Electric and Gas Utility Advertising: The First Amendment Legacy of Central Hudson

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ELECTRIC AND GAS UTILITY ADVERTISING:
THE FIRST AMENDMENT LEGACY OF CENTRAL HUDSON

Contrary to past practice,¹ state public service commissions² now restrict advertising³ by electric and gas public utilities.⁴ Motivated pri-

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² For a more complete discussion of the economic theory of public utilities, see notes 20-30 infra and accompanying text.

³ “Public service commission” may be defined as a legislatively or constitutionally created body charged with the responsibility of regulating costs and profits of public utilities in securing the benefits while avoiding the abuses of natural monopolies. See A. Finder, The States and Electric Utility Regulation 16-17 (1977). For a more detailed discussion of public service commissions, see notes 31-52 infra and accompanying text.


Due to the similarity of content of information, safety, consumer, and conservation advertising, this Note will combine all four into a broad category under the label “informational.” See Re Consumers Power Co., No. U-5979 (Mich. P.S.C. Aug. 8, 1980) (allowable informational advertising includes safety, conservation, consumer rate explanation, and factual programs). Accord, Promotional Practices of Elec. Util., 8 Pub. Util. Rep. (PUR) 4th 268, 275 (Fla. P.S.C. 1975) (informational the same as consumer). For a more complete discussion of the four categories of advertising analyzed in this Note, see notes 82-88 infra and accompanying text.

⁵ “Public utility” is defined as a company operating in such a way as to be “affected with a public interest.” See E. Clemens, Economics And Public Utilities 12-37 (1950); F. Welch, Cases And Text On Public Utility Regulation 1 (1968). See generally J. Barnes, The Economics Of Public Utility Regulation (1942); Munkirs, Ayers & Grandys, Rape of the Rate-Payer: Monopoly Overcharges in the Regulated Electric-Utility Industry, 8 Antitrust L. & Econ. Rev. 57, 57-58 (1976). The term “public utility” is somewhat of a misnomer in that it “refers only to the nature of the business, not to its ownership or operation . . . .” F. Welch, supra. Professor Welch divided public utilities into three main classes of businesses: public trans-

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marily by conservationist, environmental, and economic concerns.

Portion services for hire, communication for hire, and entities that provide service within the home or place of business. See F. Welch, supra, at 2. He further defined the latter category to include natural gas, manufactured gas, and electric light and power utilities. Id. Courts have recognized the following factors as indicia of whether a business entity is a public utility:

1. Whether the business devotes property to a public use.
2. Whether the business has been regulated in the past.
3. Whether a franchise is necessary to enter the business.
4. Whether the service rendered is a necessity to the users.
5. Whether the business has the characteristics which create monopoly.
6. Whether excessive competition will exist without public control.


This Note will focus only on the gas and electric energy producing “public utilities.” Due to the differences in advertising policies and the distinctive operating nature of gas and electric utilities, telephone, water, and trucking public utilities will not be considered. Accord, Pub. Util. Fort., Nov. 8, 1979, at 51, 53-54; Note, supra note 3, at 203 n.4. It is interesting to note, however, that telephone utility advertising is experiencing similar restrictive policies. See, e.g., Re Rule Making Relating to Advertising Expenditures, 39 Pub. Util. Rep. (PUR) 4th 296 (N.C. Util. Comm'n 1980). Because this Note will deal only with gas and electric utilities, “utility” means both gas and electric public utilities unless specified otherwise. For further discussion on public utilities, see notes 19-36 infra and accompanying text.


Concern over conservation was precipitated largely by the 1973 Arab oil embargo. See, e.g., Notice of Proposal to Issue Order Restricting Certain Uses of Electric Energy, 13 N.Y. PSC 2074-76 (Dec. 5, 1973) [hereinafter cited as Notice of Proposal]. The New York Public Service Commission, assessing what appeared to be a grim energy forecast, stated that “the demands for electric energy in this state cannot be met for the foreseeable future . . . .” Id. at 2072. Accord,
state commissions are implementing these restrictions either by direct prohibition\(^8\) or by refusal to allocate advertising costs to operating expenses.\(^9\) Although utilities have responded to these restrictions with various defenses,\(^10\) one defense in particular has fostered constitutional

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8. See, e.g., Notice of Proposal, supra note 5, at 2074-76. For a partial reproduction of the New York direct prohibition, see note 145 infra.

9. For purposes of this Note, cost allocation consists of the process by which a utility expense is passed on to the consumer in the form of rate charges. For a complete discussion of the cost allocation issue, see notes 65-81 & 196-276 infra and accompanying text.

debate. By asserting that restrictions on advertising¹¹ operate as a denial of first amendment¹² free speech rights, utilities bring into conflict substantial national concerns: the notion of constitutionally protected free speech versus the nationwide concern over energy conservation, environmental control, and inflation.¹³

The resolution of this conflict is tied directly to the recent United States Supreme Court commercial speech decision in Central Hudson Gas & Electric Co. v. Public Service Commission.¹⁴ Commercial speech,¹⁵ which includes utility advertising,¹⁶ is not accorded full first amendment protection.¹⁷ In reaffirming that some first amendment protection exists for commercial speech, the Court in Central Hudson established a four-part test.¹⁸ This test is the current standard by which courts must analyze public service commission advertising restrictions.

This Note assesses the impact of the Central Hudson test on electric and gas utility advertising and explores the tension between free speech


¹². The first amendment provides in pertinent part: “Congress shall make no law . . . abridging the freedom of speech . . . .” U.S. Const. amend. I. The first amendment is applicable to the states through the due process clause of the fourteenth amendment. See, e.g., Bigelow v. Virginia, 421 U.S. 809, 811 (1975).

¹³. See notes 107-09 & 208-10 infra and accompanying text. Another issue raised by this current regulatory trend is whether the “reasonableness” standard for advertising expenses and deference to management prerogative established in West Ohio Gas Co. v. Ohio Pub. Util. Comm'n, 294 U.S. 63 (1935), is still valid. See notes 91-109 & 273-76 infra and accompanying text.


¹⁷. For a discussion of the first amendment status of commercial speech, see notes 124-51 infra and accompanying text.

¹⁸. See note 147 infra.
rights and energy, environmental, and economic considerations. Part I examines the economic theory of public utility regulation and ratemaking. Part II traces the doctrinal underpinnings of the commercial speech defense from its inception to its apparent culmination in the Central Hudson test. Part III then analyzes the degree to which a commercial speech defense protects utility advertising. Finally, Part IV analyzes the question left unresolved by Central Hudson: whether reasonableness of the amount of expenditures remains a valid means by which to evaluate utility advertising.

I. REGULATORY ECONOMICS

A. Natural Monopolies

The rationale for regulating public utilities is based on the economic concept of natural monopoly. A natural monopoly exists when a "relevant market" has an "indispensable economic need" for a product and one firm, rather than two or more, can satisfy that need at the lowest possible cost. Public utilities are the most common examples of natural monopolies.

Economic theory indicates that public utilities will operate most efficiently and produce lower unit costs under a monopoly format. Construction of generating and transmission facilities requires large capital expenditures. A protected monopoly is able to make the most efficient use of these capital expenditures for two reasons: monopoly protection "eliminates costly duplication" of generating and transmission facilities.

20. Munkirs, Ayers & Grandys, supra note 4, at 57.
21. Posner, supra note 19, at 548. See 2 A. Kahn, The Economics of Regulation: Principles and Institutions 119 (1970). Kahn defines "natural monopoly" as one in which there is an inherent tendency to decreasing unit costs over the entire extent of the market. This is so only when the economies achievable by a larger output are internal to the individual firm. . . ." Id. See generally A. Alchian & W. Allen, Exchange and Production, Theory in Use 427 (1969).
22. See Posner, supra note 19, at 548 ("[t]his set of controls has been applied mainly to gas, water, and electric power companies").
24. See A. Finder, supra note 2, at 3; P. Garfield & W. Lovejoy, supra note 10, at 17; Gabel, supra note 23, at 709; Meeks, Concentration in the Electric Power Industry: The Impact of Antitrust Policy, 72 Colum. L. Rev. 64, 82 (1972). These initial capital expenditures required to construct generating and transmission facilities may also be referred to as fixed costs. Fixed costs are defined as those costs that remain constant regardless of output. Fixed costs may also be referred to as "overhead charges." P. Samuelson, Economics 464-65 (1973).
facilities, and, more importantly, when these fixed costs are averaged on a per unit of production basis, average unit costs decrease as output increases. Hence, public utilities are subject to the principle of "economies of scale," which means that the cost of each unit becomes cheaper as the utility produces more units. Consumers' costs for a utility's services potentially are the lowest when only one firm produces that service within the relevant market. Left unchecked in this competitive void, however, a profit-maximizing public utility is free to exploit its market position by charging exorbitant prices. To curb this otherwise uncontrolled power and its potential for pricing abuse, state legislatures created public service commissions.

26. See A. Finder, supra note 2, at 3; P. Garfield & W. Lovejoy, supra note 10, at 18; 1 A. Kahn, supra note 21, at 45-46.
27. See 1 A. Kahn, supra note 21, at 11. Due to economic and social changes, the principle of economies of scale is of less significance today, especially as to electric utilities. See notes 99-100 infra and accompanying text.
28. See Munkirs, supra note 4, at 58.
30. See A. Finder, supra note 2, at 16-17. In theory, the development of the public service commissions was designed to stimulate the forces of competition that occur in a competitive market. 1 A. Kahn, supra note 26, at 17; 1 A. Priest, Principles of Public Utility Regulation 1-2 (1969). Thus, the regulatory commission acts as a surrogate competitor. Cantor v. Detroit Edison Co., 428 U.S. 579, 595-96 (1976).

The historical development of public service commissions began with the common-law state police power under which was created the "power of the state to do things to protect and promote the health and welfare of its citizens." F. Welch, supra note 4, at 3. This limited basis for regulation gained additional support in the Supreme Court's landmark decision in Munn v. Illinois, 94 U.S. 113 (1877). See A. Finder, supra note 2, at 16; F. Welch, supra note 4, at 1. In Munn the Supreme Court upheld the authority of the Illinois legislature to regulate rate ceiling for those businesses "affected with a public interest." 94 U.S. at 126.

Nevertheless, the state legislative authority to regulate businesses "affected with the public interest" was circumscribed to purely intrastate transactions in a subsequent opinion. See Wabash, St. L. & P. Ry. v. Illinois, 118 U.S. 557 (1886). This decision confirmed the authority of the federal government to regulate interstate commerce. As a result of Wabash, state legislatures were powerless to regulate organizations engaging in interstate commerce. This void was filled by the creation of the Interstate Commerce Commission (ICC) in 1877. Creation of the ICC was important for two reasons: it made possible the regulation of public utilities not solely engaged in intrastate activity, and the structure and organization of the ICC served as a model for the impending state regulatory commissions. See A. Finder, supra note 2, at 16.

In response to these developments, the Georgia, New York, and Wisconsin legislatures in 1907 established the first state public service commissions. Id. Even though their regulation was limited to intrastate activity, the subsequent creation of the Federal Power Commission and its corresponding regulations "limited the development of electric and gas utilities to statewide systems," effectively giving control of public utilities to the states. Id. at 17.
B. **Public Service Commissions**

Public service commissions of one form or another exist in all fifty states and the District of Columbia. Creation of these regulatory bodies is either by state legislative or constitutional authority. Commission size varies from one commissioner to seven, with most states having between three to five commission members. Members' terms of office, which are often staggered, range from four to eight years, with selection varying from gubernatorial appointment to statewide election. To neutralize the politics of the decision making process of public service commissions, some states regulate the political composition of the membership. In all but nine states, service on the

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31. The term “public service commission” for purposes of this Note will be used synonymously with “regulatory commission” and “commission.”

32. For purposes of clarity and continuity, the Virgin Islands and Puerto Rico, though territories of the United States, are omitted from consideration in this Note. Puerto Rico, however, does have a three-member public service commission with members serving four-year terms. Selection is by gubernatorial appointment with senatorial approval. Members serve on a full-time basis. See A. FINDER, supra note 2, at 18.

