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tection by the humanitarian doctrine and the general partiality of juries for plaintiffs under such circumstances.

In *Seaman v. Curtis Flying Service*³⁰ the Appellate Division reversed the decision of the trial court which had been based on the ground that the *res ipsa loquitur* doctrine should be applied in a case where the plaintiff's intestate was killed when the plane in which he was a passenger was wrecked in an attempted landing. Certainly the doctrine should not be applied to airplane accidents. It is true that the plaintiff is probably ignorant of the details of flying and hence would have difficulty in pointing out specific negligence, but too little is yet known about flying for it to be said that accidents are solely due to negligence. Instruments and flying equipment have not yet been perfected to a sufficient degree to give the pilot complete control over his plane regardless of atmospheric conditions.

It would be a great aid to the development of a proper legal system if the courts would undertake to decide each case as it arose by reference to the fundamental principles which govern the application of the rule. It may perhaps be desirable that under certain circumstances liability regardless of negligence should be imposed. If so, this should be done by the legislature rather than by the judges' permitting the jury to infer negligence under such circumstances.

NORMAN PARKER, '34.

UNSETTLED PROBLEMS IN STATE CONTROL OF CONTRACTS BETWEEN PUBLIC UTILITIES AND AFFILIATED COMPANIES

The troubles which recently have beset the tangled mass of public utility holding companies have thrown into sharp relief the need for further regulation of these companies. The pyramiding of financial structures and the excessive prices paid for controlling stock interests in operating utilities and other holding companies show that somewhere there must be possibilities of great financial returns to the groups which control a far flung organization of local operating companies. To many of the state commissions charged with the regulation of public utilities it has appeared that a rich source of such revenue is profits on contracts made by local utilities with other companies controlled by the same interests. These contracts may be for the supply of

³⁰ (1930) 231 App. Div. 867, 247 N. Y. S. 251. See also *Sollack v. State of New York* (N. Y. Ct. of Claims, 1927) 1929 U. S. Av. Rep. 42; *Osterhous, Doctrine of Res Ipsa Loquitur as Applied to Aviation* (1931) 2 Air L. Rev. 9.

services, such as expert engineering, accounting or legal advice, or for the sale or rental to the operating company of necessary materials either manufactured or bought wholesale by the affiliate.

In a series of recent cases the United States Supreme Court has undertaken to determine how far the state commissions are bound to accept the price set in such contracts as a proper operating or construction expense. Unfortunately the opinions of the Court in these cases have used such varied language that it requires careful analysis to determine exactly what the Court meant to decide. The first, and apparently least thoroughly considered, of these cases was the *City of Houston v. Southwestern Bell Telephone Co.*¹ This case involved the question whether the charge of 4½ per cent. of the income of the subsidiary made by the American Telephone and Telegraph Company should be allowed as an operating expense. In return for this payment the parent company furnished a variety of engineering, accounting, and legal services and also supplied many of the instruments used by the subsidiary. The Court ruled that the Commission must accept this sum as a proper operating expense since the local company had produced "much evidence tending to show that the charge made . . . was reasonable and less than the same could be obtained from other sources".

The problem was more fully and adequately discussed in *State ex rel. Southwestern Bell Telephone Co. v. Public Service Commission*.² Here the Missouri Public Service Commission had disallowed more than half of the sum charged under the 4½ per cent. contract on the ground that outside of the supply of telephonic instruments on a rental basis no service was rendered thereunder which should not have been performed by the officials of the local operating unit. The case involved many issues and a general order of reversal was made, but the Court clearly indicated that the ruling of the Commission was improper.

There is nothing to indicate bad faith. So far as appears plaintiff in error's board of directors has exercised a proper discretion about this matter requiring business judgment. It must never be forgotten that while the State may regulate with a view to enforcing reasonable rates and charges, it is

¹ (1921) 259 U. S. 518. The present author wishes to acknowledge his indebtedness to two articles by Mr. David E. Lilienthal, *The Regulation of Public Utility Holding Companies* (1929) 29 Columbia L. Rev. 404 and *Recent Developments in the Law of Public Utility Holding Companies* (1931) 31 Columbia L. Rev. 189. A valuable note on the earlier phases of this subject appeared in (1929) 15 St. Louis L. Rev. 299.

