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ADDRESS

of

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Some Aspects of Service Companies Under the Holding Company Act

After ten years with a State Commission, I can appreciate some of the difficulties you have experienced in your efforts to control the fees for services and construction, and the price for goods, paid by public utility companies. I should like to discuss now some of the related administrative problems under the Holding Company Act.

Section 13 of the Act filled a gap in public utility regulation. My experience with this section convinces me that it affords an opportunity for constructive and cooperative effort by all regulatory bodies and the industry, with no need for the industry to have any anxiety about the future requirements to be met. Many service company representatives agree with this viewpoint.

The Commission has jurisdiction over mutual and subsidiary service companies within holding company systems, affiliates which, generally speaking, are related to the holding company systems through 5% to 10% stock ownership, and those independent persons and companies whose principal business is the rendering of services to holding company systems, although the jurisdiction is not the same as to all of these classes.

Fifty-three holding company systems with consolidated assets, as of December 31, 1937, of approximately $13,900,000,000 have registered with the SEC. Of this group, 21 systems whose consolidated assets represent about 70% of the total, are serviced by a total of 31 subsidiary and mutual service companies, some systems having more than one service company. Of these 31 companies, 20 are subsidiary service companies and 11 are mutuals. Preliminary information indicates that at least 10 additional systems, whose consolidated assets represent approximately 2% of the total, are serviced to a major extent by independents. The other 22 systems, whose consolidated assets represent about 22% of the total, apparently consider themselves too small to warrant a service company or the holding companies render services without charge, or the operating companies are large enough to be self-sufficient.

Under Section 13, the Commission has promulgated Rules setting forth the standards that subsidiary and mutual companies must meet. The same high standards apply to both types of companies. Those companies must meet certain prerequisites to Commission approval, such as--the services must benefit the companies receiving them; the services must be rendered at cost and that cost must be reasonable; the cost of services must be equitably allocated among the companies served; direct charges must be made as far as costs can be identified and related to specific transactions and indirect charges must be apportioned on an equitable basis; and the services must be economically and efficiently performed at a saving to the serviced companies. To meet these requirements, certain large systems have employed independent public accounting firms to devise satisfactory accounting systems. Substantial reductions have been made in office space and rent, and one major service company found it desirable to make plans for curtailing its staff and restricting the specific services to be rendered. The Act and our rules have brought about a substantial overhauling of servicing operations.

One of our objectives is to mold the service companies so that in the event a regulatory Commission wishes to inquire into any charge made by a

service company to a company in a registered holding company system, sufficient supporting information will be available, and if you find a deficiency in this connection, we shall appreciate your advising us.

The billings by the new and revamped service companies are in many instances substantially less than they were formerly, having been reduced in some instances as much as one-half of the amounts previously charged.

In general, the average cost of servicing by a typical service company now amounts to approximately one per cent of the consolidated gross revenues of the system. The amounts charged by specific companies range from approximately one-half of one per cent to three per cent of consolidated gross revenues, being affected by the extent of services rendered and by the amount of salaries of so-called operating personnel carried on the service company payroll. In one instance, due to unusual circumstances, the service costs are approximately seven and one-half per cent of consolidated gross. There is now no standardization among service companies. Each presents different problems which must be carefully analyzed. Any program to accomplish the standardization of service companies must necessarily be evolutionary.

We have been asked about the regulation of affiliate and independent service companies. Each registered holding company has been required to report in its registration statement information concerning all service, sales and construction contracts. On October 22, the SEC adopted a rule which requires each affiliate and independent service company to register with the Commission by November 15 and to disclose information about its operations, including a list of the registered holding companies and subsidiaries serviced by it. These requirements are not burdensome and will provide information tending to show whether the fees paid to these companies are in compliance with the statute. Here again, no company which is conducting its business in compliance with the spirit of the Act need have any fear about our future requirements. The Act also makes possible the SEC's taking jurisdiction over persons, whose principal business is the rendering of services to holding company systems, but that power has not yet been exercised.

Service companies which have applied for our approval have been required to make material changes in organization, operation, and cost allocation methods. Much of this has been accomplished through conferences with representatives of the companies. Before public hearings, our present policy is to write each interested State Commission, soliciting suggestions for the solution of the particular problems involved. The response has been gratifying, helpful, and in several specific instances, I believe, mutually beneficial. For example, a State Commission secured, through the SEC, information concerning service charges which it had been unable to obtain from the local operating company. It is our desire to work even more closely with you in the future because our problem is one in common with you.

Our program is one of continuous and constructive scrutiny of these companies after they have been approved by our Commission. To assist in carrying out our objectives, the Commission, after consultation with representatives of State Commissions and the industry, prescribed a uniform system of accounts and an annual report form. In order to be realistic about our work it is not our intention to be mere "swivel-chair" regulators. A field staff will not only

follow up the activities of these companies, but will also be of assistance to the various regulatory bodies and to the industry itself.

The Commission has not adopted any model plan for service companies, but we expect to bring the various plans, used by the companies, within reasonable limits by retaining the best parts of the various plans and eliminating the practices which in the light of experience have proved undesirable. While we will be in close touch with the management of these companies, we will guard against usurping the functions of management. There is one additional point deserving emphasis: We are not so much concerned now as to whether a company is either a mutual or a subsidiary service company, so long as it is a *real* service company. Time, experience and the cooperation of regulatory agencies and the industry, will contribute much to the accomplishment of the objectives of the Act.

The activities of the companies that have filed with us for approval range from the proverbial "soup to nuts." One company has provisions for a lunch room for its employees. Another is an automobile company, owning, maintaining and leasing trucks, cars and motorcycles. We have also passed upon various insurance arrangements, appliance finance companies, and we now have a coal mining company seeking approval. I know you appreciate the complexities of our mutual problem.

We earnestly hope you will feel free to interchange suggestions with us. We shall appreciate your aid in our endeavor to accomplish a constructive result in service company cost-control.

Finally, we must appraise anew the proper functions of the service company in contrast with the functions of local management of operating companies. Not only must duplication of services by the service company and the operating companies be avoided, but the local companies should perform for themselves all the functions which they inherently can perform better than a central servicing agency.

Through a continuing study of the service companies, and the requirements of reports and disclosure of information, the regulatory bodies in this country should be able to proceed to the accomplishment of the objectives of common-sense regulation and fair play with much more assurance than they have been able to in the past. Our work under the Holding Company Act affords an opportunity for a positive and cooperative effort to our mutual advantage in the development of an intelligent and constructive program. We have received much cooperation from the industry after our detailed requirements were understood and there is no reason why this cannot continue in the fulfilment of both the *spirit* and the letter of our Act.

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