The Virgin Islands has a nine-member commission appointed by the governor to serve three-year staggered terms. See id.


34. See, e.g., CAL. CONST. art. XII, § 22; GA. CONST. § 2-2703; VA. CONST. art. IX, § 1.


37. Those commissions having three members include: VA. CONST. art. IX, § 1; ALA. CODE § 1 (1975); FLA. STAT. ANN. § 350.01 (West 1968); OHIO REV. CODE ANN. § 4901.02 (Page Supp. 1980); UTAH CODE ANN. § 54-1-1 (1974).

38. See, e.g., CAL. CONST. art. XII, § 22; ALA. CODE § 37-1-3 (1975); UTAH CODE ANN. § 54-1-5 (1974); VA. CODE § 12.1-6 (1973).

39. See, e.g., ALA. CODE § 37-1-3 (1975); FLA. STAT. ANN. § 350.01 (West 1968); HAWAII REV. STAT. § 26-34 (1976); OR. REV. STAT. § 756.020 (1974).


41. See A. FINDER, supra note 2, at 18.

42. See, e.g., Ga. CONST. § 2-2703; N.D. CONST. art. V, § 12; ALA. CODE § 37-1-3 (1975); FLA. STAT. ANN. § 350.01 (West 1968).

commission is a full-time position. The fundamental task of the public service commissions is to secure the benefits of a natural monopoly while preventing the inherent abuses.

Public service commissions regulate utility advertising primarily through ratemaking. Ratemaking is the process in which regulatory commissions strive to simulate the effects of a competitive market by controlling profits. Waste is an inevitable consequence of artificial profit control. Because utilities are guaranteed a profit, they have little incentive to minimize costs. This likelihood of wasteful spending compels regulatory commissions to control utility expenses as well as profits. Because utilities include some advertising expenses in their cost accounts, commissions must accordingly eliminate wasteful ad-

44. See A. FINDER, supra note 2, at 18. The nine states not having full-time commission members are Delaware, Hawaii, Kentucky, Louisiana, Maryland, Massachusetts, New Jersey, Rhode Island, and Vermont. Id. Massachusetts, Rhode Island and Vermont, however, do have full-time commission chairpersons. Id.

45. See A. FINDER, supra note 2, at 17.

46. For a complete discussion of the theory and process of ratemaking, see J. BONBRIGHT, PRINCIPLES OF PUBLIC UTILITY RATES 147-283 (1960); 1 A. KAHN, supra note 26, at 20-57; 1 A. PRIEST, supra note 30, at 45-226. See also notes 56-115 infra and accompanying text.

47. Regulation of utility advertising may be achieved by public service commission policy statements. See notes 163-95 infra and accompanying text.

48. Ratemaking is distinguishable from rate regulation despite their similarities. Rate regulation is a broad term that may include the specific act of ratemaking. Generally, rate regulation and ratemaking differ in timing. Ratemaking is initiated when a utility files for a rate increase. See, e.g., CAL. PUB. UTIL. CODE §§ 486, 495 (Deering 1970); HAWAII REV. STAT. § 269-16 (1976); MASS. ANN. LAWS ch. 159, § 19 (Michie/Law. Co-op 1979); UTAH CODE ANN. § 54-3-2(2) (1973). Once this rate schedule is on file, it is subject to challenge either by regulatory commissions or by independent sources. See, e.g., CAL. PUB. UTIL. CODE § 455 (Deering 1970); OHIO REV. CODE ANN. § 4909.27 (Page Supp. 1977); OR. REV. STAT. §§ 756.500, .515 (1979). Once challenged, the rates are subject to alteration by the commission should the charges be deemed unreasonable. See, e.g., FLA. STAT. ANN. §§ 364.14, 366.07 (West 1968); MASS. ANN. LAWS ch. 164, § 94 (Michie/Law. Co-op Supp. 1974); UTAH CODE ANN. § 54-4-2 (1974).

49. Under the rule in Smyth v. Ames, 169 U.S. 466 (1898), a utility is granted a “fair return upon the value of that which it employs for the public convenience.” Id. at 547. See notes 54-63 infra and accompanying text.

50. See A. ALCHIAN & W. ALLEN, supra note 21, at 428.

C. Ratemaking

1. Constitutional Underpinnings

_Smyth v. Ames_\(^{53}\) governs the process of establishing rates. _Smyth_ guarantees the utility a “fair return on the fair value” of its product.\(^{54}\) The _Smyth_ Court, however, left open the precise meaning of “fair value” and “fair return.”\(^{55}\) After years of shifting doctrine,\(^{56}\) the Supreme Court settled these ambiguities in _Bluefield Water Works & Improvement Co. v. West Virginia Public Service Commission_\(^{57}\) and _Federal Power Commission v. Hope Natural Gas Co._\(^{58}\) Emphasizing the “end result”\(^{59}\) of rate setting, the _Hope_ Court declared that the legal standard for “fair value” is the dollar value of the depreciated original

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52. See Jones, supra note 51, at 477. Professor Jones, in discussing wasteful expenditures, noted that “such high rates and profits generally should be disallowed to prevent monopolistic exploitation of consumers . . . .” Id.

53. 169 U.S. 466 (1898).

54. Id. at 547. The Court noted that in order for a utility “to earn a fair return on the value” of its investment, reasonable rates must be set. Id. The opinion in _Smyth_ was a precursor of the subsequent comparable earnings test stated in _Bluefield Water Works Co. v. West Virginia Pub. Serv. Comm’n_, 262 U.S. 679 (1923), and _Federal Power Comm’n v. Hope Natural Gas Co._, 320 U.S. 591 (1944). See generally 1 A. Priest, supra note 30, at 191-94; Jones, supra note 51.

55. The Court refused to choose between one of three methods of evaluation of the “fair value” standard: original cost, market value of stocks and bonds, and present cost of construction. See J. Jacobs, supra note 4, at 268.

56. See id. In the 46-year interim between _Smyth_ and _Hope_, the Court went from a focus on reproduction costs to the creation of the “prudent investment” theory in a dissenting opinion in _Southwestern Bell Tel. Co. v. Public Serv. Comm’n_, 262 U.S. 276, 306-07 (1923) (Brandeis and Holmes, JJ., dissenting). In 1933 the Court reaffirmed the reproduction costs approach in _Los Angeles Gas & Elec. Co. v. California R.R. Comm’n_, 289 U.S. 287, 307-08 (1933).

57. 262 U.S. 679 (1923). The Supreme Court, in giving meaning to “rate of return,” established a specific standard expressing a policy ensuring a utility’s guaranteed profit and an ability to attract capital:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties . . . .”

Id. at 692-93.

58. 320 U.S. 591 (1944).

59. Id. at 603.
investment. The Court further clarified that the "fair return" aspect of the Smyth decision requires a level of return sufficient to pay interest on debt and dividends on preferred stock and to maintain the firm's financial integrity.

Accordingly, under the Smyth-Bluefield-Hope analyses, the primary objective in ratemaking is to set rates so that the utility will be able to meet its legitimate operating expenses as well as to pay creditors and provide dividends to shareholders. The utility's return should be sufficient to maintain its financial integrity so that it might attract new capital. Most state regulatory commissions use this judicially developed approach.

The most frequent implementation of the objectives established in the Smyth-Bluefield-Hope trilogy occurs when a utility files a new rate schedule. After the utility files a rate request, the commission evaluates the requested rates, usually at a hearing. The figures discussed in the ratemaking process are based on "test year" results—actual detailed financial information from a previously recorded year of operation. The test year figures that have commission approval are then

60. Id. at 603-05. See 1 A. Priest, supra note 30, at 142-56; Jacobs, supra note 4, at 268.

61. 320 U.S. at 603. The Hope Court noted: "[I]t is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. . . . That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital . . . ." Id. See 1 A. PRIEST, supra note 30, at 191-92; Jones, supra note 51, at 477. The "fair return" aspect of Smyth and Hope was developed by the Supreme Court in Bluefield. See note 57 supra.


63. 320 U.S. at 603, 605; 262 U.S. at 693. See Jones, supra note 51, at 477.

64. See A. Finder, supra note 2, at 25.

65. Most rate issues arise during the actual process of ratemaking. Nevertheless, complaints may be filed about existing rates either upon initiative of an independent source or motion of a regulatory commission. See note 46 supra.


67. See A. Finder, supra note 2, at 23; J. Jacobs, supra note 4, at 267; Gabel, supra note 23, at 718.

68. See J. Bonbright, supra note 46, at 150 n.7; 1 A. PRIEST, supra note 30, at 45; Jones, supra note 51, at 477. The test year is frequently the 12 months immediately preceding rate determination. See 1 A. PRIEST, supra note 30, at 45. However, the year most often selected is the most recent one for which complete data is available. See Gabel, supra note 23, at 720 (the year for which total data is determinable); Huntington, The Rapid Emergence of Marginal Cost Pricing
injected into the traditional ratemaking formula refined from principles set out in the Smith-Bluefield-Hope trilogy: (rate base × rate-of-return) + operating expenses = revenue. The revenue component represents the total dollar amount a utility may legally receive from the retail rates it charges consumers. The rate base is the formula that expresses the Smyth “fair value” requirement. In most jurisdictions, the rate base is the sum of the utility’s original investment and the working capital

in the Regulation of Electric Utility Rate Structures, 55 B.U.L. Rev. 689, 699 (1975) (selection of test year for which detailed financial information on company's operations is available); Jones, supra note 62, at 876 (most recent annual period for which complete financial data is available); Posner, supra note 19, at 592 (ordinarily the most recent typical year of operation for which complete data are available).

In West Ohio Gas Co. v. Public Utils. Comm’n, 294 U.S. 79 (1935), Justice Cardozo emphatically rejected the notion of basing ratemaking on a single test year: “[A]doption of a single year as an exclusive test or standard imposed upon the company [is] an arbitrary restriction in contravention of the Fourteenth Amendment and of the ‘rudiments of fair play’ made necessary thereby.” Id. at 81. Furthermore, the “test year” need not be wholly “historical.” See 1 A. PRIEST, supra note 30, at 45; Gabel, supra note 23, at 720. Some have called for a future or projected test year. See Note, The Use of the Future Test Year in Utility Rate-Making, 52 B.U.L. Rev. 791 (1972). The more common solution, however, is to use a test year based partly on historical experience and partly on projected figures. See 1 A. PRIEST, supra note 30, at 45; Gabel, supra note 23, at 720; Jones, supra note 62, at 880.

Due to inflation and other factors, the test year figures may not accurately represent normal conditions. As a result, adjustments must be made in the data. See Huntington, supra, at 699 (citing rate increases, wage increases, tax consequences, and environmental compliance costs as factors requiring adjustments in test year data); Jones, supra note 62, at 877 (citing abnormal conditions such as labor disturbances, unusual weather, or atypical equipment outages as factors). See generally 1 A. PRIEST, supra note 30, at 45. For a criticism of test year data use, see Posner, supra note 19, at 593-94.

69. Pontz & Sheller, The Consumer Interest—Is it Being Protected by the Public Utility Commission?, 45 Temp. L.Q. 315 (1972). The same components have been expressed in slightly varying formulas by other sources. See also J. JACOBS, supra note 4, at 267. Jacobs expressed the formula in the following format: \[ R = E + (v) r + d + T, \] when \( R \) = revenue to be received from the rates in question; \( E \) = annual operating expense; \( v \) = value of the physical property; \( r \) = rate of return, expressed as a fraction; \( d \) = current annual depreciation; and \( T \) = taxes. Id. at 267.

70. See J. JACOBS, supra note 4, at 267; Pontz & Sheller, supra note 69, at 316. The amount of revenue represented by \( R \) does not represent a guaranteed amount, but rather the amount a utility has an opportunity to earn. 1 A. PRIEST, supra note 30, at 46, 191.