² (1923) 262 U. S. 276.

not the owner of the properties of the public utility companies and is not clothed with the general power of management incident to ownership. The applicable general rule is well expressed in *State Public Utility Commission ex rel. Springfield v. Springfield Gas and Electric Co.* 291 Ill. 209, 234:

The commission is not the financial manager of the corporation and it is not empowered to substitute its judgment for that of the directors of the corporation; nor can it ignore items charged by the utility as operating expenses unless there is an abuse of discretion in that regard by the corporate officers.

Although neither Justice McReynolds, who wrote the majority opinion quoted above, nor Justices Brandeis and Holmes, who concurred in a separate opinion which did not discuss this point, realized the fact, this latter case was a considerable relaxation of the rule of the *Houston* case. In the *Houston* case the test was competitive cost. All this case requires is good faith, without any showing whether or not the prices are higher than the prevailing market price. These cases are vitally important since they both allow the state commissions to challenge such contract rates, even though the conditions imposed are such that the challenge will probably be unsuccessful. If the test is merely competitive price, the savings of centralized management would result in ably managed affiliates being able to undersell all competitors and still make large profits. To place the burden of proving abuse of discretion on the state commission is imposing an almost impossible task.³

The first hint that these cases might not represent the settled views of the Supreme Court was given in the case of *United Fuel Gas Co. v. Railroad Commission of Kentucky*⁴ where the local company had endeavored to conceal its profits from the extraction of natural gasoline by making a contract with a specially organized affiliate by which the affiliate was to get 87½ per cent. of the profit. Justice Stone said:

We need not labor the point that a public service corporation may not make a rate confiscatory by the device of a contract unduly favoring a subsidiary or a corporation owned by

³ The impossibility of a state commission bearing such a burden of proof was regretfully admitted by the Wisconsin Commission (one of the most active of state commissions). Re Wisconsin Telephone Co. P. U. R. 1925 D, 661. Treadway, *The Burden of Proof in Rate Making Involving Inter-
corporate Charges* (1932) 31 Mich. L. Rev. 16 discusses this point with a full citation of the cases under this stage of the development of the law.

⁴ (1929) 278 U. S. 300.

its own stockholders. . . We recognize that a Public Service Commission under the guise of establishing a fair rate may not usurp the function of the company's directors and in every case substitute its judgment for theirs as to the propriety of contracts entered into by the utility; and common ownership is not of itself sufficient ground for disregarding such intercorporate agreements when it appears that, although an affiliated corporation may be receiving the larger share of the profits, the regulated company is still receiving substantial benefits from the contract and probably could not have secured better terms elsewhere. . .

But this case is not of that class.

Justice Stone cites both of the quoted cases as authority for this proposition without realizing their fundamental difference. Here either test for disallowance was met. The contract was made in bad faith and entailed charges higher than the competitive cost. Although the admission that the affiliate may take the "larger share of the profits" is striking, still the insistence that the regulated company must receive "substantial benefits" and the more critical tone of the whole opinion indicate that the pendulum is swinging back towards more stringent treatment of such contracts.

This new development culminated in the decision in *Smith v. Illinois Telephone Co.*,⁵ handed down in December 1930. Here the Illinois Commission had ordered a reduction of telephone rates in Chicago. The Illinois Company had applied for an injunction to restrain the enforcement of this rate reduction. Here both charges for supplies furnished by the Western Electric Company, all of whose stock was owned by the American Telephone and Telegraph Company, and charges for engineering, accounting, and legal services supplied by the staff of the American Company itself were involved. Both the Commission and the statutory court had found that the supplies and services were worth more than they cost, that they could not be obtained more cheaply elsewhere, and that the contracts were made in good faith. Both bodies had also found that the Western Electric Company did not make an unreasonable profit on the whole of its business. The statutory court granted the requested injunction on other grounds. Nevertheless, the Supreme Court reversed and remanded the case for further findings, saying:

That fact [the general profit percentage of the Western Electric Company] had evidentiary value but the finding does not go far enough. The Western Electric not only

⁵ (1930) 282 U. S. 133.

manufactured apparatus for the licensees of the Bell system, but engaged in other large operations and it cannot be assumed or conjectured that the net earnings on the entire business represent the net earnings from the sales to the Bell licensees generally or from those in the Illinois Company. Nor is the argument of the appellants answered by a mere comparison of the prices charged by the Western Electric Company to the Illinois Company with the higher prices charged by other manufacturers for comparable materials or by the Western Electric Company to independent telephone companies. The point of appellant's contention is that the Western Electric Company, through the organization and control of the American Company occupied a special position with peculiar advantage in relation to the manufacture and sale of equipment to the licensees of the Bell system, including the Illinois Company, that is that it was virtually the manufacturing department for that system, and the question is as to the net earnings of the Western Electric Company realized in that department and the extent to which, if at all, such profit figures in the estimate upon which the charge of confiscation is predicated. We think there should be findings upon this point. . .

In view of the findings both of the State Commission and of the Court we see no reason to doubt that valuable services were rendered by the American Company, but there should be specific findings by the statutory court with regard to the costs of these services to the American Company and the reasonable amount which should be allocated in this respect to the operating expenses of the . . . Illinois Company.

At first there was a curious tendency on the part of some commissions to disregard or minimize the effect of the decision in the Smith case.⁶ The present view as to the meaning of this decision has been well summarized by Mr. James C. Bonbright. "Such a position suggests that at least a part of the benefits resulting from a holding company should go to the consumers rather than the investors."⁷

There are, however, certain problems with reference to the application of this so called new rule which are both unsettled and of great importance. These problems may be grouped as those which relate to how the cost is to be found, the elements of the cost, and the effect of a finding as to cost.

⁶ Re Ohio Bell Telephone Company (Ohio Public Utilities Commission 1931) P. U. R. 1931 B, 46.

⁷ Bonbright, "Recent Developments in the Law of Public Utility Holding Companies"—A Comment (1931) 31 Columbia L. Rev. 208.

To find the cost of production of articles sold or of services rendered to the operating company it is absolutely necessary for the commissions to have access to the books of the affiliated company or to force the relevant portions of these books to be put in evidence before the commission. Access to the books alone is probably not sufficient, for as the Attorney General of Ohio stated when the American Telephone and Telegraph Company invited him to send a staff to New York to inspect the books, rather than having the Company prepare abstracts of the books for submission to the commission, it would be a mere invitation to hunt for a needle in a haystack.⁸ On the other hand the right of access to the books is probably desirable in that it will be the most effective check to prevent the falsifying of the alleged extracts which are submitted to the commission. It is not surprising that the statutes passed with reference to this problem since the *Smith* case all provide for access to the books.⁹ In so far as these statutes merely remove limitations upon the commissions' jurisdiction which might be implied from the language of prior laws, they are certainly wise and desirable. Unfortunately, if the holding company is not "doing business within the state," they present grave constitutional difficulties which are completely analogous with those presented by attempts to issue subpoenas duces tecum to similar companies.

The commission may desire information from the parent company. There is no legal difficulty in obtaining this if the holding company is incorporated in the state where the commission is functioning or keeps its books there.¹⁰ If the parent corporation, or the affiliate whose books are desired, is a foreign corporation, it will be impossible to secure personal service on it within the bounds of the state, unless it is doing business in the state. It is firmly settled that mere stock control of a company doing business in a state does not put the holding company within the legal category of "doing business" in the state.¹¹ For the parent company

⁸ Re Ohio Bell Telephone Co. (Ohio Public Utilities Commission 1932) P. U. R. 1932 D, 33.

