observed by all motor vehicle common carriers, specified in general order number 7, apply only to carriers transporting passengers for compensation within the City and County of Honolulu. The order provides for inspection of carriers and reporting by carriers and establishes standards for equipment and operation of vehicles. General order numbers 8 and 9 provide uniform systems of accounts to be employed by electric and gas utilities. These utilities were previously following uniform systems of accounting in accordance with specific instructions issued by the commission in various orders.<sup>1</sup>

General Guides. General guides are very different from general orders. They are not adopted as general rules and do not have the force of law. They are useful, however, as measures or limiting factors to the commission in arriving at decisions on which orders are based. They have no more force than that of precedent. They may be reversed or discarded at any time and without a hearing or the issuance of a specific order modifying the guide.

Each individual application, it is stressed by the commission's staff, is treated separately and judged on its own merits. Nevertheless, the commission tends to use the guides, which are presented in Table 9, in reaching its decisions. It is not overly significant whether these guides are in the

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<sup>1</sup>A uniform accounting system is also employed by the Honolulu Rapid Transit Company in accordance with a specific order of the commission. No specific accounting system is prescribed for the three smaller bus lines or for the three privately owned water companies, though the latter, by their own choice, follow the uniform system of accounts for water utilities.

Table 9

GENERAL GUIDES FOLLOWED BY THE PUBLIC  
UTILITIES COMMISSION IN REACHING ITS DECISIONS<sup>a</sup>  
STATE OF HAWAII

MARCH, 1961

<u>Applicability</u>	<u>Subject and General Guide</u>
Electric, Gas, and Telephone	<p><u>Rate Base Determination:</u> The rate base is composed of:</p> <p>(1) historical cost depreciated of utility property used and useful; plus (2) an allowance for working cash equal to one-sixth of annual operating expenses, excluding depreciation and taxes, plus one-twelfth of annual fuel or purchase power expense; plus (3) an allowance for materials and supplies inventory; and minus (4) reserve for deferred taxes if election has been made to take accelerated depreciation. (Taxes are normalized for rate making purposes. The difference between normalized and actual taxes is set aside in a reserve for deferred income taxes.)</p>
All Utilities	<p><u>Adequate Return:</u> (a) Net return must be sufficient to provide for the company's financial requirements.</p>
Transit	<p><u>Adequate Return:</u> (b) The range of allowable operating ratio (operating expenses divided by operating revenues) for transportation companies is 94 to 97 per cent.</p>
All Utilities	<p><u>Operating Expenses:</u> (a) Only normalized expenses and plant additions and retirements allowed.</p> <p>Expense allowed only after incurred or contracted. Pending or proposed wage increases, tax law changes, or price increases or decreases, for example, are not allowed.</p> <p>Charity contributions, which are deductible for tax purposes, are not allowed as expenses for rate making purposes.</p>
Electric and Gas	<p><u>Operating Expenses:</u> (b) Sales promotion expense found reasonable for Honolulu Gas Company is \$7.00 per customer and for Hawaiian Electric Company two per cent of gross electric sales revenues.</p> <p>Any write-up to the stated book costs of utility properties, not represented by stockholder capital contributions and reflected in charges previously made in operating expenses, must appropriately be disposed of through amortization, over a period of years, for accounting and rate-making purposes. The same procedure applies to any write-down of utility properties.</p>

Table 9 (continued)

<u>Applicability</u>	<u>Subject and General Guide</u>
Telephone	<p><u>Operating Revenues:</u> (a) Revenues from transpacific telephone and teletype, and other operations, rates for which are regulated by a federal agency, are included as utility income.</p> <p>Revenues from directory advertising, rates for which are not regulated, are included as utility income.</p>
Gas	<p><u>Operating Revenues:</u> (b) Revenues from gas manufacturing by-products, such as tar and benzene, are utility income even though rates for such by-products are not regulated.</p>
Transit	<p><u>Operating Revenues:</u> (c) Revenues from charter service and advertising are included as utility income even though rates are not regulated.</p>
All Utilities	<p><u>Depreciation:</u> Depreciation accruals accumulated through rates, while belonging to a utility company and therefore free of restrictions as to use within the utility's operations, are to be used only for the retirement of the properties in service upon which such depreciation has been taken. They shall not be duplicated by charges to the rate payer in excess of the original or historical cost of the properties.</p> <p>Where an over accrual in depreciation is evidenced, remaining life depreciation annuities are to be used in order that the undepreciated portion of the original cost of the assets will be depreciated over the remaining useful life of the properties. No adjustment will be made to the depreciation reserve even though it is over accrued.</p>
Electric and Gas	<p><u>Cost of Fuel or Power:</u> (a) Companies allowed to recover, through higher rates, any incremental increases in the cost of oil for generation above the cost of oil upon which base rates are predicated. Similarly, rates must be reduced when oil costs decrease.</p>
Electric	<p><u>Cost of Fuel or Power:</u> (b) Contracts for the purchase of power must be approved by the commission in order to test reasonableness of expense to be incurred. The cost of power shall not exceed the cost to be incurred if purchasing company were to produce its own requirement for power.</p>

Table 9 (continued)

<u>Applicability</u>	<u>Subject and General Guide</u>
Electric and Telephone	<u>Special Customer Services:</u> (a) Rates are based on overhead construction. Customer desiring underground lines must pay the increased cost of underground facilities.
Electric	<u>Special Customer Services:</u> (b) A line extension must produce sufficient revenue in 60 months to equal or exceed the required investment. If the anticipated revenues are insufficient, then the customer desiring the line must contribute or make an advance, subject to refund. Subsequent customers on the line pay their pro rata share of the contribution or advance if connected prior to the expiration of the refund period.
Transit	<u>Transit Service:</u> Urban transit systems are considered to provide adequate service if the maximum average 15-minute passenger load count at the maximum load point for any line does not exceed bus seating capacity during off peak hours and one and a half times seating capacity during peak hours.

Source: Public Utilities Commission.

<sup>a</sup>The guides included in this table do not have the force of law or a general order. Any of the guides may be discarded or modified by the commission at any time.

form of precedents or rules. It is essential, however, that they exist, for in their absence the regulatory process would verge on the chaotic; cases would be decided on the basis of the whims and caprices of individual commissioners; and no utility company or utility customer would ever have an idea of what the future held.

#### Regulation Through Adjudication

Matters requiring commission consideration and decision may be brought to the attention of the commission by a utility company or a member of the public, or the commission, on its own initiative or at the suggestion of its staff, may choose to investigate a matter and subsequently issue an order.

Utility Initiation. Utility companies file formal applications when seeking approval for a rate increase, issuance of new securities, revision in accounting procedures, modification of depreciation methods, or revaluation of the rate base, or other similar matters which are of major importance and subjects of controversy. The commission assigns a docket number to such a case, holds formal hearings which may be advertised, has a hearing record prepared, and issues a formal decision or order. Utility companies must also receive commission approval for many minor undertakings such as the extension of an electric line, revision of an existing tariff condition other than a rate, establishment of a tariff for a new type of service, or a minor change in a bus route or schedule. The utility, in such instances, writes a letter to the commission requesting its approval. The staff investigates, and reports to the commission, and, unless the investigation reveals unusual circumstances, the commission approves the request during one of its regular business (or quorum) meetings. The vast majority of formal and informal requests which the commission receives and considers are initiated by the

regulated utilities.