71. See Gabel, supra note 23, at 720.

72. See note 60 supra and accompanying text. Professor Bonbright defined “original cost” as the “cost of an asset when first devoted to public service rather than cost to a transferee company.” J. BONBRIGHT, supra note 46, at 174 n.2. Currently thirty-six state commissions employ the “original cost” method. See A. FINDER, supra note 2, at 38. A decided minority of 13 state commissions abides by the “fair value” rate base method. Id. at 39. Fair value jurisdictions compute rate base on utility property “used and useful.” 1 A. PRIEST, supra note 30, at 46. Hence, fair value jurisdictions consider more than just “original cost” in computing rate base figures. See Missouri Water Co. v. Public Serv. Comm’n, 308 S.W.2d 704 (Mo. 1957). Accord, Joplin Water Works Co. v. Public Serv. Comm’n, 495 S.W.2d 433 (Mo. 1973).
allowance 73 less accumulated depreciation. 74

When determining a utility's rate-of-return, a commission must satisfy the Hope and Bluefield policy requirements of maintaining and supporting credit and attracting capital investment. 75 Commissions usually determine rate-of-return by the "cost of capital" approach. 76 Under this method, a commission inspects the capital structure of a utility to determine cost of debt, preferred stock, and common stock. 77 By making the appropriate calculations, 78 the commission may then determine the appropriate rate-of-return.

The final element of the ratemaking formula is operating expenses, 79 which include such costs as labor, maintenance, materials, supplies, 80 and advertising. 81

2. Advertising

Public utilities employ four general types 82 of advertising: informational, institutional, political, and promotional. Informational adver-

73. See F. Welch, PREPARING FOR THE UTILITY RATE CASE 160-61 (1954). Working capital represents the amount of cash needed to satisfy day-to-day expenses in the normal operations of the utility. See P. Garfield & W. Lovejoy, supra note 10, at 71; F. Welch, supra, at 195. For example, if for an appropriate test year the original cost of plant investment were $50 million and accrued depreciation on that investment were $5 million and an allowance was granted of $3 million for working capital, the rate base for the utility would be $48 million. This amount of rate base is then multiplied by the appropriate rate-of-return percentage. Technically, rate of return is represented as a percentage of the rate base. See: 1 A. Priest, supra note 30, at 46; F. Welch, supra note 73, at 201.

74. For a discussion rate base determination, see J. Bonbright, supra note 46, at 172-91; 1 A. Kahn, supra note 26, at 35-41.

75. See note 61 supra and accompanying text.

76. See J. Bonbright, supra note 46, at 240-56; 1 A. Priest, supra note 30, at 208-10; Jones, supra note 62, at 881.

77. See Jones, supra note 62, at 881.

78. This computation is best explained by Professor Jones' example: If the utility had a capital structure consisting of 50% debt, 15% preferred stock, and 35% common stock and the commission determined the cost of debt to be 6%, the cost of preferred stock to be 8%, and the cost of common stock 12%, then the composite cost of capital can be calculated.

Debt 50% at 6% = .030
Preferred Stock 15% at 8% = .012
Common Stock 35% at 12% = .042

The composite cost of capital is .084 or 8.4%. Id. at 881.

79. See Gabel, supra note 23, at 723.

80. Id.

81. See note 51 supra and accompanying text. An expense included in the rate formula may also be referred to as "above-the-line."

82. See note 3 supra.
tising is designed to inform consumers about everyday services, safety precautions, conservation measures, and rate changes. Institutional advertising, also known as goodwill advertising because of its goal of fostering goodwill toward the public utility, is "designed to enhance or preserve the corporate image of the utility." Political advertising includes "advertising for the purpose of influencing public opinion with respect to legislative, administrative, or electoral matters, or with respect to any controversial issue of public importance."

83. See Pub. Util. Fort., Mar. 1, 1973, at 47; Note, supra note 10, at 118. The New York Public Service Commission has included "time-of-day" advertising in its definition of informational advertising: "We recognize, however, that as we move toward more and more widespread adoption of time of day rates, it may be highly desirable for companies to publicize those rates. . . [This advertising may better be described as informational . . . .]." Notice of Proposal, supra note 5, at 2-R, 3-R. Informational advertising may also be referred to as "consumer," "safety," or "conservation" advertising. See Pub. Util. Fort., Mar. 1, 1973, at 47; note 3 supra.


public utilities engage in promotional advertising, which encourages the use of a utility's services or the use of appliances or equipment designed to use the utility's services. 88

In order to prevent a utility from exploiting its monopoly position, 89 the operating expense element of the ratemaking formula can include only those advertising expenses that are reasonable. 90 The Supreme Court developed the reasonableness standard in *West Ohio Gas Co. v. Ohio Public Utilities Commission*. 91 The Court held that commissions must accord management discretion a presumption of validity 92 and

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89. See notes 51-52 *supra* and accompanying text.

90. For a discussion of the "reasonableness" standard, see notes 91-109 *infra* and accompanying text.

91. 294 U.S. 63 (1935).

92. *Id.* at 72. Justice Cardozo, writing for the majority, stated:
that regulatory commissions can disallow advertising expenses only if those expenses are a by-product of inefficiency or improvidence. 93

After \textit{West Ohio Gas}, courts consistently overturned arbitrary regulatory commission decisions that had disallowed advertising cost allocation. 94 As a result, regulatory commissions readily accepted advertising outlays between 1935 and the early 1970s. 95 During this period of laissez-faire utility advertising regulation, the principle of economies of scale operated at its zenith of efficiency. 96 Growth and consumption were desirable elements for utilities. 97 Hence, advertising that stimulated growth received broad approval. 98

In the early 1970s regulatory commissions abruptly changed this policy.

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94. See, e.g., \textit{West Ohio Gas} Co. v. Ohio Pub. Utils. Comm'n, 294 U.S. 63, 72 (1935) ("[w]ithin the limits of reason, advertising or development expenses to foster normal growth are legitimate expenditures for the public's benefit.")
icy of promoting growth and consumption. Primarily because of reduced economies of scale,\textsuperscript{99} especially for electric utilities,\textsuperscript{100} the expansion oriented policies no longer brought about reduced per unit service costs. Cognizant of these and other developments,\textsuperscript{101} most regulatory decision makers abandoned the traditional reasonableness standard and began restricting electric and gas utility advertising on the basis of content.\textsuperscript{102} By directly prohibiting advertising\textsuperscript{103} and disallow-


\textsuperscript{100} The decline in efficiency of the economies of scale principle applies primarily to the electric utility industry. See The Energy Source Book, supra note 4, at 92; Note, supra note 96, at 611-12. Because gas and electric utilities have distinctive operating efficiencies, the principle of economies of scale operates more economically for gas utilities today. See Brief for Appellants at 19, 66-67, Laclede Gas Co. v. Public Serv. Comm'n, 600 S.W.2d 222 (Mo. Ct. App. 1980), appeal dismissed, 449 U.S. 1072 (1981).

\textsuperscript{101} Since the 1973 Arab oil embargo, the nation and especially public service commissions have developed an acute consciousness for energy conservation. See note 5 supra. Closely paralleling the energy shortage has been the rapid acceleration of retail energy costs. See R. Pierce, G. Allison & F. Martin, supra note 4, at 739; The Energy Source Book, supra note 4, at 92; Netschert, supra note 5, at 17. Accordingly, public service commissions have become even more cost conscious. See Note, supra note 10, at 107 n.118.


\textsuperscript{103} See notes 165-67 infra and accompanying text.
ing the allocation of advertising costs in ratemaking proceedings, \textsuperscript{104} state\textsuperscript{105} and federal\textsuperscript{106} decisionmakers have given new meaning to the reasonableness standard. A reasonable advertising expense today must promote energy conservation, \textsuperscript{107} environmental policies, \textsuperscript{108} or economic prudence.\textsuperscript{109}

Responding to commission restrictions on advertising, effectuated either by direct prohibition or by denial of cost allocation to the ratemaking formula, public utilities have employed, in addition to their

\textsuperscript{104} See notes 54-81 supra and accompanying text.


The Supreme Court, perhaps unwittingly, adopted this approach to utility advertising regulation in \textit{Central Hudson Gas & Elect. Corp. v. Public Serv. Comm'n, 447 U.S. 557} (1980). The Court declared energy conservation to be a substantial state interest worthy of justifying a regulation of utility advertising. \textit{Id.} at 569. \textsuperscript{107} See notes 273-76 supra and accompanying text.


traditional defenses, a new first amendment defense based on the commercial speech doctrine.

II. THE COMMERCIAL SPEECH DOCTRINE

A. Early Doctrine

The Supreme Court first confronted the commercial speech doctrine in 1942 in *Valentine v. Chrestensen*. In defiance of a New York ordinance banning the streetside distribution of commercial advertising, Chrestensen distributed handbills that on one side solicited customers to tour his Navy submarine for a fee and on the other side criticized a city ordinance banning his submarine from utilizing city owned docks. Police restrained Chrestensen for violating a city commercial handbill ordinance. Chrestensen sought to enjoin the prohibition of handbill distribution on free speech grounds. The Court held, without explanation, that the Constitution did not protect commercial speech.

The Court reinforced this exception doctrine for commercial speech in *Breard v. Alexandria*. To justify the exception the Court

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110. 316 U.S. 52 (1942).
111. The specific ordinance involved in *Valentine* was the New York Sanitary Code, § 318, which provides in pertinent part: "No person shall... distribute, or cause... to be... distributed, any handbill, circular,... or other advertising matter whatsoever in or upon any street or public place... This section is not intended to prevent the lawful distribution of anything other than commercial and business advertising matter." 316 U.S. at 53 n.1.
112. Id. at 53.
113. Id.
114. Id. at 54. Although Chrestensen sought relief under the fourteenth amendment, the Supreme Court framed the issue in terms of "whether the ordinance... was... an unconstitutional abridgement of the freedom of... speech." Id.
115. Justice Roberts concluded:

This court has unequivocally held that the streets are proper places for the exercise of the freedom of communicating information... and municipalities may... not unduly burden or proscribe its employment in these public thoroughfares. We are equally clear that the Constitution imposes no such restraint on government as respects purely commercial advertising. Id.

116. Commentators have labeled the commercial speech exception to the first amendment's general protection of speech as the "exception doctrine." See, e.g., Heller, supra note 115, at 927-30.
117. 341 U.S. 622 (1951). In *Breard*, the Court upheld a city ordinance banning door-to-door
cited the commercial speaker's profit motive as the distinguishing factor for denying commercial speech the full first amendment protection accorded other types of speech.118

After Breard, the Supreme Court did not address the commercial speech issue again until the late 1960s.119 Toward the end of this period, a concept referred to as the "right to know"120 warranted the at-

solicitation for magazine subscriptions. Id. at 645. Chrestensen and Breard have since been cited as denying all protection to commercial speech. See L. Tribe, AMERICAN CONSTITUTIONAL LAW 653 n.16 (1978).

118. In upholding the ordinance, the Court distinguished Martin v. City of Struthers, 319 U.S. 141 (1943), in which the Court had struck down an ordinance forbidding the free distribution of advertisements of religious meetings. Id. at 146-47. After comparing the differences between the commercial nature of the magazine solicitations in Breard and the religious nature of the handbill distribution in Martin, Justice Reed concluded that the two cases should be distinguished: "As no element of the commercial entered into [Martin]. . . and the opinion was narrowly limited to the precise fact of the free distribution of an invitation to religious services, we feel that it is not necessarily inconsistent with the conclusion reached in this case." 341 U.S. at 643. For a discussion of the purported economic justification for the commercial speech exception, see Heller, supra note 115, at 928-30.

Even though the Court sought to rest the justification for the exception doctrine on the grounds of profit motive, the Court nevertheless in subsequent decisions approved first amendment protection for other profit motivated media activities. See New York Times v. Sullivan, 376 U.S. 254 (1964) (newspaper print advertisements); Smith v. California, 361 U.S. 147 (1959) (books); Joseph Burstyn, Inc. v. Wilson, 343 U.S. 495 (1952) (movies). See also Note, Commercial Speech—An End in Sight for Chrestensen?, 23 DePaul L. Rev. 1258 (1974). The contradictory nature of the Valentine-Breard exception doctrine and the Court's subsequent treatment of economic motive cases prompted one commentator to describe the status of commercial speech under the first amendment to be in a "chaotic state." T. Emerson, THE SYSTEM OF FREEDOM OF EXPRESSION 16 (1970).