⁹ R. S. Kan. (Supp. 1931) ch. 74, sec. 602 a, b, c.; N. C. Code Ann. (Michie 1931) sec. 1037 (e); Ore. Laws 1931 ch. 103, sec. 9; Wis. Laws 1931 ch. 183. A similar statute was passed in Massachusetts in early 1930. C. S. Mass. (Michie Supp. 1931) ch. 164, sec. 85. The New York statute passed at the same time is weaker in that it contains no such provision. C. S. N. Y. (Cahill 1930) Public Service Law sec. 110. The new statutes are collected in a note (1932) 45 Harvard L. Rev. 729.

¹⁰ Under such circumstances it could be served directly with a subpoena duces tecum as would any ordinary person who might be found within the state.

¹¹ Cannon Manufacturing Co. v. Cudahy Packing Co. (1925) 267 U. S. 333; Bachelor v. Maytag Co. (1930) 251 Mich. 439, 232 N. W. 194.

to be "doing business" in the state, there must be circumstances which would justify the disregarding of the corporate entity.¹² Unfortunately the decisions have not clearly set forth what those circumstances are;¹³ but the question was squarely presented to the Supreme Court of the United States in the *Smith* case and it was ruled that there were not sufficient grounds to disregard the separate entity of the Illinois Telephone Company so as to reach more directly a valuation of the property of the American Telephone and Telegraph Company. Certainly, if the circumstances did not exist in so closely knit an organization as the group of subsidiaries of the American Telephone and Telegraph Company, then it will not exist in the more loosely organized subsidiaries of most holding companies (provided their officials are meticulous in observing the formalities of the corporate separation).¹⁴ In at least one instance the local commission tried the expedient of serving the local company and mailing a copy of the summons to the head office of the parent organization. A federal district court promptly granted an injunction against the enforcement of this order.¹⁵ It is probably fair to adopt the conclusion of Mr. Lilienthal, the chairman of the Wisconsin commission, that there is no direct way by which a subpoena can be issued against a foreign holding company.¹⁶

However, the same result may probably be obtained by indirect means. There has been unfortunately no court decision since the *Smith* case which has expressly decided on whom is imposed the burden of proof as to the fairness of the contract price. The only case which specifically considered this problem arose when it was thought that the only basis for attack was by a showing of want of good faith (under the doctrine of *State ex rel. Southwestern Bell Telephone Co. v. Public Service Commission*). This decision held that good faith will be presumed and that the commission must bear the burden of proof.¹⁷ The commissions have

¹² *Cheney Bros. Co. v. Massachusetts* (1918) 246 U. S. 147; *Ruff v. Manhattan Oil Co.* (1927) 172 Minn. 585, 216 N. W. 333.

¹³ Cf. *Douglas and Shanks, Insulation from Liability Through the Use of Subsidiary Corporations* (1929) 39 *Yale L. Jour.* 193.

¹⁴ Cf. *State ex rel. Daniel v. Broad River Power Co.* (1929) 280 U. S. 551; *State ex rel. Potter v. Michigan Telephone Co.* (1929) 246 Mich. 198, 224 N. W. 438.

¹⁵ *New Hampshire Gas & Electric Co. v. Morse* (D. C. D. N. H. 1930) 42 F. (2d) 490. After considerable investigation the Missouri Public Service Commission reached the same result. In *Re Utilities Power & Light Corp.* P. U. R. 1930 B, 359.

¹⁶ Lilienthal, *Recent Developments in the Law of Public Utility Holding Companies* (1931) 31 *Columbia L. Rev.* 189, 206.