Public Complaint or Request. Members of the public may file a formal complaint with the commission which will result in the issuance of a docket number, the holding of a formal hearing, and the issuance of an order or decision by the commission. This occurs infrequently--perhaps once every two or three years. Citizen petitions are usually treated as informal matters. Such petitions frequently concern extension of bus service and sometimes the extension of electric service.<sup>2</sup> The commission may on its own initiative, after considering a citizen petition, issue a show-cause order to a utility requesting the company to demonstrate why it should not provide the service requested by the petitioners. The commission may, in such cases, hold a formal hearing following which it may order the utility to provide the requested service.

Members of the public frequently file informal complaints with the commission either by writing letters or telephoning. Depending upon the nature of the complaint, the staff answers immediately or investigates the matter further. Such a complaint may result in a suggestion by the commission or its staff that a utility make certain changes in its operations.

Commission Initiative. The commission may institute an informal investigation or a formal proceeding on its own initiative. Sometimes the results of staff investigations are sufficient to cause the commission to hold a formal hearing. Generally, however, the commission initiates few formal actions. It prefers to urge strongly a utility company to follow a particular course of action or adopt a specific suggestion. Show-cause

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<sup>2</sup>A petition may also be filed in a formal case which a utility company has initiated. Such a petition becomes part of the record in the case.



orders are considered to constitute an affront to the regulated company which should only be employed as a last resort.

The commission, in issuing an order granting a rate increase, may also suggest that the company should make a particular study or revise certain operating procedures. While such suggestions do not have the force of an order, they are usually accepted.

Time Required to Process an Application. Private utility companies frequently complain that long delays occur before a regulatory body rules on a company's application and that these delays make it difficult to plan for future growth and operations. If the utility is permitted to collect the increased rates subject to refund, then the regulatory lag results in company managers and investors being unable to determine how much they have earned until an order is issued. If the utility cannot collect the increase during the period its application is being considered, then the company owners must pay the higher costs which should have been but were not reflected in higher rates.

The Hawaii public utilities commission, however, has made it a practice to process cases as quickly as possible consistent with an adequate consideration of issues. Usually a case is first heard, as the data in Table 10 indicate, within two months of the time an application is filed with the commission, and a commission order is usually issued within six months of the date a docket was initially filed. Frequently an order is issued within two months while occasionally a case may take longer than a year. Often the delays which do occur result from company requests. Even with respect to major rate cases, which present the commission with some of

Table 10

TIME REQUIRED TO PROCESS CASES BEFORE THE  
PUBLIC UTILITIES COMMISSION  
STATE OF HAWAII

Selected Years

<u>Year</u>	<u>Average Time Lapse Between Date Docket Filed and Date First Heard</u>		<u>Average Time Lapse Between Date Docket Filed and Date Order Issued</u>	
	<u>Major Rate Cases (Months)</u>	<u>All Cases (Months)</u>	<u>Major Rate Cases (Months)</u>	<u>All Cases (Months)</u>
1950	1.6	4.9	5.4	6.7
1952	1.6	1.5	5.0	2.6
1954	1.6	a	6.6	a
1956	1.0	1.5	5.7	3.4
1958	1.7	1.0	5.0	2.0
1960	1.6	1.1	4.8	1.6

Source: Computed from data furnished by Public Utilities Commission.

<sup>a</sup>1954 data on all cases not compiled and computed.

its most difficult problems, an order is issued in the average case within six months of the date the original application was filed.

The only difficulty with the present procedure is that the staff frequently is pressed to prepare its case in a very short period of time while the company may take as much time as it desires in developing its case prior to filing an application. It might be advisable for the commission to require that a utility give notice of its intention to file an application concerning rates, depreciation, valuation, a merger, or some other major matter, at least two months and not more than four months prior to filing such an application. Such a procedure would permit the staff to commence preparing its case prior to receipt of the utility's case, and would eliminate the feeling among some staff members that they are given insufficient time to prepare an adequate presentation. An alternative possibility is for the commission to establish a policy that no major rate case decision will be entered until at least six months after the filing of an application. This might encourage companies to file their applications earlier.

#### Regulation Through Administrative Action

It is the staff, as distinguished from the five-member commission, who performs most of the actual administrative tasks involved in regulation, although this work is undertaken at the direction and under the general supervision of the commission. Administrative actions may be divided into two general categories: (1) the preparation and presentation of the staff's position in formal proceedings before the commission including the examination and questioning of a company's claims; and (2) routine administrative reviews designed to insure that private utilities are complying with the

orders of the commission, planning for future development, rendering adequate service, and are not indulging in any practices which are considered to be improper or unfair.

Preparation and Presentation of Case. The staff, in preparing for and presenting a case to the commission, plays a role which has elements of the role of the public prosecutor and that of the probation officer. The prosecutor is an advocate of a particular point of view. His responsibility is to present his case as vigorously and effectively as he can. He is a party to a contest, and as a result of this contest between him and the attorneys for the defendant, the judge and jury are believed to be in a better position to evaluate the facts and ensure that justice is served. The probation officer is simply an assistant to the judge. He makes investigations and reports to his superior. He does not defend his findings in the open court.

The staff of the public utilities commission is the commission's consulting service and as such is considered by the commission to be a source of impartial, objective information. It makes recommendations to the commission in some but not all matters. It never suggests, for instance, the selection of a specific rate of return. At the same time, however, the staff functions during a hearing as if it is a party to a contest. The staff disputes the claims of the utility company, it interrogates the company's witnesses, it probes for weak points in the utility company's testimony, and, in general, it plans its strategy much as any party to a dispute would. In this role, its responsibility is that of an administrative agency charged with defending the public interest before the commission.

The commission, it should be noted, while relying heavily on its staff and even going as far as to consult with members of the staff on particular points after a hearing is closed, feels itself under no obligation to accept staff findings and/or recommendations. It has rejected such findings in many of its decisions.

Routine Administrative Reviews. The staff, in its second administrative role, reviews utility operations, finances, and plans. These reviews frequently result in findings which are brought to the attention of the commission. The commission, in some cases, may direct the staff to investigate the local situation further, ascertain what occurs in other states, make suggestions to the utility involved, or not to proceed with the matter any further. Or the commission may determine that the matter warrants the instituting of formal action. In making such a determination the commission is functioning in its role as supervisor of the administrative staff.