119. Until 1973 the Supreme Court considered the commercial speech exception only in passing. See New York Times Co. v. Sullivan, 376 U.S. 254 (1964). In New York Times, the Court, upholding first amendment protection for a libelous political advertisement, distinguished Chrestensen on the basis that the New York Times advertisement was injected with political overtones, whereas Chrestensen "was based upon the factual conclusions that the handbill was 'purely commercial advertising.'" Id. at 266.

During this same period, lower courts confirmed the commercial speech exception doctrine. See Pollack v. Public Util. Comm'n, 191 F.2d 450, 457 (D.C. Cir. 1951), rev'd on other grounds, 343 U.S. 451 (1953); Halstead v. SEC, 182 F.2d 660, 668 (D.C. Cir. 1950). The Supreme Court recognized the commercial speech hiatus as well in Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, 425 U.S. 748 (1976). "Since the decision in Breard . . . the Court has never denied protection on the ground that the speech in issue was 'commercial speech.'" Id. at 759.

120. This concept may also be referred to as the "right to receive." See Heller, supra note 115, at 931; Comment, The Right to Receive and the Commercial Speech Doctrine: New Constitutional Considerations, 63 Geo. L.J. 775 (1975). The "right to know" has been defined as "a right to receive information communicated by another." See Note, Attorneys' Rights Under the Code of Professional Responsibility: Free Speech, Right to Know and Freedom of Association, 1977 WASH.
tention of constitutional commentators and some members of the Court. This concept fostered the eventual change in thought that favored first amendment protection of commercial speech.

The change came in *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council*, in which the Court based its decision on a "right to know" concept and held that even purely commercial speech was entitled to some first amendment protection. The *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council* decision was significant because it expanded the scope of first amendment protection.

The "right to know" concept was developed in an effort to ensure that individuals had access to information necessary for making informed decisions. This concept was traced back to the *Martin v. City of Struthers* case, where the Court stated that "freedom of speech necessarily protects the right to receive [speech]." The "right to know" was justified by Professor Meiklejohn as an incident to the "marketplace of ideas." The notion of the "marketplace of ideas" was first expressed judicially by Justice Holmes in *Abrams v. United States*, in which the Court acknowledged the right to receive information and ideas.

In *Pittsburgh Press v. Human Relations Comm'n*, a decision reaffirming the holding in *Valentine*, tensions surfaced between the *Valentine* commercial speech exception and the "right to know" concept. The *Pittsburgh Press* Court, which affirmed *Valentine*’s denial of first amendment protection for commercial speech, decided the case by a 5-4 margin. Four justices lodged strong dissents. The close outcome in *Pittsburgh Press* indicated that some members of the Court had reevaluated their views regarding commercial speech protection.

Two years after *Pittsburgh Press*, four justices expressed doubt as to the validity of the commercial speech exception in *Bigelow v. Virginia*, an abortion advertising case. At that point, with five justices willing to overrule the commercial speech exception, the fall of *Valentine* was imminent.

The free flow of commercial information, even an individual advertisement, though entirely "commercial," may be of general public interest. Advertising is the dissemination of information. It is a matter of public interest that those decisions, in the aggregate, be intelligent and well informed. To this end, the free flow of commercial information is indispensable.

Board plaintiffs, consumers of prescription drugs, challenged a Virginia statute\textsuperscript{126} prohibiting pharmacists from advertising prices of prescription drugs.\textsuperscript{127} In protecting commercial speech by striking down the statute, the Court nevertheless stopped short of extending full first amendment protection to commercial speech by specifically mentioning two commercial speech areas in which it would accord no first amendment protection whatsoever.\textsuperscript{128} The Court failed to delineate fully the extent to which the decision does provide protection.

Post-Virginia State Board commercial speech cases\textsuperscript{129} indicate that different forms of commercial speech receive varying degrees of protection.\textsuperscript{130} These distinctions are primarily a function of three overriding concerns articulated by the Court. One concern focused on honoring the common sense differences between commercial and noncommercial speech.\textsuperscript{131} Another concern was fear of diluting the protection for “pure speech”\textsuperscript{132} by treating commercial speech and noncommercial

\textsuperscript{126} The challenged Virginia statute stated in pertinent part: “Any pharmacist shall be considered guilty of unprofessional conduct who . . . publishes, advertises, or promotes . . . any amount, price, fee, premium, discount, rebate or credit terms for professional services or for drugs containing narcotics or for any drugs which may be dispensed only by prescription.” VA. CODE § 54-524.35 (1974) (current version Cum. Supp. 1981).

\textsuperscript{127} 425 U.S. at 749-50.

\textsuperscript{128} The forms of permissible regulation the Court mentioned were reasonable time, place, and manner restrictions and restrictions on untruthful, deceptive, or misleading speech. \textit{Id.} at 771.


\textsuperscript{131} See Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447, 455-56 (1978); Linmark Assocs., Inc. v. Township of Willingboro, 431 U.S. 85, 98 (1977); Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, 425 U.S. 748, 771 n.24 (1976). The Court in \textit{Ohralik} noted: “We have not discarded the 'common sense' distinction between speech proposing a commercial transaction, which occurs in an area traditionally subject to government regulation, and other varieties of speech.” 436 U.S. at 455-56. \textit{See generally Note, supra note 130}.

\textsuperscript{132} “Pure speech” as used in this context is that speech which is noncommercial. Pure speech, or speech that is noncommercial, is generally accorded a preferred position enjoying the full panoply of first amendment protection. Thus, in order for infringements on such speech to be justified, a “compelling,” “significant,” or “important” governmental interest must be shown. \textit{See, e.g.}, Erznoznik v. City of Jacksonville, 422 U.S. 205, 217 (1975); Grayned v. City of Rockford, 408
speech on constitutional parity. Finally, the Court explained that commercial speech, due to its economic motivation, is more durable and less likely to be "chilled" than noncommercial speech. Motivated by these concerns, the Court developed a two-tiered approach for protection of commercial speech: commercial speech that is related to regulatable governmental activity is more amenable to control, while commercial speech not related to an area of regulatable governmental activity is accorded more traditional first amendment protection.
Post-Virginia State Board decisions concerning regulatable commercial speech clarified the doctrine. Subsequent decisions, for example, reaffirmed the policy to which the Court alluded in pre-Virginia State Board decisions that false or misleading commercial speech is not constitutionally protected. Furthermore, the state's interest, when balanced against the interests of commercial speech, must be substantial. In addition, under Bates v. State Bar, the state's legislation must have a direct causal connection to its asserted interest and must further the interest in a reasonable manner. Accordingly, a state protection. See Note, supra note 130, at 438. See also Carey v. Population Servs. Int'l, 431 U.S. 678 (1977) (Court upheld a right to privacy in striking down a statute prohibiting advertisement of contraceptives); Linmark Assocs., Inc. v. Township of Willingboro, 431 U.S. 85 (1977) (Court, employing a right to travel rationale, declared unconstitutional an ordinance forbidding the display of residential “For Sale” signs); Bigelow v. Virginia, 421 U.S. 809 (1975) (Court invalidated a Virginia statute prohibiting New York abortion advertisements because the citizens of Virginia had a right to travel to New York and privacy issues were involved).

137. See Friedman v. Rogers, 440 U.S. 1 (1979); Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447 (1978). See also Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, 425 U.S. 748, 771, 772 n.24 (1976), in which the Court stated that “[u]ntruthful speech, commercial or otherwise, has never been protected for its own sake... We foresee no obstacle to a State's dealing effectively with this problem.” Id. at 771 (citations omitted).

In Friedman, the Court upheld a ban restricting optometrists' use of trade names that the Court found could mislead the public as to the source and quality of the optometric service. The Court declared that “it is clear that the state's interest in protecting the public from the deceptive and misleading use of optometrical trade names is substantial and well demonstrated.” 440 U.S. at 15.

In Ohralik, the Court upheld an Ohio State Bar Association rule that prohibited in-person solicitation of clients. The Court determined that the potentiality for deception created by the untrained at the hands of a “professional” counselor and persuader was too great to go unchecked. 436 U.S. at 464-65. See also Farber, supra note 121, at 384-95.

138. See Bigelow v. Virginia, 421 U.S. 809, 821 (1975); Pittsburgh Press Co. v. Pittsburgh Comm'n on Human Relations, 413 U.S. 376, 389 (1973). The Court in Pittsburgh Press stated that “[a]ny First Amendment interest which might be served by advertising an ordinary commercial proposal and which might arguably outweigh the governmental interest supporting the regulation is altogether absent when the commercial activity itself is illegal and... incidental to a valid limitation on economic activity.” Id. at 389 (emphasis added).

139. 425 U.S. at 766-70.

140. See, e.g., Friedman v. Rogers, 440 U.S. 1, 15 (1979) (state's interest in protecting public from deceptive and misleading use of trade names is a substantial one); Ohralik v. Ohio State Bar Ass'n, 436 U.S. 458, 462 (1978) (State's interest in protecting public from attorney solicitation legitimate and important).


142. Id. at 378. In Bates, the Court confronted the legality of an Arizona State Bar Association rule that prohibited price advertising by attorneys. In extending first amendment protection to the newspaper advertisements for routine legal services, the Court determined that the regulation was only remotely related to the asserted state interest of prohibiting unprofessional conduct. Id. at 382.

143. The Virginia State Board Court concluded that a complete suppression of “concededly
may use only those means necessary to effectuate its goals; if possible, a state should invoke less inhibiting regulation.

B. The Central Hudson Test

The Court crystallized *Virginia State Board* and its subsequent clarifications into a formal test in *Central Hudson Gas & Electric Co. v. Public Service Commission*. In *Central Hudson*, the New York Public Service Commission had imposed a promotional advertising ban originally in response to the 1973 Arab oil embargo and the resultant energy crisis. When the Commission extended the ban after the energy crisis abated, Central Hudson Gas & Electric challenged the ban on first amendment grounds. Deciding in favor of Central Hudson, the Court established a four-part test for balancing a utility's right to commercial speech against a governmental regulation prohibiting such speech.

Rooted in *Virginia State Board* and its progeny, the four-part analysis focuses on the governmental interest that the regulation is to

truthful information about [an] entirely lawful activity was too sweeping in nature. 425 U.S. at 773. In subsequent cases this concept was given further consideration. In *in re Primus*, 436 U.S. 412 (1978), the Court held that the "state's . . . interest in regulating members [whose] profession it licenses . . . amply justifies the application of narrowly drawn rules to proscribe solicitation . . . ." Id. at 438 (emphasis added).

447 U.S. 557 (1980). After discussing the doctrinal history of commercial speech, the Court enunciated a four-part test:

In commercial speech cases, then, a four-part analysis has developed. At the outset, we must determine whether the expression is protected by the First Amendment. For commercial speech to come within that provision, it at least must concern lawful activity and not be misleading. Next, we ask whether the asserted governmental interest is substantial. If both inquiries yield positive answers, we must determine whether the regulation directly advances the governmental interest asserted, and whether it is not more extensive than is necessary to serve that interest.

Id. at 566. See notes 151-55 infra and accompanying text.

45. *See Notice of Proposal*, *supra* note 5, at 2074-76. The Commission, in determining that the "demands for electrical energy . . . cannot be met for the foreseeable future without significant reductions in usage in view of the lack of sufficient fuels to generate electricity," ordered the electric utilities of New York to discontinue "promoting the use of electricity through advertising . . . ." Id. at 2072, 2076.


47. 447 U.S. at 566.

48. The Court disapproved of the "complete suppression of Central Hudson's advertising." *Id.* at 571.
serve and the means employed to achieve that interest. The *Central Hudson* test, as a practical matter, consists of five parts, because a court must make an initial decision as to whether the speech at issue is indeed commercial.  