¹⁷ *Northwestern Bell Telephone Co. v. Spillman* (D. C. D. Neb. 1925) 6 F. (2d) 663. Cf. authorities cited n. 3 *supra*.

uniformly acted on the view that the *Smith* case imposes on the local company the burden of supporting this operating expense by a showing of the cost of the services or supplies to the parent company.¹⁸ This view is certainly correct in so far as it applies to proceedings to attack an order of the commission before a federal court. The *Smith* case was reversed and remanded for a finding to be made on this subject. If a finding is to be made, evidence must be presented, and in the nature of things the holding company alone possesses the evidence. If there is no finding, there cannot be a permanent injunction. It would seem highly illogical that the burden of proof should be on different parties, depending upon whether the question is before a commission or a reviewing court. In the course of an opinion concerned partially with other matters the Supreme Court of the United States has ruled that the local company must make "a fair showing of the reasonableness" of such a contract price and that it is not enough to present a mere comparison of charges made by others for similar services.¹⁹ However, in this case the holding company had also been legally served with a subpoena and it was held proper to force it to produce evidence which would show the cost of the service rendered. Thus, this case cannot be cited as a binding precedent in situations in which the parent company has not been served, particularly as it only requires the

¹⁸ *California Farm Bureau Federation v. San Joaquin Light & Power Co.* (California Railroad Commission 1932) P. U. R. 1932 D, 310; *Re Home Telephone Co.* (Indiana Public Service Commission 1930) P. U. R. 1930 D, 481; *Public Utilities Commission v. Gould Electric Co.* (Maine Public Utilities Commission 1930) 1930 D, 289; *Re Dayton Power & Light Co.* (Ohio Public Utilities Commission 1930) P. U. R. 1931 A, 332; *Re St. Croix Valley Telephone Company* (Wisconsin Railroad Commission 1929) P. U. R. 1929 B, 597. It is true that many of these cases were decided before the Supreme Court had decided the *Smith* case, but these commissions were already applying the same tests, regardless of the earlier decisions of the Supreme Court. The vital importance of what the commissions are actually doing is shown by a survey of the cases appearing in the public utility reports between 1925 A and 1930 C. Of those involving rate making only 20 per cent. ever reached the courts. The action of the commissions with reference to rules of law may be summarized as follows: (1) the commission simply follows the rule as laid down by the courts, 15 per cent. of the cases; (2) the commission feels bound to follow the rules, but criticizes the policy of the rule, 17½ per cent. of the cases; (3) the commission says it is following the rules, but distinguishes the instant case so as to avoid all prior rules, 55 per cent. of the cases; (4) the commission flatly rejects the rule of the courts, 12½ per cent. of the cases. Note (1931) 40 *Yale L. Jour.* 1088.

¹⁹ *Western Distributing Co. v. Public Service Commission of Kansas* (1932) 52 S. Ct. 282. The case was fought out on the issue whether the order to the holding company was an interference with interstate commerce. It was held that it was not.

local company to "make a showing" of the reasonableness of the contract price, while it specifically places on the holding company the duty of revealing the cost basis of this price. If the doctrine should finally be adopted that the burden of proof is on the local company, then self-interest would force the parent company to reveal its costs, except in cases where the amounts involved were relatively trivial, compared to the expense of submitting such evidence.²⁰

It can be truthfully urged that this indirect compulsion does not go far enough, since the commission may desire information when there is no rate hearing pending.²¹ This difficulty is obviated by the newer statutes and commission decisions in the absence of statute, which undertake to give the commission the power to prevent the local company from making payments to an affiliate under such a contract. The legality of such measures will be discussed below; but, if they are legal, then the commission can merely institute proceedings to order a discontinuance of the payments and force the parent company to come before it and prove the reasonableness of the contractual rate, if the parent company desires to receive any payments under this contract.