The staff receives monthly financial reports from each utility as well as annual statements and auditor's certificates. These reports are reviewed briefly and if a particular entry appears to be improper, questions are asked of the utility. The staff each year brings its information on the rate base of the various utilities up-to-date by adding new plant, subtracting retired plant, and revising the data on depreciation, depreciation reserves, and working capital as required. If a company's earnings appear to be excessive, compared to its allowed rate of return or operating ratio, then this matter is brought to the attention of the

commission. The staff also, as noted earlier, investigates formal and informal complaints from members of the public. It also makes special investigations and studies as directed by the commission and performs the usual functions of an administrative agency in terms of replying to inquiries from the governor and legislature, answering general requests, and other similar functions.

But routine administrative review by the staff of the operations of the utility companies which the commission regulates is quite limited. The staff does not: conduct on-the-spot checks of utility accounting and other financial procedures; scrutinize monthly reports in depth; follow through on decisions and orders to make sure that utilities are complying with the provisions thereof; compare actual operating results in test years with forecasts; make field inspections of utility plants and services; make routine investigations to determine if general orders of the commission are being violated; keep abreast of data on rates of returns being earned by utilities; review utility procedures for inspecting meters; and review plans of utilities to make sure that plans for future development are adequate.

The disadvantages of inadequate routine review are that particular questions and practices do not come to light unless the company initiates a request, and companies, it should be noted, are unlikely to file applications simply because they are earning too much money, not providing services in accordance with their tariff regulations, not planning adequately for future needs, or failing to operate as efficiently as they might. The staff must acquire almost all of the information it needs in a rate case, for instance, after the utility company has filed its application, and clearly

this does not allow it sufficient time.

The staff is well aware that the public interest may better be protected if the matters noted above are checked on a routine basis, but it sees no possibility of performing such tasks, given the nature of its present workload, the complexity of current dockets, and the number of its employees.

## V. THE ESTABLISHMENT OF UTILITY RATES

The best known and the most critical function of a public utility regulatory agency is the establishment of utility rates. The adoption of new general rate schedules affects almost all of a utility's customers, not only in terms of how much each customer will pay but also in terms of what portion of the total cost of utility operations will be paid by each of the various classes of users. The financial well-being of a utility is in large measure determined in rate cases. A company may be able to effect certain economies in operations and it may be able to convince customers to consume an increased amount of the company's products, but the effect of these actions on a utility's earnings is seldom as significant as that of a rate increase.

A good portion of a company's business before the public utilities commission, much of the work of the staff, and many of the commission's most difficult decisions deal with requests for rate increases. There are no clear black and white answers available to the commission as to how much a company should be allowed to make. Such a decision, in the last analysis, represents the judgment of the commission based on the facts developed during the hearing of a case.

Utility rates, it should be noted, might need to be lowered rather than raised, but this has not happened frequently in the recent years of rising prices. Further, companies are not as likely to request decreases as increases. If they are earning in excess of what is considered a fair return, they would prefer to invest the excess earnings in plant replace-



ment, accelerated maintenance, and increased service rather than reduced rates.

The process of establishing utility rates is a complicated one requiring the services of experts in utility finances and engineering. It involves a fair amount of conflict, for even if the experts agree on the factual data, they will disagree on how the data should be interpreted or on what constitutes a proper rate of return. In the sections which follow, the significant elements of the rate-setting process in Hawaii are discussed briefly.

#### The Earnings Position

The commission, in rate-setting proceedings, first examines the earnings position of a utility company. Revenues, expenses, and the rate base are projected for a period of a year, which is wholly or in part in the future, on the basis of data recorded in past years. By using a test year, the commission is able to grant rates which are more realistic in terms of future costs than if rates were established on the basis of the last recorded year. After the anticipated revenues, expenses, and rate base data are calculated, it is possible to estimate the size of the revenue deficiency assuming different rates of return on the rate base. It is this deficiency which must be overcome if the company is to receive the selected rate of return.

Revenues, Sales, and Customers. In determining the earnings position of a utility company, the recorded operating revenues for the past three to five years from each class of users for whom a separate rate schedule applies and from sources other than the sale of the utility's primary product are analyzed. Based on these analyses, a projection is made

of the estimated sales of the utility's product and revenues from such sales during the test year as well as of revenue from other sources. The staff also analyzes the effect of the company's proposed rate changes on the entire system and on each class of users.

Data on the number of customers, the average monthly consumption per customer for each category of users, and related information, are analyzed and plotted on graphs in order to make the necessary test-year projections. When the rate is permitted to vary with the cost of fuel, as in the case of electricity, summary revenue projections are made using both the base and current fuel prices.

All revenues which may be considered to be directly or indirectly derived from the utility operation are included. Thus, bus advertising revenue is included when considering transit rates, since this income could not be earned unless the company were permitted to operate as a utility. Sale of home equipment by a gas or electric company, however, is excluded since such sales are not dependent on the company's status as a public utility.

Expenses, Taxes, and Depreciation. Operating expenses, depreciation, and taxes paid by the utility for the preceding three to five years are analyzed and a projection of such costs is made for the test year. The operating costs of an electric utility, for example, include production, transmission, distribution, commercial, sales promotion, and administrative and general expenses. To the total of these costs are added depreciation and taxes in order to determine the total amount which should be deducted from total revenue to find net earnings. The operating cost estimates are based, of course, on the same consumption data as the revenue estimates.

Certain expenditures are not included in the amount deducted from total revenues. It is not believed proper, for instance, to charge the consumers with the cost of donations. The size of other expenditures is limited. Promotional expenditures may be deducted as long as they do not exceed a specified amount. A company may spend more on promotion but the excess will not be deducted from revenues in determining net earnings. The theory is that promotional expenses designed to promote better utilization of current services and obtain new customers may legitimately be charged. The cost of institutional advertising, however, may not be allowed. Occasionally other administrative and plant maintenance and operating expenses are disallowed after a rate application has been filed. Information on the efficiency of utility operations is not usually available to the commission except at the time of a rate case.

One utility company, Kauai Electric, which purchases its power from plantations, is permitted to pay more for power than it costs the supplier to produce it. The plantation electrical generating operations are not subject to commission control. The contracts between the plantations and the utility provide that the utility pays approximately what it would cost to produce power using fuel oil but not allowing for stand-by capacity. The rates rise when the price of fuel oil rises even though the plantation does not use fuel oil for all of its generation. The justification for this arrangement is that if plantation power were not available, the company would have to construct, operate, and maintain its own power plant including adequate reserve capacity. The company's production costs would under such a system probably exceed the amount it is currently paying for power.

Depreciation expense includes the amount allowed on all classes of

depreciable plant and equipment in accordance with the depreciation rates which have been established for the utility. In forecasting the amount of taxes due during the test year, since several are based on earnings, it is assumed that the revenues and expenses of the company will be as estimated.

The federal government permits utilities and other companies to take accelerated depreciation for tax purposes, which for a growing company reduces its current tax bill. The commission does not allow this practice. Most, but not all, companies are on straight line depreciation for rate-making purposes. The commission therefore insists that each company using accelerated depreciation establish a reserve for deferred income tax. In this reserve is placed the difference between the taxes based on depreciation allowed by the federal government and the taxes based on depreciation allowed by the commission for rate-making purposes.