If a court determines that the speech is commercial, the first step is for the court to decide whether the speech is either "misleading or related to the unlawful." If the speech falls within either of those categories, the court can properly validate the government regulation. If the speech is not within the categories, the second part of the test requires the state to show a substantial interest in promulgating the regulation. The third part of the test requires an analysis of whether the asserted state interest is directly effectuated by the regulatory means. The fourth part requires that the state's regulatory means restrict advertising no more than necessary. If a state regulation satisfies each element of the test, the regulation is immune to a first amendment commercial speech defense. Although the *Central Hudson* test is relatively new, courts have already employed it in several commercial speech defense cases. Recently, utilities have invoked this defense when challenging advertising

149. See notes 124-43 supra and accompanying text.

150. The Court provided: "At the outset, we must determine whether the expression is protected by the first amendment." 447 U.S. at 566. The traditional definition of commercial speech is that which does no more than propose a commercial transaction." Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, 425 U.S. 748, 771 n.24 (1976). The Court in *Central Hudson* expanded the notion of commercial speech by defining it as "expression related solely to the economic interests of the speaker and its audience." 447 U.S. at 561.

If the speech in question qualifies as commercial, the *Central Hudson* test must be used to evaluate it. If, on the other hand, the speech is noncommercial, and thus fully protected, the speech will be evaluated on traditional first amendment grounds. See note 132 supra.


152. See notes 140-43 supra and accompanying text.


155. 447 U.S. at 570-71.

restrictions.\textsuperscript{157}

III. ANALYSIS OF ADVERTISING REGULATIONS UNDER CENTRAL HUDSON

Public service commissions can regulate utility advertising by directly prohibiting the advertising\textsuperscript{158} or by disallowing allocation of the advertising expense to the rate schedule.\textsuperscript{159} In response to both types of regulation, a utility may invoke the first amendment commercial speech defense.\textsuperscript{160} The advantages and viability of this defense will


\textsuperscript{158} See notes 163-95 infra and accompanying text.

\textsuperscript{159} See notes 196-271 infra and accompanying text. For purposes of this Note, "rate schedule" refers to the inclusion of certain advertising expenses in the revenue formula discussed at notes 71-85 supra and accompanying text. The effect of including an expenditure in the rate schedule is to pass that cost on to the consumer in the form of customer rates. See \textit{id}. The term "rate base" should not be used synonymously with the term "rate schedule," "revenue formula" or "consumer charge." "Rate base" is a technical term of art used in the ratemaking process. The rate base is the formula that expresses the Smyth "fair value" requirement and is defined to be the sum of the utility's original investment and the working capital allowance less accumulated depreciation. See notes 74-77 supra and accompanying text. Members of the Supreme Court apparently indiscriminately used this term in Consolidated Edison Co. v. Public Serv. Comm'n, 447 U.S. 530, 543 (1980); \textit{id.} at 544 (Marshall, J., concurring).

\textsuperscript{160} See note 12 supra and accompanying text.

Indeed, some argue that the first amendment is the only plausible defense available to utilities in this context. Those who make this assertion argue that the traditional defenses of due process and undue assault on management prerogative, see note 10 supra, are no longer valid. See Note, supra note 96, at 623. Those who espouse this theory correctly point out that the "current conditions . . . [produce] the dilemmas of demand growth and rising costs in . . . the power industry," \textit{id}. This situation differs considerably from the status of utilities during the \textit{West Ohio Gas} era.

\textit{West Ohio Gas} was decided under a fourteenth amendment due process analysis. 294 U.S. at 71. Fourteenth amendment due process "demands . . . that the law shall not be unreasonable, arbitrary or capricious, and that the means selected shall have a real and substantial relation to the object sought to be attained." Nebbia v. New York, 291 U.S. 502, 525 (1934). The Supreme Court liberalized this analysis in a later opinion by allowing the means to bear only a "rational relation" to the desired end. See United States v. Carolene Prods. Co., 304 U.S. 144, 153-54 (1938). Accord, Williamson v. Lee Optical Co., 348 U.S. 483, 491 (1955). In \textit{West Ohio Gas}, the Court determined that the Ohio Public Service Commission did not satisfy the "rational relation" test in attempting to disallow advertising expenses from being passed on to consumers in the form of service rates. The Court rightfully feared that the disallowance of advertising costs would inhibit the "normal growth" of utilities. 294 U.S. at 72. During this period of economic history, continued growth was essential to maintain the financial fitness of the utility so that it could meet the burgeoning energy needs of its customers. See notes 91-98 supra and accompanying text. Hence, unless the advertising expenses were unjustifiably excessive, a determination by a public
vary depending upon the scope of regulation,161 the category of advertising,162 and whether the speaker is a gas or electric utility.

A. Direct Prohibition

Typically, public service commissions effectuate direct prohibitions on utility speech by issuing policy statements.163 Regardless of the category of advertising164 or the type of utility-speaker,165 a defense under the commercial speech doctrine is likely to succeed if the direct prohibition imposes a total ban on speech.

The Supreme Court in Central Hudson struck down a total prohibition on promotional advertising.166 Applying the four-part analysis established in that opinion, the Court reasoned that the Public Service Commission of New York failed to show that its total prohibition of promotional advertising was no more extensive than necessary to achieve the asserted state interest.167 Although the Court recognized New York’s legitimate interest in conserving energy in the wake of the service commission prohibiting those expenses from being passed on to the consumers as a valid operating expense would violate the rational relation standard.

In the current context, the need for uninhibited expansion no longer exists: energy conservation is now a primary concern; the efficiencies of the “economies of scale” have waned; and the increase in demand is proceeding at a slower rate. See notes 91-101 supra and accompanying text. This situation provides an impetus for some to conclude that a rational basis does exist for a regulation denying the cost of advertising expenses to be passed on to consumers. See Note, supra note 96, at 612, 623. Accordingly, this conclusion renders a fourteenth amendment due process defense largely impotent in providing a justification for advertising cost allocation by utilities. Id. An analysis of whether or not the foregoing argument is valid is beyond the scope of this Note. The mere spectre of doubt raised by this argument, however, underscores the importance of the first amendment defense for utilities.

161. Public service commissions regulate utility advertising by direct prohibition, see notes 163-95 infra and accompanying text, and by denial of cost allocation of advertising expenses to consumer rates, see notes 196-271 infra and accompanying text.

162. See notes 82-88 supra and accompanying text.

163. See, e.g., Notice of Proposal, supra note 5, at 2074-76 (ordering discontinuance of “promoting the use of electricity through advertising”).

164. The various types of advertising engaged in by a utility include promotional, political, informational, and instructional. For a complete discussion of these categories of advertising, see notes 3 & 82-88 supra and accompanying text.

165. Whether the speaker is an electric utility, as opposed to a gas utility, may affect the validity of a commercial speech defense. For a discussion of the import of the electric-gas distinction, see notes 234-72 infra and accompanying text.

166. 447 U.S. 557 (1980). Promotional advertising may be defined as “advertising which is designed to obtain new customers, increase usage by present customers, or to encourage customers to select and install appliances using one form of energy in preference to another.” Pub. Util. Fort., Mar. 1, 1973, at 47. See note 88 supra and accompanying text.

167. 447 U.S. at 569-70.
1973 Arab oil embargo, the majority feared the prohibition's broad language would sweep within its ambit other speech that the Commission had not intended to regulate.\textsuperscript{168}

Similarly, \textit{Consolidated Edison Co. v. Public Service Commission}\textsuperscript{169} and \textit{First National Bank of Boston v. Bellotti}\textsuperscript{170} struck down total bans on political advertising.\textsuperscript{171} In \textit{Consolidated Edison}, the New York Public Service Commission issued a policy statement forbidding utilities to discuss political matters in bill inserts.\textsuperscript{172} The order directly affected Con-Ed's practice of including pronuclear power inserts in its billing envelopes.\textsuperscript{173} The Commission's ban, however, did not extend to inserts discussing "non-controversial" subjects.\textsuperscript{174} Presented with this overt instance of content regulation,\textsuperscript{175} the Court found that the policy statement impermissibly infringed on the utility's first amendment rights.\textsuperscript{176}

\textsuperscript{168} Id. at 570.
\textsuperscript{169} Id. at 530.
\textsuperscript{170} 435 U.S. 765 (1978).
\textsuperscript{171} For a definition of political advertising, see notes 86-87 supra and accompanying text.
\textsuperscript{172} On February 17, 1977, the New York Public Service Commission issued a statement prohibiting "utilities from using bill inserts to discuss political matters, including the desirability of future development of nuclear power." 447 U.S. at 532.
\textsuperscript{173} Id.
\textsuperscript{174} Id. The Court noted that the Commission openly admitted that its order discriminated between types of speech content:

The Commission does not pretend that its action is unrelated to the content or subject matter of bill inserts. Indeed, it has undertaken to suppress certain bill inserts precisely because they address controversial issues of public policy. The Commission allows inserts that present information to consumers on certain subjects, such as energy conservation measures, but it forbids the use of inserts that discuss public controversies. Id. at 537.

\textsuperscript{175} The Court, in assessing the Commission's reasoning for implementing the ban, declared: "The Commission's own rationale demonstrates that its action cannot be upheld as a content-neutral time, place, or manner regulation." Id.


In \textit{Consolidated Edison}, Justice Blackmun, joined by Justice Rehnquist, dissented from the majority's position and embraced the New York Public Service Commission's argument that the "use of the billing envelope to distribute management's pamphlets amount[ed] to a forced subsidy of the utility's speech by the ratepayers." \textit{Id.} at 551. Justice Blackmun suggested that the compulsion of ratepayers to finance a utility's advertising might violate the ratepayers' first and fourteenth amendment rights. \textit{Id.} at 552 n.1 (citing Abood v. Detroit Bd. of Educ., 431 U.S. 209 (1977)).

Justice Marshall, in a concurring opinion, made special note of the fact that the court limited its analysis to the issue of prohibition of speech and in no way attempted to resolve the more difficult
In *Bellotti*, the Massachusetts legislature had passed a statute prohibiting corporate political contributions or expenditures. The state designed the law to prevent corporations from influencing the outcome of referendum proposals. First National Bank of Boston challenged the statute on first amendment grounds. Reasoning that the right to speak on public issues should not turn on the source speaking, the Court held that the statute regulated content and thus violated the first amendment. The Court's decision rested on its determination that the state failed to show a "compelling" interest achieved by a precisely drawn means.

In both *Bellotti* and *Consolidated Edison*, the majority declined to invoke the commercial speech doctrine and instead based its decision on traditional first amendment grounds. By not deciding these cases under the more lenient commercial speech standard, the Court demonstrated a willingness to provide greater protection for politically oriented advertising. Despite the commercial nature of the speakers, the Court's result was correct because the content of the speech was non-commercial. Accordingly, a court must evaluate a state's total prohibition of a utility's political advertising under the narrower compelling state interest standard. This stricter standard will cause a direct

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177. Mass. Gen. Laws Ann. ch. 55, § 8 (West Supp. 1977) specifically prohibited corporations from making contributions "for the purpose of... influencing or affecting the vote on any question submitted to the voters, other than the one materially affecting any of the property, business or assets of the corporation.”

178. Id. at 770.

179. Id. at 777. The Bank wanted to make expenditures to publicize its opposition to a proposed Massachusetts constitutional amendment imposing a graduated income tax upon private individuals. Id. at 785.