The scope of the data which must be submitted is of the greatest practical importance to the holding company. If the required evidence is too detailed, it will involve great expense in its preparation and greater inconvenience because of the disorganization of records necessary to prepare the required schedules. Perhaps the most extreme example of such a requirement is the Montana commission's order which requests detailed invoices for each service, apparently requiring the absurdity of engineers, lawyers, and accountants punching a time clock to determine exactly how much time they devoted to each problem.²² In the course of an inquiry into state-wide telephone rates the Wisconsin commission issued a very sweeping request for information to be supplied by the American Telephone and Telegraph Company and its subsidiary the Western Electric Company. An idea of the mass of material required may be given by the fact that one item was a

²⁰ The sum involved may be quite large and yet the holding company will consider it better policy not to attempt to secure its allowance as an operating expense. Thus, in a case in which the evidence was submitted prior to the ruling in the Smith case, the Laclede Gas Company made no claim for the allowance of a management fee amounting according to exhibits filed to \$212,000 a year. *State ex rel. St. Louis v. Public Service Commission* (Mo. 1931) 47 S. W. (2d) 102.

²¹ Lilienthal, *Recent Developments in the Law of Public Utility Holding Companies* (1931) 31 *Columbia L. Rev.* 189, 205.

²² *City of Polson v. Public Utilities Consolidated Corp.* (Montana Public Service Commission 1929) P. U. R. 1929 E, 557.

detailed statement of the manufacturing cost of each type of item sold to the Wisconsin Company by the Western Electric Company between the years 1916 and 1930.²³ Similar requests were made by the special master for the federal statutory court, who was hearing evidence on a request for a permanent injunction against the enforcement of an order of the Michigan commission.²⁴ On the other hand, the Ohio commission expressly indicated a desire to be more moderate in its demands and with reference to the same subject only requested a general statement of standard shop costs for each class of items.²⁵ As the Ohio commission pointed out, the commissions would never finish investigating a given case if they must find every detail concerning the business of so wide flung and diversified an organization as the American Telephone and Telegraph Company and its subsidiaries. It is probably true that the commissions could not safely accept the sworn testimony of the officials without some reference to the figures upon which such testimony is based, for this testimony would be practically untested by cross-examination, since no state official would have the information needed for an intelligent exercise of this privilege.

Granting that the commission has been able to secure the information upon which it can make a finding as to the cost of the services and supplies, there still remains the even more vital question as to what are the elements of this cost. The most controversial elements are the compensation to be made for "stand-by" services and the allowances to be made for profit.

Under the contracts of the American Telephone and Telegraph Company and many other holding companies, the parent company or some affiliate undertakes to answer all engineering, legal, and accounting problems that may be referred to it. To answer these a large and well-paid research staff must be maintained. In one case the California commission took the view that as long as no questions were asked, no service was rendered, and hence no allowance should be made.²⁶ However, the mere existence of such a staff eliminates the necessity for the local company main-

²³ Re Wisconsin Telephone Co. (Wisconsin Railroad Commission 1931) P. U. R. 1931 E, 101.

²⁴ Michigan Bell Telephone Co. v. Michigan Public Utilities Commission (D. C. E. D. Mich. 1931) P. U. R. 1931 E, 222. The printed reports do not give the full terms of the requests, but they were before the Wisconsin commission when it made its order and the Wisconsin commission states that they were substantially identical with those made by it.

²⁵ Re Ohio Bell Telephone Co. (Ohio Public Utilities Commission 1932) P. U. R. 1932 D, 33.

²⁶ Re Los Angeles Gas & Electric Co. (California Railroad Commission 1930) P. U. R. 1931 A, 132.

taining a smaller, but proportionately more costly, because less constantly-occupied staff of its own. The allocation of the expenses of this staff was one of the items in controversy in the Wisconsin²⁷ and Ohio²⁸ cases previously referred to. The Wisconsin Commission was very suspicious lest the Wisconsin Company was being called upon to bear the cost of development of discoveries which eventually became commercially saleable for non-utility purposes, like the Western Electric Movietone. It would seem that the fairest system of allocation of this cost would be that proposed by the American Telephone and Telegraph Company before the Wisconsin commission, which was based on gross income of the local companies, with an allowance out of the profits of commercial by-products to repay the cost of their development (apparently including also some allowance out of the profits of commercial successes to repay sums spent on commercially unsuccessful by-products).