#### Rate Base and Net Revenues

The company's rate base, that is the value of the company's utility property on which the owners are entitled to a return, consists of the value of the fixed capital used and useful in rendering utility services less the reserve for depreciation and certain other amounts plus amounts for working capital. The Hawaii commission uses original (i.e. historical) cost in determining the value of fixed capital and the cost

of depreciation.<sup>1</sup> The detailed components of the rate base are shown in Table 11 in which hypothetical figures are used to illustrate the computation.

Net Revenues. The final step in determining the earnings position of a utility is calculating: (1) the rate of return which a company would earn under present and proposed rates; and (2) the revenue deficiencies which would result if the company were to be allowed different, higher rates of return. Net revenue available as a return on investment is computed by subtracting total revenue deductions (i.e., expenses including depreciation and taxes) from anticipated revenues for the test year. The actual rate of return is then computed by dividing the net revenue available as a return on investment by the average depreciated rate base for the test year.

Next the net returns which would be required if higher rates of return were to be allowed are calculated by multiplying rates of return, usually varying from six to seven per cent, by the rate base. The net revenue deficiency is the difference between the projected net revenue at the higher rate of return and what would be earned at the current rate. The gross revenue deficiency is the total amount which would have to be raised through increased rates in order to produce the net return (less taxes) to yield the desired rate of return on the rate base.

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<sup>1</sup>Original cost is the cost of procuring utility property. It is a fixed base to which are added plant additions and from which are subtracted plant retirements. The value of the base does not vary with economic conditions. Arguments are put forth, from time to time, that reproduction costs are a better measure of value than original costs. Reproduction costs disregard past prices and deal only in present costs, i.e., the cost of acquiring or constructing the property at the present time and at present costs. It is felt that the value of a property tends to equal the cost of reproducing it, and thus a rate base using reproduction costs would be much fairer to those who have invested in a company than an original cost rate base. However, supporters of original costs question the practice of allowing owners to receive a return on monies they never invested.

Table 11

AN ILLUSTRATIVE COMPUTATION  
OF A PUBLIC UTILITY'S RATE BASE

<b>Fixed Capital</b>			
Balance at beginning of year	equals	\$1,000	
Additions during year	plus	115	
Retired property (charged to depreciation reserve)	minus	25	
Balance at close of the year	equals	<u>\$1.090</u>	
<b>Reserve for Depreciation</b>			
Balance at beginning of year	equals	\$ 200	
Depreciation accrual	plus	20	
Other credits (i.e. salvage)	plus	5	
Charge to reserve (i.e. retirement)	minus	25	
Other debits (i.e. cost of removal)	minus	5	
Balance at close of year	equals	<u>\$ 195</u>	
<b>Fixed Capital Less Reserve for Depreciation</b>	<b>equals</b>	<b>\$ 895</b>	
Customer advances and contributions in aid of construction	minus	30	
Deferred income tax	minus	20	
Working capital--materials and supplies	plus	15	
Working capital--cash	plus	20	
Rate Base at end of year <sup>a</sup>	equals	<u>\$ 880</u>	

Source: Compiled from reports of the Public Utilities Commission.

<sup>a</sup>For illustrative purposes, the rate base at the end of year is shown. The commission, in actual practice, uses the average of the rate bases at the beginning and the end of the year.

## Financial Requirements

A private utility requires money in order to operate and expand. The cost of acquiring this money, both bond and equity, represents a very real cost which a utility must pay in order to remain financially healthy and to be in a position to borrow more money or sell more equity whenever necessary.

Capitalization. Utilities and the commission make a determined effort to preserve a balance between equity and bond financing. Bond financing, within limits, costs the consumer less because bonds command a lower interest rate than the dividend rate of most common stocks and, further, the interest payments on bonds are deductible in computing income taxes. On the other hand, as the proportion of bonds to equity increases, it becomes harder to obtain bond financing and the interest rate rises sharply. The commission encourages companies not to have more than half of their capitalization in bonds.

Cost of Money. It is simple to compute the net annual interest requirement on bonds for the test year; the amount remains the same regardless of the earnings allowed on common equity. The same is true of preferred stock if there is any outstanding. It is next necessary to compute the earnings on common stock equity at different rates, usually varying from 8 to 11 per cent. Common stock equity is composed of three elements: (1) the value of the common stock at par; (2) the premiums over and above par which have been paid to the company for common stock (capital surplus); and (3) the earned surplus (or retained earnings) of the utility. The capital surplus and the retained earnings are owned by the owners of common stock but have not been distributed to them in the form of dividends. The total value of these three elements does not

necessarily equal the market value of the outstanding common stock, but this difference is due, at least in part, to the fact that market value reflects such factors as anticipation of future value and earnings.

The cost of interest on the bonds and preferred stock plus the earnings allowed on common stock equity, depending on the earnings rate selected, equal the total cost of money. This amount divided by the total capital value of the firm equals the average percentage cost of money, a figure which will be somewhat more than the bond interest rate and less than the allowed return on common stock equity.

Rate of Return on Rate Base. The return on the rate base anticipated during the test year at specified rates of return have been computed. By subtracting bond interest and other interest charges from these returns, the remainders available for common stock at different rates of return are determined. These remainders can be divided by the number of shares outstanding in order to determine the estimated earnings per share available for distribution to common stock owners. Further, by assuming that the dividend will continue to be the same dollar amount, the balance available for surplus and the percentage paid out in dividends may be calculated for each assumed rate of return on the rate base.

Operating Ratio. The rate base of transit companies is composed primarily of motor vehicles which have relatively short anticipated lives. Further, because an equal number of replacement vehicles is not purchased every year and because new buses usually cost more than the vehicles they replace, the rate base of transit companies has been subject to rather large fluctuations. To permit a fixed rate of return on a rate base that

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may increase sizably in a few days and then decrease rapidly over the next few years until such time as new equipment is acquired will result in a transit company earning much money one year and little money the next year even though it may continue to carry the same number of passengers. If a transit company is to earn a relatively constant income, it is necessary to use a different method of measuring return. The commonly accepted alternative measure is the operating ratio, i.e., the ratio of operating expenses to operating revenue. This ratio is intended to lie between 94 and 97 per cent for transit companies in Hawaii. This means that a transit company should spend \$94 to \$97 for each \$100 it earns.

The operating ratio is simply a convenient device for measuring return with respect to transit companies. It is difficult to justify the operating ratio approach on other than empirical grounds.

The Decision on Rates. The commission, when it makes its decision in a rate case, has before it information on a utility's expenses and revenues, the cost of money assuming different rates of earning, and the estimated amounts available for common stock given different rates of return on the rate base. It also generally has data available on the earning of other corporations on their book values, on the earnings of other utility companies, and on the rates of return awarded by other commissions. Out of all of these data comes a value judgment which is the rate decision.

