Michigan Law Review

Volume 33 | Issue 3

1935

PUBLIC UTILITIES - HOLDING COMPANIES - POWER OF STATE COMMISSION TO REGULATE INTERCORPORATE CHARGES

PUBLIC UTILITIES — HOLDING COMPANIES — POWER OF STATE COMMISSION TO REGULATE INTERCORPORATE CHARGES — The Public Service Commission of Kansas issued an order directing nine local gas companies to cease setting up as an item of operating expense more than a certain amount for gas being furnished the companies by an interstate pipe line company. The nine distributing companies and the pipe line company, all of which were affiliated companies within the meaning of a Kansas statute and ultimately controlled by the same holding company, secured an injunction in the three-judge federal court, and the commission appealed to the United States Supreme Court. *Held*, that the injunction should not have been granted. *State Corporation Commission for State of Kansas v. Wichita Gas Co.*, (U. S. 1934) 54 Sup. Ct. 321.

It is a well recognized principle of public utility law that a regulatory commission may disapprove unreasonable expenditures made by a public utility which said utility seeks to charge to operating expenses.[1] While a state commission may not regulate interstate commerce by fixing charges made to a local company by an out-of-state company shipping the commodity in question across a state line,[2] it may fix charges where the two companies are commonly owned so that in effect the out-of-state firm is directly serving the local consumer.[3] It was once thought that a reduction of the amount paid an affiliated company by a local utility for services rendered or commodities furnished could be made only where the commission had shown that the officers of the utility had not acted in good faith or had failed to exercise a proper discretion.[4] Thus, in the early cases the

[1] Chicago and Grand Trunk Ry. v. Wellman, 143 U. S. 339, 12 Sup. Ct. 400, 36 L. ed. 176 (1892); Tagg Bros. & Moorhead v. United States, 280 U. S. 420, 50 Sup. Ct. 220 (1930); Reno Power, Light, & Water Co. v. Public Service Comm., 298 Fed. 790 (1923); 2 POND, PUBLIC UTILITIES, sec. 701 at p. 1383 (1932).

[2] Public Utilities Comm. for Kansas v. Landon, 249 U. S. 236, 39 Sup. Ct. 268, 63 L. ed. 577 (1919); State of Missouri v. Kansas Gas Co., 265 U. S. 298, 44 Sup. Ct. 544, 68 L. ed. 1027 (1924); Public Utilities Comm. of Rhode Island v. Attleboro Steam & Electric Co., 273 U. S. 83, 47 Sup. Ct. 294, 71 L. ed. 549 (1927).

[3] Pennsylvania Gas Co. v. Public Service Comm. of New York, 252 U. S. 23, 40 Sup. Ct. 279, 64 L. ed. 434 (1920).

[4] Public Service Comm. of Missouri v. Southwestern Bell Tel. Co., 262 U. S. 276, 43 Sup. Ct. 544, 67 L. ed. 981 (1923); Northwestern Bell Tel. Co. v. Spillman, (D. C. Neb. 1925) 6 F. (2d) 663; Treadway, "Burden of Proof in Rate Cases Involving Inter-corporate Charges," 31 MICH. L. REV. 16 (1932); 2 POND, PUBLIC UTILITIES, sec. 701 at p. 1377 (1932).

usual market value test of reasonableness was applied in the consideration of these intercorporate payments as items of operating expense,[5] and the intercorporate aspect was important only in requiring a more careful scrutiny of the transaction.[6] But the tendency of the more recent decisions, beginning with the now historic case of *Smith v. Illinois Bell Telephone Co.*,[7] has been to require a showing of the actual cost of the service or commodity to the holding or affiliated company and to place the burden of proof on the local utility company whose rates are called in question.[8] A Kansas statute under which the principal case arose strengthens the prevailing judicial view.[9] In this manner the state commissions achieve an indirect regulation of the holding company, but the practical shortcomings of this "indirect regulation" have been widely pointed out.[10] In a few instances a more direct control has been attempted.[11] But in view of the legal obstacles confronting the more direct approach,[12] the recognition of the power

[5] Houston v. Southwestern Bell Tel. Co., 259 U. S. 318, 42 Sup. Ct. 486 (1922); United Fuel Gas Co. v. Railroad Comm. of Kentucky, 278 U. S. 300, 49 Sup. Ct. 150, 73 L. ed. 390 (1929); State ex rel. Hopkins v. Southwestern Bell Tel. Co., 115 Kan. 236, 223 Pac. 771 (1924); Wichita Gas Co. v. Public Service Comm., 126 Kan. 220, 268 Pac. 111, P. U. R. 1928D 124 (1928). But see Re New York Tel. Co., P. U. R. 1925C 767 (N. J. Bd. Pub. Util. Com'rs 1924); Re Northwestern Bell Tel. Co., P. U. R. 1923B 112 (Neb. Ry. Comm. 1922); Re Wisconsin Tel. Co., P. U. R. 1925D 661 (Wis. R. R. Comm. 1925), where state commission held that consideration must be given to the cost of the services to the affiliated company. See also comment, 40 YALE L. J. 1088 (1931).