180. Id. at 786.

181. Id. at 786.


183. Under traditional first amendment analysis, a state must demonstrate that the regulation effectuates a compelling interest. See Consolidated Edison Co. v. Public Serv. Comm’n, 447 U.S.
prohibition on a utility’s political speech to be more constitutionally suspect than a similar ban on promotional speech.\textsuperscript{185}

Under \textit{Central Hudson}, a court is likely to strike down a total ban on informational advertising,\textsuperscript{186} even though such a ban is not protected under traditional first amendment principles. The commercial speech cases of \textit{Virginia State Board}\textsuperscript{187} and \textit{Bates},\textsuperscript{188} which comprise the underpinnings of the \textit{Central Hudson} test,\textsuperscript{189} specifically allowed advertising of informational material.\textsuperscript{190} Thus, a state’s interest in prohibitory regulation is unlikely to outweigh the value of informational advertising. Even if a regulation could pass the “substantial state interest” part of the test, a total ban on informational advertising would likely fail the “no more extensive than necessary” requirement. Informational advertising benefits consumers.\textsuperscript{191} Hence, a court would

\begin{footnotesize}
\begin{enumerate}
\item[184.] See notes 181-82 \textit{supra} and accompanying text.
\item[185.] Under the stricter compelling state interest standard, the Supreme Court has recognized only two narrow exceptions to the first amendment policy of voiding content-based regulations. In \textit{Greer v. Spock}, 424 U.S. 828 (1976), the Court allowed the federal government to prohibit partisan political speech on a United States military base. \textit{Id.} at 840. In \textit{Lehman v. City of Shaker Heights}, 418 U.S. 298 (1974), the Court allowed a city transit system to refuse partisan political advertising in favor of commercial advertising to fill its rental advertising space. The Court thought that the city’s fears of jeopardizing long-term commercial revenue and offending paying passengers with potentially offensive political propaganda were justified. \textit{Id.} at 304.
\item[186.] See note 83 \textit{supra} and accompanying text.
\item[189.] See notes 124-55 \textit{supra} and accompanying text.

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probably conclude that a flat ban on informational advertising is unconstitutionally overinclusive, because the prohibition could prevent consumers from receiving valuable information.

A total ban on institutional advertising would similarly fail part four of the Central Hudson test as being overly restrictive. The Oklahoma Supreme Court, addressing the constitutionality of a total ban on institutional advertising in a pre-Central Hudson case, specifically concluded that the state could achieve its goal of regulating institutional advertisement by less drastic measures. The Oklahoma court, in effect, based its decision on the same grounds subsequently employed by the United States Supreme Court in the fourth part of the Central Hudson test. Furthermore, the Oklahoma court noted that, as in the informational advertising context, consumers benefit, at least to some degree, from institutional advertising. Relying on this determination, a court using the Central Hudson analysis would probably hold a total ban on institutional advertising in violation of the least restrictive means requirement. Hence, in the face of a total ban on institu-

192. Institutional advertising may be defined simply as advertising “designed to enhance the public image of the utility.” See notes 84-85 supra and accompanying text. State v. Oklahoma Gas & Elec. Co., 536 P.2d 887 (Okla. 1975).


194. Commenting on the validity of the direct total ban on institutional advertising, the court concluded: “The same end could be achieved by disallowing such expenditures as operating expenses for ratemaking purposes and this method would not impede the utilities' ability to communicate with the public. We conclude the prohibition on expenditures for institutional advertising is an unreasonable means of protecting ratepayers from these expenditures.” Id. at 894 (emphasis added).

The Missouri Court of Appeals confronted the same issue in a slightly different context in Laclede Gas Co. v. Public Serv. Comm’n, 600 S.W.2d 222 (Mo. Ct. App. 1980), appeal dismissed, 449 U.S. 1072 (1981). In Laclede, the commission refused to allow, as part of operating expenses for ratemaking purposes, $204,691 of institutional or goodwill advertising. Although the court was not faced with a total ban on institutional advertising, it alluded to the negative consequences of such a prohibition:

The evidence herein does not support Laclede's argument that . . . the P.S.C. violated any constitutional right of Laclede to the exercise of its right of free speech. . . . The order of the P.S.C. does not prohibit advertising by Laclede. If it had, this order would, without question, have violated the constitutional and managerial rights of Laclede.

Id. at 228.

195. 536 P.2d at 895.

Another ratepayer benefit of institutional advertising cited by courts is the attraction of investment capital that reduces the amount of financing needed to operate. The result may be lower rates at the retail level. See Re Alabama Power Co., 97 PUB. UTIL. REP. (PUR) 3d 371, 377 (Ala. P.S.C. 1972); Re Consolidated Edison Co., 73 PUB. UTIL. REP. (PUR) 3d 417, 468 (N.Y.P.S.C. 1968). One commentator suggested that institutional advertising will foster a feeling of goodwill by the consumer toward the utility and will result in the consumer economizing on utility services to achieve the national energy conservation goal. See, Duffy, supra note 5, at 6.
tional advertising, a utility may successfully invoke the first
amendment commercial speech doctrine.

B. Cost Allocation Denial

When a public service commission does not allow a utility to include
expenses in operating costs for ratemaking purposes, the utility may
seek to defend its cost allocation\textsuperscript{196} attempt under the first amend-
ment.\textsuperscript{197} In response to this defense, commissions and courts draw a
distinction between denying the speech altogether and denying the al-
location of advertising costs as part of the ratemaking formula.\textsuperscript{198} Util-
ities, in defending their attempts to allocate costs, usually argue that
because the commission refused to charge the advertising to operating
costs, the funds for the advertising must come out of shareholder prof-
its.\textsuperscript{199} Utilities further assert that a reduction of shareholder profits
hinders their ability to attract new investment capital\textsuperscript{200} and denies
shareholders of their regulated, but constitutionally circumscribed, rate
of return.\textsuperscript{201} Utilities contend that these financial considerations dis-

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\item For purposes of this Note, "cost allocation" is used synonymously with the concept of
allowance of advertising cost as part of the ratemaking formula. \textit{See} notes 9 \& 54-81 \textit{supra} and
accompanying text.
\item \textit{See}, \textit{e.g.}, Laclede Gas Co. v. Public Serv. Comm'n, 600 S.W.2d 222 (Mo. Ct. App. 1980),
Supreme Court in \textit{Central Hudson} reaffirmed the right of utilities to seek cost allocation: "Unreg-
ulated businesses pass on promotional costs to consumers, and this Court expressly approved the
practice for utilities in West Ohio . . . ." 447 U.S. at 568 n.11.
Under the first amendment, if a regulation is void on its face, the speaker may deliver his
message in violation of the regulation and defend his actions on the unconstitutionality of the
regulation. Lovell v. City of Griffin, 303 U.S. 444, 452-53 (1938). Hence, utilities may charge the
costs of advertising to operating expenses and subsequently defend their inclusion during test year
analysis.
\item \textit{See}, \textit{e.g.}, \textit{Central Hudson Gas & Elec. Corp. v. New York Pub. Serv. Comm'n}, 447 U.S.
(1980) (Marshall, J., dissenting); Laclede Gas Co. v. Public Serv. Comm'n, 600 S.W.2d 222, 228
\item Advertising costs become part of the rate schedule when included in the operating costs
of the ratemaking formula: (rate base x rate of return) + operating costs = revenue. Cost in-
cluded within the revenue amount may be charged to consumers. Those expenses not included
must come out of shareholder profits. \textit{See} notes 54-81 \textit{supra} and accompanying text.
\item \textit{See} Note, \textit{supra} note 96, at 633 \& n.136.
\item \textit{See} notes 54-64 \textit{supra} and accompanying text.
\item Some commentators and legislators have argued that ratepayers, in the long run, subsidize those
\end{enumerate}
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encourage them from engaging in advertising speech.\textsuperscript{202} When a utility raises a first amendment defense, courts, contrary to past practice,\textsuperscript{203} must now evaluate the legitimacy of a cost allocation denial under the \textit{Central Hudson} four-part analysis.\textsuperscript{204} The likelihood of a successful commercial speech defense under \textit{Central Hudson} depends primarily on the category of advertising and the type of utility-speaker.

1. \textit{Allocation of Informational and Political Advertising: Uniform Treatment of Gas and Electric Utilities}


Alternatively, if the costs of advertising cannot be passed on to the consumer, the economic incentive that places the advertising in the commercial speech realm is absent. Accordingly, the advertising is no longer commercial speech because it would be unprofitable for the utility to continue to engage in it. The speech should then be entitled to the more protective evaluation standard for traditional or pure speech. \textit{See generally note 132 supra.}

203. Prior to the adoption of the \textit{Central Hudson} test, courts evaluated the validity of advertising expense allocation on various grounds, including conservation, \textit{see, e.g.}, \textit{Re Gas Co.}, 35 PUB. UTIL. REP. (PUR) 4th 106 (N.M.P.S.C. 1980); no benefit to ratepayers, \textit{see, e.g.}, \textit{Re Minnesota Gas Co.}, 32 PUB. UTIL. REP. (PUR) 4th 1 (S.D.P.U.C. 1979); environmental concerns, \textit{see, e.g.}, \textit{In re Hawaiian Elec. Co.}, 56 Hawaii 260, 535 P.2d 1102 (1975); economic concerns, \textit{see, e.g.}, \textit{Promotional Practices of Elec. Utils.}, 8 PUB. UTIL. REP. (PUR) 4th 268 (Fla. P.S.C. 1975). This practice continues unabated today. \textit{See notes 107-09 supra} and accompanying text.


204. \textit{See notes} 151-55 \textit{supra} and accompanying text. Although the Supreme Court considered a total prohibition in \textit{Central Hudson}, Justice Powell, writing for the majority, briefly addressed the cost allocation issue. \textit{See 447 U.S. at 568 n.11.}
penses to operating costs does not hinge on the nature of the utility-speaker. It depends, rather, on the four Central Hudson criteria: whether the advertising is misleading or related to the unlawful; whether the denial of allocation promotes a substantial state interest; whether the state interest is effectuated by direct regulatory means; and whether that regulation is no more extensive than necessary.\textsuperscript{205}

Courts should uphold allocation of informational\textsuperscript{206} advertising expenses under a Central Hudson analysis. Both shareholders and rate-payers benefit from informational advertising.\textsuperscript{207} Public service commissions and consumer groups traditionally have proffered several state interests when denying allocation of advertising expenditures, including conservationist,\textsuperscript{208} environmental,\textsuperscript{209} and economic\textsuperscript{210} con-

\textsuperscript{205} See notes 151-55 supra and accompanying text.
\textsuperscript{206} See note 83 supra for a definition of informational advertising.

The demise of the efficiencies of economies of scale began in the late 1960s. The spiraling costs of new plant construction and generating plant fuel now outstrip the efficiencies of large generating capacity economies of scale. See note 99 supra. In effect, it is no longer economically prudent for electric utilities to encourage consumption. See id.
cerns. These recognized or purported state interests, however, neither conflict with nor outweigh the value of informational advertising. Although conservationist, environmental, and economic concerns may be legitimate state interests, they are not directly promoted by disallowing informational advertising costs. Furthermore, informational advertising that includes energy conserving time-of-day rate ads, consumer oriented customer service ads, and information-disseminating public service ads does not infringe on these asserted state interests. Accordingly, a refusal to allocate informational advertising expenses fails the direct means requirement of Central Hudson. Yet, even if some expenses for informational advertising are not warranted,

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211. Courts must consider the issue of whether the preservation of managerial prerogative is a substantial state interest. Managerial prerogative involves [the] responsibility of the duly authorized manager of a utility to decide the type, quantity or form of advertising which would most benefit the corporation in its continued growth. . . . The function of [a public service commission] . . . is that of regulation, and not of management. . . . [It] should not be allowed to interfere with the proper operation of the utility as a business concern by usurping managerial prerogatives. Alabama Power Co. v. Alabama Pub. Serv. Comm'n, 359 So. 2d 776, 780 (Ala. 1978). Accord, West Ohio Gas Co. v. Ohio Pub. Utils. Comm'n, 294 U.S. 63, 72 (1935) ("[i]n the absence of a showing of inefficiency or improvidence, a court will not substitute its judgment for theirs as to the measure of a prudent outlay"). Under the managerial prerogative analysis, advertising expenditures are evaluated on a "reasonableness" standard as to amount. See, e.g., Central Me. Power Co. v. Maine Pub. Utils. Comm'n, 153 Me. 228, 244, 136 A.2d 726, 736-37 (1957); New England Tel. & Tel. Co. v. Department of Pub. Utils., 360 Mass. 443, 493-94, 275 N.E.2d 493, 524 (1971); State ex rel. Dyer v. Public Serv. Comm'n, 341 S.W.2d 795, 802 (Mo. 1960). The recent trend, however, has been to give the "reasonableness" standard a different meaning. See notes 100-09 supra and accompanying text.