#### Apportionment of Charges

It is just as important to determine who will pay the bill as it is to decide what is the proper total bill. Almost all utilities receive

their revenues from several classes of users. An electric company, for instance, may serve some major industrial consumers with power at primary voltages and other industrial establishments, commercial enterprises, residences, and street lighting systems with power at secondary voltages. It is possible by analyzing the nature of the utility's operation and the use made of its services by its various classes of customers to divide the costs fairly among the utility's users.

Allocation of costs in an electrical system, for instance, necessitates dividing the system between production and transmission on the one hand and distribution on the other. Each function is next expressed in terms of plant investment and expenses of operation and both functions are divided into their three cost components: the cost of being ready to serve (demand cost); the cost of producing and transmitting the electrical current (commodity cost); and the cost necessitated by having to serve individual customers (customer cost). Plant investment and expenses of operations, subdivided as to demand, commodity, and customers' costs, are next allocated among the various customer classifications based on data on annual sales, excess demand, and number of customer equivalents. The final allocations are expressed in terms of class rates of returns.

Once these data are developed, it is possible for the commission to determine how it desires to distribute the cost of a revenue increase among the various classes of utility users, so that each group of users may pay what the commission determines to be that class' fair share of the total cost of the utility service. To increase rates to all classes of users

by the same percentage may simply represent the continuation of an already inequitable situation, thereby resulting in discriminatory rates. Further, the proper allocation among various users may change from time to time.

## VI. SOME MATTERS FOR LEGISLATIVE CONSIDERATION

The necessity for the regulation of public utilities is a product of the private ownership of such utilities, for the owners of the utility companies and their customers are different people having different interests. It has been assumed in the United States that, in most instances, utility services will be more efficiently and adequately provided by private enterprise than by government, as long as such private companies are subject to effective regulation by the state. The protection of the public interest, however, is not achieved simply by the passage of a law and the establishment of a regulatory agency. Many factors influence the effectiveness of utility regulation, including the nature of the legislative mandate, the organization of the regulatory agency, the selection and term of the members of such an agency, the relationship of the agency to the legislature and the chief executive, the way in which the agency is financed and staffed, and the manner in which the agency conceives of its own role as protector of the public interest.

The stakes in utility regulation are high. Even though the directors of a privately-owned utility may be inclined to believe that their interests and those of the public are similar if not identical, others need not accept this assumption. A utility, like any other enterprise, should be expected and even encouraged to press for its own interests as it conceives them. Therefore, there must be workable provisions in the regulatory process to insure that the public interest is adequately identified and defended. Most of the difficult problems associated with regu-

lation of public utilities, whether they are legal, organizational, budgetary, or procedural, are related to the basic problem of determining and protecting public interest.

#### The Promulgation of Regulatory Standards

The designation of a business as a public utility and its subsequent regulation by a governmental agency generally occur as a consequence of decisions made by a legislature. The legislature also selects those operations of each class of utilities which may be controlled and determines the degree of discretion the regulatory agency will have in promulgating regulations. The legislature may choose to define what it means by the public interest or it may permit the regulatory agency almost complete freedom in giving substance to this concept.

In Hawaii, as in many other states, responsibility for determining substantive policy in the field of utility regulation has been delegated to the public utilities commission. The public utilities law gives the commissioners little guidance, except to specify that rates should be just and reasonable. It does not include any statement as to what constitutes reasonable rates, what costs consumers should be expected to pay, what is a utility's rate base, how a rate base should be measured, what constitutes proper or allowable rates of return, what kinds of controls the commission may exercise over operating expenses, how returns should be stabilized if at all, or what the state's responsibility is for overseeing the planning for adequate utility services in the future. The commission, under the circumstances, has done the best it could, to serve as a subsidiary legislature by enacting some general rules, developing general

guides, and being guided by the actions of other states and the decisions of the courts of Hawaii, other states, and the United States.

It may be useful for the legislature to consider the desirability of furnishing the commission with as much guidance on substantive matters of regulation as it does on procedural ones. The enunciation of such legislative policies should follow, of course, the careful consideration of alternative standards.

#### Commission Organization and Financing

The legislature in Hawaii is responsible for determining how the State will organize to discharge its regulatory responsibilities and for deciding how much it will spend on regulation.

The decisions as to whether to vest regulatory responsibility in specialized or generalized agencies, to have commissioners serve part-time or full-time, or to finance regulation from special or general funds will clearly have a significant impact on the nature of the state's public utility regulatory program.

Specialized and Generalized Regulatory Agencies. Responsibility for state regulation of utilities may be vested in a public utilities commission as in Hawaii or in specialized regulatory agencies as in the federal government and a few states. The primary arguments for creating separate regulatory bodies in Hawaii are: (1) the present commission is part-time and does not have sufficient time to assume additional duties; and (2) the members of a regulatory board which specialize in the problems of a single industry will understand its problems better than members of a generalized board. It is questionable, however, even with their present duties, whether commissioners should serve only part-time. It is likely that the additions

of substantial new duties would necessitate the appointment of full-time commissioners. The argument against a specialized board is that such a board is likely to become a servant of the industry it regulates. A commission with responsibility for regulating a variety of utility operations, it is argued, will be more cognizant of the need for identifying and protecting the public interest than one solely concerned with a single industry.

Part-time or Full-time Commissioners. Hawaii commissioners, unlike those in other states, serve part-time. The commissioners, most of whom are businessmen, are paid only a nominal per diem for the days they work for the commission. They serve as commissioners because they enjoy the work, they can afford the time, and they desire to perform a worthwhile public service. Commissioners, even now, however, are asked to work an inordinate number of days considering the fact that they are expected to make their living elsewhere.

Even if the commission is not assigned responsibility for regulating additional utilities, it will be necessary to give consideration to the establishment of a three or five member commission whose members serve full-time, if it is desired that the commission assume responsibility for performing some of the legislative and administrative functions which are by necessity currently omitted. An alternative to a full-time commission is the appointment of a full-time chairman responsible for administration of the commission, assisted by two or four part-time commissioners in adjudicatory and legislative matters. One difficulty in such an arrangement is that the chairman, who has the advantage of serving full-time, may tend to dominate the commission unduly.

If commissioners are to serve full-time, consideration should be given to lengthening their terms of office. It will be difficult to obtain the services of outstanding individuals if all one may offer is a tenure of four years. A successful lawyer, for instance, would be extremely hesitant about giving up his private practice to serve as commissioner for such a short period. It has recently been suggested that federal commissioners should be appointed for ten-year terms.<sup>1</sup>

A possible alternative to full-time commissioners is the employment of hearing officers, who would hear and render decisions in matters in dispute before the commission. Hearing officers are supposed to be able to hear cases more expeditiously and professionally than lay commissioners. Since delay is not a major factor in cases before the public utilities commission, the need to use hearing officers may not be as strong here as elsewhere. Further, the employment of hearing officers may have a few disadvantages: (1) a hearing officer may not give various facets of a case as adequate consideration as they would receive from a board of commissioners; and (2) if the appellant is free to appeal an adverse decision of a hearing officer, then the amount of time saved by employing such officers may not be great. Some of the advantages of employing hearing officers may be obtained by permitting an individual commissioner to hear a case and then letting the full commission determine whether it wishes to reconsider his decision.