The treatment of "profits" in such contracts presents even greater difficulties. Much of this difficulty is due to loose terminology. For instance the California Commission says that it is firmly committed to the policy of not allowing profits to be included in such costs and yet in the same opinion it allows a credit of enough to give a return of 7 per cent. on invested capital²⁹ (which is obviously more than the true interest rate for money, if we disregard the factor of compensation for risk-taking which is normally considered as an element of profit rather than of interest).³⁰ It is certainly true that in so far as profits are the result of superior bargaining power, they should not be allowed in computing costs where the independence of the contracting parties is so nearly fictional. In the *Smith* case it was expressly stated that the element of profit on goods manufactured should be

²⁷ Re Wisconsin Telephone Co. (Wisconsin Railroad Commission 1931) P. U. R. 1931 E, 101.

²⁸ Re Ohio Bell Telephone Co. (Ohio Public Utilities Commission 1932) P. U. R. 1932 D, 33.

²⁹ Re Pacific Telephone & Telegraph Co. (California Railroad Commission 1929) P. U. R. 1930 C, 31. A similar view was followed in a federal district court. *Wabash Valley Electric Co. v. Singleton* (D. C. S. D. Ind. 1932) 1 F. Supp. 106. In a case involving the authorization of the issuance of securities, the Missouri Public Service Commission has adopted the same view. *Re Western Light & Power Co.* (1931) P. U. R. 1931 C, 188. In a case involving the valuation of properties of a lessee of a federal water power site, the Federal Power Commission considered it necessary to find facts sufficient to disregard the corporate entity to reach this same result. *Re Alabama Power Co.* (1932) P. U. R. 1932 D, 345.

³⁰ Cf. 2 Taussig, *Principles of Economics* (3rd. ed. rev. 1927) 164-180.

included, but it is not clear in what sense the term was used.³¹ The staggering losses which Western Electric Company is currently reporting show the absolute necessity of making a large allowance for compensation for the risk involved in investing vast sums so as to be able to supply affiliated operating companies.

Let us suppose that the commission has overcome all difficulties and discovered what is the legally correct cost of the services or supplies furnished by the holding company to the local company. What is the effect of this finding?

In the *Smith* case the United States Supreme Court merely required a finding, but did not say what effect it should have. By reference to the language in the cases of *City of Houston v. Southwestern Bell Telephone Co.* and *United Fuel Gas Co. v. Railroad Commission of Kentucky*, it would seem that no finding as to cost would justify the allowance of a contract price which was higher than that for which the local company could perform the services itself or obtain outsiders to perform them for it. It is true that the Michigan Supreme Court in the case of *State ex rel. Potter v. Michigan Bell Telephone Company* expressly limited the sum allowable to the cost of service, but this case was based on a radically different theory in that it involved the disregarding for some purposes of the separate entity theory, while the separation of parent and subsidiary is expressly recognized in the *Smith* case. It may well be that the *Smith* case is going to cause as much confusion as the famous enumeration of the items of value for rate making purposes contained in *Smyth v. Ames*. It would seem desirable that cost be established as the maximum limit of the sum payable.³² This view seems to be the one adopted by the commissions in actual practice.³³

It is clear that the commission can in a proper case disallow all or part of the sum paid under such a contract in a rate case or in a petition for the authorization for issuance of securities, but the

³¹ *Supra* p. 66.

³² Of course in each instance there must be a showing that the services and supplies were more valuable to the local company than the contract price. The commissions have frequently disallowed contractual charges on the ground that no valuable services were actually rendered. *City of Loogootee v. Loogootee Water Co.* (Indiana Public Service Commission 1932) P. U. R. 1932C, 494; *Re New York State Railways* (New York Public Service Commission 1932) P. U. R. 1932 D, 479; *Re Warren Telephone Co.* (Ohio Public Service Commission 1931) P. U. R. 1931 E, 416. The commission may also disallow the expense, in whole or in part, because it finds it was solely for the benefit of the holding company. *Re Salamonina Telephone Co.* (Indiana Public Service Commission 1930) P. U. R. 1930 E, 39; *Re Pacific Telephone & Telegraph Co.* (Oregon Public Service Commission 1919) P. U. R. 1919 D, 345.