To resolve this tension between upholding the managerial prerogative concept and promoting content-based social policies, courts must balance the two interests and decide under a Central Hudson analysis which is more substantial.

212. See, e.g., Notice of Proposal, supra note 5, at 2-R, 3-R.


215. See note 153 supra and accompanying text.
a court must make a partial allocation\(^{216}\) to satisfy the "least restrictive means"\(^{217}\) requirement. A complete disallowance of any expenditures legitimately chargeable to ratepayers would violate this standard. Hence, a commission should remove from the rate schedule only those expenditures that clearly conflict with the state's substantial interest. In addition, if the advertisement purporting to convey an informational message is deceptive or related to unlawful activity,\(^{218}\) cost allocation is disallowed under the *Central Hudson* test.

Allocation of political advertising expenses is more difficult to justify than informational advertising expenses. Even though *Bellotti*\(^{219}\) and *Consolidated Edison*\(^{220}\) may signify the need to evaluate politically oriented advertising on the more protective, traditional first amendment grounds,\(^{221}\) the denial of allocation of expenses does not, of itself, prohibit that speech altogether. A utility still may engage in political speech; it simply may not force ratepayers to subsidize that speech. Neither *Bellotti* nor *Consolidated Edison* can be read to stand for any broader proposition.\(^{222}\)

Whether a hybrid type of political advertising, such as politically charged promotional advertising,\(^{223}\) is allowed as an operating cost will depend on the substantial state interest involved. Under the *Central Hudson* approach, a court must balance the speech and regulation interests.\(^{224}\) When running pronuclear power advertisements, for example, a utility may have a distinct interest in speaking on important


\(^{217}\) *See* note 154 *supra* and accompanying text.

\(^{218}\) *See* note 151 *supra* and accompanying text.


\(^{221}\) *See* notes 169-85 *supra* and accompanying text.

\(^{222}\) The Supreme Court specifically avoided the cost allocation issue for political advertising in *Consolidated Edison*. *See* 447 U.S. at 543 n.13; *id.* at 544 (Marshall, J., concurring).

\(^{223}\) *See* Pub. Util. Fort., Nov. 8, 1979 at 51, 54 (nuclear power advertising as an example of promotional advertising with political overtones). *See*, e.g., *Re Public Serv. Co.*, F.C. No. 2548 (N.H.P.S.C. July 31, 1980) (expense of Seabrook Station Education Center explaining nuclear generation concepts disallowed as institutional advertising designed to promote the image of the utility).

\(^{224}\) *See* note 147 *supra* and accompanying text.
industry-related matters. Furthermore, utilities have evidence demonstrating that nuclear technology facilitates economical production of electricity and ultimately decreases retail costs. The state, on the other hand, has a substantial interest in not having ratepayers subsidize activities for which they receive no benefit and to which they are philosophically opposed. Furthermore, some state commissions argue that allowance of these costs as part of the rate schedule would violate the ratepayers' first amendment rights.

In deciding whether to allow an allocation of political advertising costs, a court must balance countervailing interests. To the extent that political advertising benefits ratepayers and outweighs any other state interest in refusing allocation, the commission should allow the utility to charge this advertising cost to the rate schedule. Moreover, when allocation is justified, a commission should allocate the appropriate parts of the advertising expenses so as to satisfy the least restrictive means requirement of Central Hudson. On the other hand, the commission should not charge to the retail rate those costs that do not
benefit consumers, even in the face of a utility claim that denial infringes its speech.232 If the utility believes the advertising message is important enough, it will likely advertise at shareholder expense.233

2. Allocation of Institutional and Promotional Advertising: Effect of Interfuel Competition

In some geographic areas, gas and electric utilities directly compete with one another for the same consumer market. This interfuel competition234 requires separate consideration for each utility in discussing the allocation of institutional and promotional advertising expenditures.

a. Electric Utilities: Institutional and Promotional Advertising

Until recently, regulatory commissions allowed electric utilities to al-


233. See Pierson, Sales-Related and Institutional Advertising: The Case of Rate-Regulated Public Utilities, in THE POLITICAL ECONOMY OF ADVERTISING 187, 207 (D. Tuerck ed. 1978). This concept is echoed in Justice Blackmun's dissent in Consolidated Edison: "Due to the greater likelihood that a recipient would read an insert with the bill, the utility well might desire to place its insert with the bill even if the total cost of the mailing were charged to the shareholders." 447 U.S. at 554 n.4 (1980) (Blackmun, J., dissenting) (citations omitted). See also Note, supra note 96, at 604 n.9.

234. Interfuel competition for purposes of this Note is defined as competition between utilities selling a different fuel product in the same market area. See West Ohio Gas Co. v. Public Utilts. Comm'n, 294 U.S. 63, 72 (1935). In West Ohio Gas, Justice Cardozo stated:

The suggestion is made that there is no evidence of competition. We take judicial notice of the fact that gas is in competition with other forms of fuel, such as oil and electricity. A business never stands still. It either grows or decays. Within the limits of reason, advertising or development expenses to foster normal growth are legitimate charges upon income for rate purposes as for others.

Id. (emphasis added).

Those utilities that provide both gas and electric service are grouped with the all-electric utilities for the purposes of this Note. Studies show that combined gas-electric utilities advertise less than utilities that must engage in interfuel competition. See Wilder, Public Utility Advertising: Some Observations, 49 LAND. ECON. 458-62 (1973).
locate institutional advertising to the rate schedule. This policy reflected the economic belief, widely espoused prior to the 1970s, that utilities should maximize their resources to benefit from great economies of scale. As economic and philosophical conditions changed, regulatory commissions began the current trend of disallowing institutional advertising cost allocation. This change is due partly to the belief that the benefits from this advertising inure only to shareholders. Moreover, some courts consider institutional advertising a questionable endeavor altogether.

Institutional advertising is designed to enhance the utility's public image. If the advertisement projects a misleading or false image of the electric utility, cost allocation will be denied under the Central Hudson test, which denies first amendment protection for speech "misleading or relating to the unlawful." As with a direct prohibition on institutional advertising, Central Hudson probably would prevent a


236. See notes 23-27 & 91-98 supra and accompanying text.

237. See notes 99-102 supra and accompanying text.


239. The New York Supreme Court, Appellate Division, in discussing what it designated "information" advertising (but what in effect was institutional advertising) stated: Assuming for present purposes that a corporate body or person has the full and complete protection of the constitutional right to freedom of speech unrelated to the immediate cultivation of profit and income in the matter of public service, or freedom of educating the public, as propaganda is often entitled, the present record discloses no interference with that right. . . . It is certain that the consumers are not concerned with such niceties as the image of a utility.

240. See notes 84-85 supra and accompanying text.

241. See note 151 supra and accompanying text.

242. See notes 14-17 supra and accompanying text.
commission from disallowing the allocation of all or part of such an advertising cost. Under part two of the test, the asserted substantial state interest is having the consumers pay for only that which benefits them. The court must balance this interest against the electric utility's argument that image building advertising facilitates the attraction of new capital needed to sustain service levels and meet expansion needs. This argument, however, was unsuccessful in at least two states and is not likely to prevail over the state's "benefit to the consumer" interest. Moreover, the speculative nature of public relations programs makes the specific amount of consumer benefit from institutional advertising difficult to measure accurately. Faced with this uncertainty, some courts may be inclined to disallow completely allocation of these costs. Those courts should be mindful, however, of the least restrictive means requirement of Central Hudson.

Cost allocation of electric utility promotional advertising, also once allowed and even encouraged, is now regularly denied. Regulatory commissions justify this current trend by citing energy, environment-

243. See cases cited note 238 supra.

244. See Re Alabama Power Co., 97 PUB. UTIL. REP. (PUR) 3d 371 (Ala. P.S.C. 1972); Re Consolidated Edison Co., 73 PUB. UTIL. REP. (PUR) 3d 417 (N.Y.P.S.C. 1968); Re Consolidated Edison Co., 41 PUB. UTIL. REP. (PUR) 3d 305 (N.Y.P.S.C. 1961). In the 1961 Consolidated Edison ruling, institutional advertisement was credited with producing benefit to both consumers and shareholders: "To the extent that such advertising fosters sound consumer relations or encourages people to invest in the company, it seems clear that the consumers, as well as the stockholders, are ultimately benefited through the lessening of the expense of doing business." Consolidated Edison Co., 41 PUB. UTIL. REP. (PUR) 3d 305, 364 (N.Y.P.S.C. 1961).

At least one commentator suggested that public relations advertising may foster goodwill between customer and utility, thus resulting in an "economizing" of utility services. See Duffy, supra note 5, at 9.


246. See note 154 supra and accompanying text.

247. See note 216-17 supra and accompanying text.


tal, and economic concerns. Under a *Central Hudson* analysis, these interests must be weighed against the electric utility's arguments that promotional advertising costs should be passed on to the consumer.

Electric utility management justifies promotional advertising cost allocation by arguing that a refusal to allocate costs will result in a reduction of shareholder profits. This result acts as a disincentive to advertise. Accordingly, utilities assert that they are hesitant to engage in promotional advertising for fear of undesirable financial ramifications. Another management justification is that promotion of electric heating may convince users of home heating oil to switch to electricity, thereby encouraging conservation of scarce petroleum resources.

b. Gas Utilities: The Impact of Interfuel Competition on Institutional and Promotional Advertising Cost Allocation

The *Central Hudson* limitation on cost allocation of electric utility advertising does not apply automatically to a gas utility's attempt to allocate promotional advertising costs. Gas utilities often engage in interfuel competition with electric utilities. In those markets, gas utili-

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252. See note 199 supra and accompanying text.

253. See note 200 supra and accompanying text.

254. See note 202 supra and accompanying text.


Approximately 21.3% of the homes in the United States used fuel oil or kerosene as a primary source of heat. See *The Energy Factbook*, supra note 4, at 36. Consumers have shown a propensity to switch from gas and oil to electricity. See *The Energy Source Book*, supra note 4, at 96. In 1977, 50.6% of all new homes completed in that year were heated by electricity. See *The Energy Factbook*, supra note 4, at 38.

If the *Central Hudson* substantial state interest test is now the proper standard by which to evaluate gas and electric utility advertising, promotional advertising designed to convince users of home heating oil to switch to electricity would serve energy conservation, a recognized substantial state interest. In this context, cost allocation could not be denied under the substantial state interest part of *Central Hudson*.

256. Electricity tends to displace the use of gas and oil as the primary heating system in the residential sector. See *The Energy Source Book*, supra note 4, at 96. This trend is most evident in the newly completed home market. In 1976 and 1977 approximately 50% of all newly
ties are placed at a distinct disadvantage because virtually every home in any given competitive market area will need electricity for lighting and most appliances. 257 Gas, by contrast, is used only for some appliances and home heating and is less indigenous to domestic use. 258 This inherent disadvantage compels gas utilities, in order to remain competitive, to solicit customers by advertising more zealously than electric utilities. 259 This added measure of advertising is merely an integral part of a gas utility's ordinary operating expenses. 260 Accordingly, promotional advertising cost allocation is recognized in many jurisdictions as essential to gas utility viability. 261

Courts must take notice of the unequal position of gas and electric utilities. Under _Central Hudson_ a court must weigh the asserted state interest against the utility's interest in promotional advertising cost al-

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constructed homes were heated by electricity. See _The Energy Factbook_, _supra_ note 4, at 38. During this same period, the percentage of newly completed homes heating with gas consistently declined to below 39%. See _id._

257. In 1979, 99.8% of all homes in the United States were wired for electrical appliances. See _The Energy Factbook_, _supra_ note 4, at 47. Electricity is used to power most household appliances, including air conditioners, dishwashers, clothes dryers, ranges, freezers, refrigerators, televisions, washers, and lighting. See _id._

258. Only 55% of all housing units utilized gas for heating in 1977. See _id._ at 36. The uses of gas to operate appliances is less extensive and more specialized. In addition to home space and water heating, gas is used for air conditioning, gas grills, gas lights, and clothes dryers. See _id._ at 462.

259. Promotional advertising enables a gas utility to compete with an interfuel competitor. The degree of competition determines and justifies the reasonableness of advertising costs. See Duffy, _supra_ note 5, at 9.