Financing, Staffing, and Workload. The work which the public utilities commission can perform depends in some measure on the size of its staff and the amount of money available to the commission. This is not to imply that

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<sup>1</sup>  
Ibid.



the only limiting factor on the efficiency of utility regulation is the number of employees and amount of money available. Equally important is the attitude of the commissioners. If the commissioners, assuming they are employed full-time, view their regulatory responsibilities as a challenging and exacting task and can convey this attitude to the staff, then the possibility of effective regulation is greatly enhanced. If, on the other hand, such an outlook is lacking, it is not likely that additional staff and money will make much difference.

Comparatively little, \$150,000 per year, has been spent by the State on regulating the utilities which include an electric industry that grosses \$35 million a year, a gas company that earns \$4.5 million, a telephone company that collects \$22 million, and passenger motor vehicle carriers earning over \$5 million. The cost of regulation, in fact, is about a dollar per household per year or less than half of one per cent of a family's expenditure on regulated utility services in a year. Again, simply to raise appropriations for regulation without a plan for a more comprehensive approach to regulation, than has been feasible in the past, would not be wise.

One reason that so little has been spent on utility regulation over the years may have been the existence of the public utilities commission special fund whereby regulation was considered to be self-supporting operation paid for in toto by the regulated utilities. Commission expenditures were limited by fees collected, regardless of the fact that there may have been a need for a more intensive and expensive regulatory program. The legislature understandably did not review the operations of special fund agencies with a view to supplementing their special sources of income with

general funds. Now that the commission is financed from the general fund, however, it should be feasible to measure its need for appropriations independently of the amount of money a particular special levy may produce. Further, if the money which pays for regulation is not derived from the industry that is being regulated, there is less tendency for the industry to look upon the agency as its own.

If the commission assumes active jurisdiction over freight motor vehicle common carriers and other transportation companies, it will be necessary to increase the staff of the transportation branch. If commission jurisdiction remains unchanged but the commission becomes full-time and a more intensive and comprehensive regulatory program is undertaken, it will probably be necessary to add to the finance and engineering staffs and to establish a small unit concerned with research.

#### The Commission's Tripartite Role

The basic organizational pattern for the execution of the utility regulatory function in Hawaii and the other states is the lodging of responsibility in a multi-member commission, assisted by a staff, which enacts regulations, adjudicates cases, and administers regulatory agency affairs. This arrangement, in spite of criticism by some experts for various alleged shortcomings, has achieved a wide degree of acceptance which is not likely to be lessened in the future. Thus the improvements which do occur in the regulation of utilities are most likely to occur within the framework of regulation by commission.

Legislative Responsibilities. The Hawaii public utilities commission does not now have sufficient time or staff to devote to its legislative or

policy-making responsibilities. Even if the legislature assumes responsibility for defining basic public policy, as discussed earlier, there still exists the need to develop rules and guides which will implement legislative intent and to recommend revisions in basic policies. The commission also has a responsibility to review its rules and guides, in order to determine if they are adequately achieving the desired ends and to make revisions it finds necessary.

If the commission's policy-making functions are viewed more broadly in the future than they have been in the past and if the commission has more staff available, then it will be proper to expect the commission to study, analyze, and report on basic utility problems which are beyond the immediate limitations of the regulatory process. The commission, for example, might consider the problems involved in maintaining privately-owned public transit companies when the transit industry is faced by rising costs, decreased numbers of riders, and increased competition from private automobiles. The commission may not be able to solve the problem but it is in an excellent position to observe the symptoms early and report them to the legislature and governor. Similar questions of public policy may evolve with respect to the development of power from atomic energy, power from volcanic steam, interisland telephone and teletype communications, or any number of other public utility matters which are of material importance to the people of Hawaii.

Adjudicatory Functions. Much of the attention directed at regulatory commissions has been concerned with the commission as an adjudicator of disputes. There is a certain amount of continuing disagreement between

those who think a commission should be a court and follow court procedures and those who wish it to enjoy the latitude of an administrative board and not be bound by formal rules of evidence and similar requirements.

While one may debate the desirable degree of formality which should obtain in proceedings before commissions, once commissions are required to be courts there will no longer be any necessity for having commissions. One of the basic reasons for utilizing commissions is to permit some flexibility with respect to the procedures employed in making business-type judgments concerning rates, valuations, security issues, depreciation schedules, and certificates.

Commissions, here and elsewhere, have been criticized for the fact that commissioners consult with staff members after a hearing is closed and that staff members very often write the commission's opinion. Some commissions have established special decision writing sections in order to provide the desired segregation. Critics feel that a staff member writing an opinion for a commission cannot help but impinge on the commission's responsibility for determining the reasons why a case should be decided in a certain manner. Since a commission is not a jury bound by the rules of court procedure, there seems to be little reason to restrict a commission from having contacts with either its staff or the utility's or both following the formal termination of a hearing. It might, however, result in sounder and more independent decisions if one of the commissioners, assisted if desired by the counsel to the commission, prepared the commission's written decision.

Some problems arise concerning the dual role of the commission's counsel during hearing. The part-time deputy attorney general, presently assigned to the commission (who is occasionally assisted by another deputy)

must function not only as public counsel defending the public interest and questioning the facts and judgments of company officials before the commission but also as legal adviser to the commission. These roles are not always compatible. It would be worthwhile to consider having one deputy serve in only one role at one time. Possibly the attorney general could assign another experienced member of his staff to give legal advice and opinions to the commission and to assist commissioners in writing opinions. This arrangement would permit the deputy who is assisting the staff to enter wholeheartedly and without reservation into his role as public counsel.

Administrative Activities. Most administrative activities of the Hawaii public utilities commission, as was noted earlier in the report, are staff activities concerned with the preparation and presentation of the staff's positions in formal proceedings before the commission and few with routine administrative reviews of utility operations. Unless these routine reviews, however, are performed by the commission, which is the only agency in the Islands responsible for ensuring that the public interest is protected, it is doubtful if they will be performed at all. Further, neither citizen groups nor municipalities, which might serve as spokesmen for consumers and bring matters to the attention of the commission, have assumed responsibility for surveillance of utilities in Hawaii and neither of them participates in commission proceedings.

The lack of vigorous direction of administrative activities by plural executives, including utility commissions, has frequently been noted. One

proposal for overcoming this deficiency is to strengthen the position of the chairman of the commission by making him responsible for directing the administrative activities of the commission's staff and for appointing personnel, subject to commission confirmation of important appointments. The chairman would be appointed by the chief executive and serve at his pleasure.<sup>2</sup>

#### The Basis for Utility Rates

Utilities occupy a unique position in the business world. They are privately-owned but government-regulated. They are granted certain privileges in exchange for which they agree to be subjected to regulation. The effectiveness of the regulation determines the soundness of this exchange from the public's viewpoint.