[6] Houston v. Southwestern Bell Tel. Co., 259 U. S. 318, 42 Sup. Ct. 486 (1922).

[7] 282 U. S. 133, 51 Sup. Ct. 65, 75 L. ed. 255 (1930).

[8] Smith v. Illinois Bell Tel. Co., 282 U. S. 133, 51 Sup. Ct. 65, 75 L. ed. 255 (1930), discussed in 40 YALE L. J. 809 (1930); Western Distributing Co. v. Public Service Comm., 285 U. S. 119, 52 Sup. Ct. 283, 76 L. ed. 655 (1932), discussed in 41 YALE L. J. 929 (1932), 30 MICH. L. REV. 1315 (1932); In re Wisconsin Pub. Util. Co., P. U. R. 1930A 119 (Wis. R. R. Comm. 1929); Re Dayton Power & Light Co., P. U. R. 1931A 332 (Ohio Pub. Util. Comm. 1930); Treadway, "Burden of Proof in Rate Cases Involving Inter-corporate Charges," 31 MICH. L. REV. 16 (1932); Lilienthal, "Recent Developments in the Law of Public Utility Holding Companies," 31 COL. L. REV. 189 (1931).

[9] Kansas Laws, 1931, 239, secs. 1, 2, 3, 1933 Supp. to Rev. Stat. of Kansas, 74-602 a, b, c. The statute provides for access to the books of the affiliated company, requires approval by the commission of the contracts made by the utility with the affiliated company, and requires the utility to show actual cost of the services to the affiliated company before it can be given consideration in rate determination. For similar legislation see North Carolina Code Ann. (Michie 1931), sec. 1037 (c), (e); New York Laws 1930, c. 760, sec. 110 (2); McKinney's Consol. Laws of New York Ann., New York Pub. Serv. Commissions Law, sec. 5 (7) (Supp. of 1934). Oregon Laws 1931, c. 103, sec. 9; Wisconsin Stats. 1931, c. 196:52. For a discussion of the legislation see 45 HARV. L. REV. 729 (1932) and 17 MARQ. L. REV. 283 (1933).

[10] Comment, 42 YALE L. J. 941 (1933); comment, 30 MICH. L. REV. 1315 (1932); comment, 17 MARQ. L. REV. 283 (1933); and especially JONES AND BIGHAM, PRINCIPLES OF PUBLIC UTILITIES 604 *et seq.* (1931).

[11] People ex rel. Potter v. Michigan Bell Tel. Co., 246 Mich. 198, 224 N. W. 438 (1929), with which compare Michigan Bell Tel. Co. v. Odell, 45 F. (2d) 180 (1930). Comment, 42 YALE L. J. 66 (1932).

[12] Smith v. Illinois Bell Tel. Co., 282 U. S. 133, 51 Sup. Ct. 65, 75 L. ed. 255

of the state commissions to disallow or reduce payments made to the parent company seems desirable, at least as a step toward the greater protection of the public. While the decision of the Supreme Court went off on a procedural point,[13] the lower court, expressly recognizing the *Smith* case and *Western Distributing Co.* case as controlling,[14] granted an injunction only after it had determined that the commission had not made adequate allowance for the cost of the service to the pipe line company.[15] This would seem to be a slight extension of the "indirect regulation" device in the federal courts, since the *Western Distributing Co.* case arose on application for an increase in rates, whereas in the principal case the commission had taken the initiative in an attempt to reduce rates.[16]

W. A. B.

(1930); Lilienthal, "The Regulation of Public Utility Holding Companies," 29 COL. L. REV. 404 (1929); Comment, 42 YALE L. J. 941 (1933).

[13] The court held the order of the state commission to be legislative in character, not operative *res adjudicata* in a confiscation proceeding, and therefore not enjoinable. On this point see Prentis v. Atlantic Coast Line Co., 211 U. S. 210, 29 Sup. Ct. 67, 53 L. ed. 150 (1908); Bacon v. Rutland R. R., 232 U. S. 134, 34 Sup. Ct. 283, 58 L. ed. 538 (1914); Lilienthal, "The Federal Courts and State Regulation of Public Utilities," 43 HARV. L. REV. 379 (1930); 29 MICH. L. REV. 1067 (1931).

[14] Smith v. Illinois Bell Tel. Co., 282 U. S. 133, 51 Sup. Ct. 65, 75 L. ed. 255 (1930); Western Distributing Co. v. Public Service Comm., 285 U. S. 119, 52 Sup. Ct. 283, 76 L. ed. 655 (1932). In the latter case a gas distributing company was refused an injunction to prevent the state commission's interference with an increase in rates because the distributing company failed to prove the cost of gas to the affiliated company from which it was purchased. See n. 8, supra.

[15] Wichita Gas. Co. v. Public Service Comm. of Kansas, 2 F. Supp. 792 (1933).

[16] Accord, Re Wisconsin Fuel & Light Co., P. U. R. 1927E 212 (Wis. Ry. Comm. 1926).