The gas utility industry is recognized by the Missouri Public Service Commission as a "high risk" business in which a utility "may lose (because of the gas supply shortage generally endemic in the industry) customer after customer to alternate fuels and eventually lose all its customers." Brief for Appellant at 50-51, Laclede Gas Co. v. Public Serv. Comm'n, 600 S.W.2d 222 (Mo. Ct. App. 1980) (citing findings of Missouri Public Service Commission), appeal dismissed, 449 U.S. 1072 (1981). For data on projected supplies of natural gas, see note 263 _infra._


location.\textsuperscript{262} A gas utility's unique need for promotional advertising should outweigh any asserted state conservation interest.\textsuperscript{263}

Moreover, gas utility promotional advertising serves substantial state environmental and economic interests. Natural gas is the cleanest burning of the fossil fuel energy group.\textsuperscript{264} By promoting the use of gas, a utility furthers the state's interest in environmental protection. The promotion of gas consumption also supports a state concern for prudent economic policy. First, the principle of economies of scale is still largely operative in the gas utility industry.\textsuperscript{265} Additionally, promotional advertising by gas utilities encourages the most economic use of available resources. Heating with electricity instead of gas is more expensive and less efficient.\textsuperscript{266} Relative to electricity, consumption of gas

\textsuperscript{262}See note 153 supra and accompanying text.

\textsuperscript{263}From 1969 to 1975, gas was in a relative state of short supply. See R. Pierce, G. Allison & P. Martin, supra note 4, at 448. When supply is low, a state can rightfully assert a substantial interest in preventing promotion of consumption of a scarce fuel. Conversely, if supply is sufficient to meet expanded need, promotional advertising cost allocation should be allowed because the increased consumption would further the benefits of economies of scale. See, e.g., Re Brooklyn Union Gas Co., 27 Pub. Util. Rep. (PUR) 4th 452 (N.Y.P.S.C. 1978). Recent studies and projections indicate that natural gas supplies will be abundant for the foreseeable future. See Pub. Util. Fort., Sept. 10, 1981, at 46; id., at 13; id., June 15, 1981, at 37; id., Feb. 12, 1981, at 41.

\textsuperscript{264}See The Energy Source Book, supra note 4, at 283; R. Pierce, G. Allison & P. Martin, supra note 4, at 457. The fossil fuel energy group includes the following primary fuel sources: coal, natural gas, and petroleum. See The Energy Fact Book, supra note 4, at 10. These three fuels provide the bulk of total energy consumed by the end-use sector. For example, in 1979, 78,787 quadrillion Btu of energy were consumed in the United States. Of that amount, coal, natural gas, and petroleum represented 72.721 quadrillion Btu.

\textsuperscript{265}See I A. Kahn, supra note 26, at 125; Brief for Appellants at 19, 66-67, Laclede Gas Co. v. Public Serv. Comm'n, 600 S.W.2d 222 (Mo. Ct. App. 1980), appeal dismissed, 449 U.S. 1072 (1981). The appellants in Laclede noted:

As to the evidence, both the staff [Missouri Public Service Commission] witness and the Company [Laclede] witness agreed that advertising promoting the use of gas is beneficial to Laclede and to its customers. . . . Laclede's ability to hold down the cost of gas service to its customers is due in large part to the Company's sustained growth, which growth has and will require advertising support. Increases in sales on Laclede's system produce a greater overall utilization of the system and a spreading of the costs of both the physical facilities and managerial overheads, thus lowering overall unit costs to all customers' benefit.

\textit{Id.}

\textsuperscript{266}See Brief for Appellants at 19, Laclede Gas Co. v. Public Serv. Comm'n, 600 S.W.2d 222 (Mo. Ct. App. 1980), appeal dismissed, 449 U.S. 1072 (1981) (quoting Missouri Public Service Commission Staff witness). Another valid justification for the promotion of gas consumption is that gas is readily storible for future use. See 2 A. Kahn, supra note 21, at 120. Since 1975, total gas in storage has ranged from 4,497 billion cubic feet to 6,563 billion cubic feet. See The Energy Fact Book, supra note 4, at 478. Gas is generally stored in depleted underground geologic formations. See R. Pierce, G. Allison & P. Martin, supra note 4, at 456. In contrast to gas,
promotes the substantial state interest of economic efficiency. Hence, contrary to recent commission rulings, a gas utility's inherent market disadvantage, its benefit to the environment, and consumer economic interests should justify cost allocation of gas promotional advertising.

Similarly, contrary to recent regulatory commission rulings, institutional advertising by gas utilities also deserves cost allocation. Unlike electric utilities, the lustre of the gas utility industry is tarnished by a safety stigma. Institutional advertising is a necessary expense for gas utilities to assure actual and potential customers of the safety and reliability of their product. This expense is an incidence of doing business in a market in which the electricity utility competition does not face a safety stigma. Under Central Hudson the gas utility's spe-


268. See notes 263-66 supra and accompanying text. Those regulations affecting commercial speech related to fundamental interests have met with court disapproval. See Carey v. Population Servs. Int'l, 411 U.S. 678 (1977); note 49 supra. Gas utilities have a fundamental right to operate and receive a "fair return" on their investment. See Smyth v. Ames, 169 U.S. 466 (1898); notes 54-64 supra. Accordingly, regulations that put gas utilities at a distinct disadvantage with respect to interfuel competitors should not be upheld.


This point is poignantly illustrated by the disasters that occurred in Centralia, Missouri, on January 29, 1981 and Zanesville, Ohio, on August 9, 1969. In both instances, a ruptured gas pressure regulator sent high pressure gas of 40 pounds per square inch into low pressure lines designed for four ounces per square inch. St. Louis Globe-Democrat, Jan. 29, 1981, at 6, col. 1. As a result, the sudden surge of gas turned pilot lights into "blow torches." Id. at col. 3. In the Centralia fire, nine homes were destroyed and 19 others were damaged. Id. at col. 6. Property damage was estimated at $250,000 to $500,000. Id. at col. 2. The Zanesville fire caused $67,000 damage. Id. at col. 6.

271. Institutional advertising to remove a safety stigma should be distinguished from informational advertising purveying safety tips. The former is needed and intended to convince potential customers of the positive qualities of gas use in the home.
cialized need for institutional advertising cost allocation should outweigh any asserted state conservationist, environmental, or economic interest, including benefit to the consumer. Hence, in those situations in which a commission wholly or partially denies institutional advertising cost allocation to electric utilities, it should allow the cost allocation for gas utilities.272

IV. THE INTERFACE OF CENTRAL HUDSON AND WEST OHIO GAS

Justice Powell recognized energy conservation as a substantial state interest in Central Hudson.273 In making this observation, the Court followed the current regulatory trend of evaluating the content of the advertisement rather than focusing on the reasonableness of the amount of the expenditure. By endorsing a test based on advertising content, the Court adopted, perhaps unwittingly, a new meaning of "reasonableness."274 The Court, without comment, bypassed constitutional precedent275 and established an analysis not based on the West Ohio Gas reasonableness of amount approach.

The Central Hudson test raises serious questions and engenders constitutional confusion as to the continued validity of the West Ohio Gas reasonableness standard. If the current trend of content regulation is proper, environmental and economic concerns, as well as energy conservation, will qualify as substantial state interests and lead to disallowance of advertising cost allocation, regardless of the reasonableness of the cost's actual amount. Without the benefit of cost allocation, advertising by utilities will portend undesired financial consequences.276 Unwilling to incur economic imprudence voluntarily, utilities may forego advertising altogether. The effect of the Central Hudson approach may

272. The Supreme Court has not addressed the issue of cost allocation for goodwill advertising and, in fact, has deliberately skirted it. See Consolidated Edison Co. v. Public Serv. Comm'n, 447 U.S. 530 (1980); Laclede Gas Co. v. Public Serv. Comm'n, 600 S.W.2d 222 (Mo. Ct. App. 1980), appeal dismissed, 449 U.S. 1072 (1981). The dismissal of the appeal in Laclede Gas, however, should not be viewed as an attempt by the Supreme Court to preclude cost allocation of institutional advertising. The specific wording of the dismissal leaves open the possibility for review of this issue at a later time. In fact, a closer inspection of the Laclede Gas appeal reveals that the cursory and conclusory opinion of the Missouri Court of Appeals gave the Supreme Court little room to explore the parameters of this issue. Hence, the dismissal of the appeal does not preclude the possibility of eventual Supreme Court review of this issue.


274. See notes 102-09 supra and accompanying text.

275. See notes 91-101 supra and accompanying text.

276. See notes 199-202 supra and accompanying text.
promote a "chilling" of commercial speech. In light of these implications, the Supreme court should undertake a thorough reevaluation of *West Ohio Gas* to determine whether the results of the current regulatory trend are desirable.

V. CONCLUSION

Contrary to past practice and policy, state regulatory commissions now restrict electric and gas utility advertising either by direct prohibition or denial of cost allocation. Commissions justify these restrictions on content-based conservationist, environmental and economic policies. Thus, regulatory commissions, aided by state and federal legislative and judicial support, have given the traditional *West Ohio Gas* reasonableness standard a new meaning. The reasonableness of utility advertising now depends on its content instead of the amount of its cost.

In response to these restrictions on advertising, gas and electric utilities recently have raised a first amendment defense under the commercial speech doctrine. As a result, utilities have brought into conflict substantial national concerns: the sacrosanct notion of free speech and the nation's interests in energy conservation, environmental protection, and inflation control. The resolution of this conflict depends upon the four-part commercial speech analysis established in *Central Hudson*. Under this analysis, a public service commission's direct prohibition of a gas or electric utility's informational, political, institutional, or promotional advertising will violate the first amendment commercial speech doctrine.

The resolution under *Central Hudson* of the more difficult issue of cost allocation depends on the type of advertising and the nature of the

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277. See notes 1 & 94-99 supra and accompanying text.
278. See notes 8, 158 & 163-95 supra and accompanying text.
279. See notes 9, 159 & 196-271 supra and accompanying text.
280. See notes 5, 107 & 208 supra and accompanying text.
281. See notes 6, 108 & 209 supra and accompanying text.
282. See notes 7, 109 & 210 supra and accompanying text.
283. See notes 105-06 supra and accompanying text.
284. See notes 91-93 supra and accompanying text.
285. See notes 102-09 supra and accompanying text.
286. See notes 11, 115 & 157 supra and accompanying text.
287. See notes 62-72 supra and accompanying text.
288. See notes 163-95 supra and accompanying text.
utility speaker. Commissions will not likely permit an electric utility to allocate institutional and promotional advertising. 289 Regulatory commissions, however, should allocate both gas and electric utility informational advertising costs to consumer rates. 290 Political advertising cost allocation by either gas or electric utilities, though likely to be denied, 291 may receive protection under the traditional first amendment standard. 292 Finally, gas utilities, because of inherent interfuel inequities, 293 should receive special consideration as to institutional and promotional advertising cost allocation. 294

The advent of content-based advertising restrictions and the adoption, by the Supreme Court of a content-based policy raises serious questions as to the role and continued validity of the West Ohio Gas reasonableness standard. Should the Court reevaluate West Ohio Gas and determine that content-based restrictions on advertising are valid, gas and electric utilities will be stripped of any due process or management prerogative defenses. 295 These utilities would be left with only the commercial speech doctrine with which to justify advertising and cost allocation. Accordingly, courts and regulatory commissions should consider the inherent inequities of interfuel competition and strive to perform the concededly difficult task of partial allocation to encourage continued use of that advertising which is economically and socially warranted. 296

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289. See notes 241-45, 252-53 & 274-76 supra and accompanying text.
290. See notes 205-15 supra and accompanying text.
291. See notes 219-23 & 231-33 supra and accompanying text.
292. See notes 169-85 & 219-23 supra and accompanying text.
293. See notes 256-60 supra and accompanying text.
294. See notes 173-78 supra and accompanying text.
295. See note 10 supra and accompanying text.
296. See notes 216-17, 230 & 247 supra and accompanying text.