There is need for more study of the basis upon which rates are set. The concept of a fair return on a rate base has already proved not particularly useful in determining a sound rate structure for motor vehicle passenger common carriers and has been replaced in part by a measuring device called operating ratio. Very possibly the single most important consideration in establishing rates for any utility is how much money it must charge to make enough money to continue to operate successfully. Perhaps the primary measurement should be strictly an empirical one based on the financial requirements of the company. Possibly the theoretical obligation to furnish a given return on a specifically measured rate base

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<sup>2</sup> See James M. Landis, Report on Regulatory Agencies to the President-Elect (Washington, D. C.: Government Printing Office, December 1960).

or a particular return on the book value of common equity plus retained earnings is not significant.

If, on the other hand, the fundamental entitlement of the company owner is to a particular return on his investment, i.e., to a specific rate of return on the rate base, then a great deal more care should be taken than at present to assure that the owner earns just such an amount and no more or less. A company will earn a higher rate of return when its revenues increase and its rate does not. On the other hand, a utility's rate base may increase without a parallel increase in revenues, and thus its rate of return would drop. If the rate of return is the important measure, these variations should be offset through the use of a rate equalization fund. Then, if the utility earns more than the rate the commission has set, the excess revenue would be placed in the reserve; if the company earns less, then it would be entitled to draw the difference from the reserve. Such a procedure would have added advantage of lengthening the period between rate requests. The procedure, however, has no particular validity unless it is the rate of return on the investment which is the crucial feature in the rate regulatory process.

Whether financial requirements or rate of return and cost of money are relied on in determining rates, the application of such measures must be preceded by the determination of what constitutes allowable expenses which are properly chargeable to the utility consumer. If it is assumed that only those expenses incurred by a utility which is operating as economically and efficiently as possible are proper charges, then it is necessary for the commission to evaluate, on a continuing basis, a utility's performance in order to establish

fair rates. If a company is operating inefficiently, the cost of this inefficiency should not be reflected in the rates paid by consumers.

If the commission is to discharge its responsibility with respect to determining the efficiency and economy of company operations and as a result of such determinations, allow or disallow expenses, it is going to be accused of interfering with management and substituting its judgment for management. The only answer to such accusations is that the judgments must be expert and informed. Since there is no market mechanism which penalizes the inefficient utility producer, the commission must serve as the market.

#### A Commission Program for Utility Regulation

The public utilities commission and the administration of which it is a part are responsible for the formulation of a program or plan for utilities regulation which takes into account the long and short-term objectives of regulation, the means employed in accomplishing the desired ends, and the effectiveness of the regulatory program. This program should be reviewed and considered by both the executive and the legislature when decisions concerning the regulation of public utilities are made.

Today the commission and its staff, by necessity live from case to case without ever adequately and comprehensively reviewing their past and planning their future regulatory program. The public interest is the commission's criterion in evaluating individual applications, but regulation to be effective, must represent more than the deciding of individual cases on the basis of merit. A comprehensive regulatory program needs to include the full spectrum of regulatory activities from the recommendation of basic public policies to the performance of routine administrative reviews. It is in terms of such



a program that the legislature and others may know what has been achieved and what needs to be accomplished.

The program, which should be in writing, would specify the activities in which the commission should indulge if it is to do an effective job of protecting the public interest. The program should, of course, be revised as required by new developments or completion of particular special projects. The commission periodically should translate the program into a time-table of commission and staff operations which would serve as a guide to the commission in scheduling the work it intends to perform in the near and more distant future. Further, the program and schedules should serve as a basis for reporting and analyzing accomplishments and omissions.

## Appendix

### REPLIES OF SELECTED STATE PUBLIC UTILITIES COMMISSIONS TO QUESTIONS ABOUT THEIR ORGANIZATION AND OPERATIONS<sup>1-</sup>

During the course of the Legislative Reference Bureau's study of the regulation of utilities by the Hawaii Public Utilities Commission, requests were submitted to four selected state regulatory agencies soliciting information on their organization and operations. The four agencies, which were selected because of their reputation as outstanding state regulatory bodies, are the California Public Utilities Commission, the New York Public Service Commission, the Wisconsin Public Service Commission, and a fourth commission which prefers to remain anonymous.

The replies of the commissions to the questions asked of them were both well-considered and thought-provoking. The assistance rendered by these commissions is gratefully acknowledged. The bureau's questions and the replies of the California, New York, and Wisconsin commissions are presented in this appendix.

#### I. Commission Initiative

Question: Does the staff on its own or at the direction of the Commission undertake studies or investigations of particular companies or particular classes of utilities other than in response to a specific company application or public complaint? If yes, what are some of the typical subjects of such studies or investigations? Does such work constitute a significant portion of the commission's total program? Do such studies or investigations frequently result in the Commission's issuing show-cause or compliance type orders?

California: In answer to paragraph (1), you are informed that the

## Appendix (continued)

staff of this Commission, at the direction of the Commission, keeps the objects of regulation by the Commission under constant surveillance and is constantly making investigations and reporting to the Commission with regard to both rates and service and any other matter subject to the jurisdiction of the Commission. This constitutes a considerable part of the function of the Commission. These investigations result, in many instances, in the Commission issuing show-cause orders or other types of compliance process.

New York: Aside from studies and reviews made informally in the ordinary course of business, at the staff (i.e., bureau and section) level on its own initiative, of particular companies and particular classes of companies, the Commission also institutes formal proceedings of both specific and general scope. Some of these proceedings, while instituted "on motion of the Commission", originate with an informal complaint on the part of one or more individuals or groups, which upon informal investigation by the staff discloses violations or possible violations of the Public Service Law or service inadequacy. The consequence of instituting the investigation on motion of the Commission, rather than upon complaint of an individual, is that in the former case the Commission staff assumes the burden of proof, i.e., of demonstrating the existence of the violations or inadequate conditions. Typical examples of such cases are investigations into the adequacy of service of utility companies or the propriety of the rates which they charge. Other investigations relate to the operating practices of motor carriers, particularly as they involve the question of dormancy of operating rights. Another type of proceeding is the investigation into the adequacy of railroad station facilities and train service particularly where the company has indicated its intention of discontinuing or reducing service. Investigations as to the adequacy of railroad crossing protection are also common. Proceedings on motion of the Commission, while numerically small in relation to the number of cases instituted on petition or application, constitute a significant portion of our work and are also significant from the substantive standpoint. These proceedings often result in ordering specific improvements and compliance with directives. Proceedings of a more general nature, affecting a class of utilities, are instituted from time to time, such as investigations for the purpose of determining whether certain rules or regulations of general applicability should be adopted. Occasionally also, we are directed by the Legislature to investigate a particular situation, such as the one culminating in our 1959 report on the financial condition of the railroad industry.