³³ Cf. cases cited in notes 22, 23, 24, 26, and 29 *supra*.

commissions have recently claimed the power to do more. Some of the newer statutes expressly authorize the commissions either to pass on new contracts between affiliates³⁴ or to order the local company to make no payments under such a contract until the contract has been approved by the commission.³⁵ The new Wisconsin statute³⁶ is even broader and expressly authorizes the commission to review its prior rulings as to the validity of any particular contract at any time in the light of the circumstances then present. On such a review, the commission may order that payment be suspended. Even in the absence of such statutes, some commissions have exercised this power.³⁷ The theory back of such rulings has been well expressed by the Alabama Commission:³⁸

We cannot conceive that it will be contended that a Commission is without authority to halt a raid on the treasury of the operating utility on the plea that it has no right in law to manage the property. From our point of view, it is not an assertion of management, but rather an assertion of reasonable control over practices which the Commission has a right to prevent and should prevent before the injury has been done if it is possible for us to arrive there in time.

To be able to render the proper service to the public, the local company must have good credit. It will not enjoy this if there is even a suspicion that its earning power is being surreptitiously diverted to the owners of the common stock. Thus it would seem that the courts should hold when the question is fully and fairly presented to them that the exercise of this power to stop payments is a legal exercise of the power of regulation and is not con-

³⁴ These statutes say the commission may either approve or disapprove, they do not specify the consequences which will follow such action. C. S. N. Y. (Cahill 1930) Public Service Law sec. 110 (3); R. S. Kan. (Supp. 1931) ch. 74, sec. 602; N. C. Code Ann. (Michie 1931) sec. 1037 (e). The Massachusetts statute only applies to contracts for more than two years. C. S. Mass. (Michie Supp. 1931) ch. 164 sec. 85.

³⁵ Ore. Laws 1931 ch. 103 sec. 9.

³⁶ Wis. Laws 1931 ch. 183.

³⁷ Re New Hampshire Gas & Electric Co. (New Hampshire Public Service Commission 1931) P. U. R. 1931 D, 225; Re Southern Bell Telephone & Telegraph Co. (Alabama Public Service Commission 1932) P. U. R. 1932 E, 207; Re New York State Electric & Gas Corporation (New York Public Service Commission 1932) P. U. R. 1932 E, 1. The New Hampshire Supreme Court has recently declared that the New Hampshire commission did not possess the power it assumed to exercise. *New Hampshire Gas & Electric Co. v. New Hampshire Public Service Commission*, not yet reported.

³⁸ Re Southern Bell Telephone & Telegraph Co. (1932) P. U. R. 1932 E, 207.

trary to due process of law. It must be noted that the *Smith* case speaks of the "power of regulation" rather than using the narrower phrase the "rate making power."

Perhaps the most hopeful solution of these tangled problems lies in the recently adopted practices of some of the holding companies themselves. In at least one case the companies voluntarily submitted the contract to the commission, together with full data, before any payments were made.³⁹ Several of the Morgan group of companies have announced that they will endeavor not to derive any profit from the rendition of services to affiliated local companies (by periodic price changes) and have set up the financial structure of the service-rendering affiliates in such a way that any profits which may arise will be distributed back through stock ownership to the local companies in proportion to their gross income.⁴⁰ The commission's tasks will be made easy if such arrangements spread, but it will probably be necessary to retain the "big stick" of stringent regulation to see that good faith is present. It would be all too easy for unscrupulous promoters to divert to themselves the actual profits of the service affiliates by the payment of excessive salaries or other forms of payment without regard to service actually rendered.

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³⁹ Re Nashville Gas & Heating Co. (Tennessee Railroad and Public Utilities Commission 1931) P. U. R. 1932 A, 270.

⁴⁰ New York Times, Nov. 15, 1932, F. 5:3.