Wisconsin: With reference to your first question, the staff reviews earnings, revenues, and expenses of the various utilities. It prepares annual statistical studies of various phases of utility operations. If these studies reveal an apparent irregularity, inquiry is made to determine the causes. Occasionally these studies result in negotiated rate reductions and improvements in operating efficiency through reductions in operating costs.

## Appendix (continued)

The staff also maintains a continuous record of utility property. Consequently there is no need to make extensive inventories and appraisals of utility property in rate and security cases to determine whether the utility actually is operating the property represented by the original cost reflected in its accounts. I believe that Wisconsin was a pioneer in adopting this practice.

### II. Routine Administrative Review of Utility Operations

Question: Does the staff, as a matter of course, inspect and review the adequacy of service offered by and the efficiency of operations of companies under its jurisdiction in a relatively detailed and systematic manner? If yes, are such reviews usually made on a continuing basis or at the time of a rate change application?

California: The answer to the questions propounded in numbered paragraph (2) of your letter is "Yes." These reviews are on a continuing basis, as indicated in paragraph numbered (1) above.

New York: Most utilities are under order directing them to report interruptions of service. Our operating bureaus receive and review these reports, as well as complaints relating to service conditions, and keep in close touch with the quality of service being rendered. In the omnibus field, the companies are required to maintain safety standards which are imposed by a trained staff of inspectors in the field who regularly inspect buses and issue certificates of inspection therefor. Our field personnel are also engaged regularly and on a continuing basis in inspecting and testing plant equipment for safety and adequacy.

Wisconsin: With reference to that part of the second question which I have not answered in discussing the answer to your first question, the Commission staff inspects and reviews the adequacy of utility service both upon complaint and its own initiative. Inspections in connection with complaints received are given priority since the personnel available for this activity does not permit simultaneous and continuous survey of all the utilities. These inspections are not directly related to rate cases but concern minimum standards for adequate service prescribed by the Commission. We have found it better practice to separate questions concerning reasonable rates from questions involving adequacy of service. The adequacy of utility service is also reviewed in connection with Commission authorization for construction of additions to utility plants.

### III. Role of the Staff in Presentation of Cases

Question: Do the commissioners generally consider the members of the staff concerned with presentation of a case before the commission as

## Appendix (continued)

a party to a contest or as an impartial source of objective information?

California: The policy of the Commission with regard to the question propounded in numbered paragraph (3) is that the staff of the Commission is charged with a positive duty to investigate and inquire into any request made by a public utility for rate or other relief so as to test the integrity of such request. This is accomplished by staff investigation, cross-examination of witnesses and the preparation of an affirmative showing by the staff in opposition to the request of the public utility, where the facts and circumstances warrant or require such affirmative showing. The staff of the Commission is a part of the Commission and, under the law of this State, has no separate existence apart from the Commission. The staff of the Commission assists the Commission in its regulatory duties. Naturally enough, the approach of the staff is objective, seeking to find out the truth and present it to the Commission. The staff is charged with the duty of seeing to it that a record is compiled in proceedings before the Commission with a view to protection of the lawful interests of the public and to furnish a basis for the determination of all lawful issues in the proceeding.

New York: The members of the staff of the Commission are public employees charged with responsibilities under the New York Public Service Law to serve in the public interest. As such, the staff is not an "interested party" in the usual sense of the word. Nevertheless, it is not quite accurate to say that the staff is always an "impartial source of objective information". Its particular role in an individual proceeding depends on the nature of that proceeding. In a rate proceeding, the staff appears as an active party. While its basic orientation is to develop all of the facts and to highlight the issues upon which the Commission may finally reach the proper results, it is entirely proper in many instances for the staff to take a definite position on a contested issue. To that extent, opinion testimony of qualified staff personnel may be offered in opposition to that of the company. The weight ultimately to be given to opposing views is for the Commission to decide, and in that regard the partiality or impartiality of the respective witnesses would be a consideration. In many other proceedings, counsel and his staff may appear in a completely objective capacity.

Wisconsin: With reference to your third question, we do not consider the staff as a party to a contested case. Instead we consider it an expert and impartial source of objective information. In contested cases, members of the staff often present testimony and are of course subject to cross-examination.

### IV. Separation of Commission from Staff

Question: Is there some feeling on the part of the regulated utility

Appendix (continued)

companies that the relationship between the commissioners and their staff is too close, especially during consideration of a case after hearings are completed? Are any special arrangements utilized or procedures followed in order to provide some institutional separation during this period?

California: In answer to numbered paragraph (4), you are informed that there has been some complaint made by public utilities that the internal relationship of the Commission may not fully protect the interests of the utility. This Commission, many years ago, inaugurated the staff counsel program in order to comply with the spirit of the Morgan case, decided by the Supreme Court of the United States. This program provides for a staff counsel to head up the staff of the Commission in proceedings filed with the Commission calculated to test the integrity of the request made by a public utility in such a proceeding. This staff counsel acts in the capacity of an advocate, with the public interest prominently in mind. The spirit underlying the staff counsel program prohibits such a staff counsel or any member of the Commission staff who participates in a proceeding before the Commission, either as a witness or in some other advocacy capacity, from advising the Commission or any member thereof or Examiner with regard to the decision in that particular case in which he has participated in an advocacy capacity. It will be seen that this Commission has taken all reasonable steps to separate the internal functions and powers of the Commission as much as possible.

New York: While I must respectfully decline to offer any opinion as to what may be the feelings on the part of the utilities with respect to the relationship of the Commissioners and our staff, I may say that there has not come to my attention any criticism of that relationship. It must be borne in mind that most hearings are conducted by Examiners and in these instances there is little or no function by the Commissioners until the case has been finally reported to the Commission. We insist upon an objective report which will fairly apprise us of the differing points of view, so that we may exercise our responsibility to determine the issue. Should a report contain material omissions which may have affected the end result, a party may petition for a rehearing or reconsideration upon such grounds. There are no statutory or procedural inhibitions against contacts by the Commission and its staff subsequent to the closing of hearings. Obviously, in resolving issues presented in the Examiner's report, the Commission must be free to call upon the technical advice of its staff in order to function most effectively.

Wisconsin: With reference to the fourth question, we do not know of any substantial complaint that the Commission and staff operate too closely in their work. We do not have any procedures attempting to separate the staff from the Commission. Of course the Commission cannot operate successfully without frequent conferences with its staff. I do

Appendix (continued)

not see any merit in attempting such a separation. Both Commission and staff have the same objective which of course is assuring that utilities furnish service at reasonable rates and more often than not, it seems to me, they should find themselves in general agreement so far as the public interest in any utility case is concerned.

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<sup>1</sup>Letters of Legislative Reference Bureau to Public Utilities Commission, State of California, Public Service Commission, State of New York, and Public Service Commission, State of Wisconsin, January 17, 1961; and letters of reply from Everett C. McKeage, President, Public Utilities Commission, State of California, January 30, 1961; James A. Lundy, Chairman, Public Service Commission, State of New York, January 30, 1961; and Leonard Bessman, Chairman, Public Service Commission, State of Wisconsin, January 31, 1961.