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The commissions require, for accounting purposes, that expense and revenue accounts for the appliance business of an electric or gas utility be separated from other accounts. Salaries and commissions of salesmen, the cost of appliance advertising and any losses on appliance sales generally are excluded from operating expenses for purposes of rate making — even when a utility's efforts are directed toward the use of efficient, conservation-rated appliances.[63] Similarly, any profits on appliance sales are not included in a company's annual utility earnings. The merchandising of appliances, therefore, is treated as a nonutility business.

Replacement Power Costs; Repair and/or Cleanup Costs. Generating plant outages, particularly in the case of nuclear plants (whether due to an accident or to a Nuclear Regulatory Commission mandate), raise two issues: Who should pay the replacement power costs and the repair and/or cleanup costs? The cause of the outage is crucial. If due to mismanagement or imprudence, replacement power costs, as well as any related repair and/or cleanup costs, generally are disallowed.[64] In the words of the New York commission:

> The company's conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problems prospectively rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable people would have performed the tasks that confronted the company.[65]

Under this standard, Consolidated Edison Company was required to refund $33.7 million (plus interest) in replacement power costs "because of lack of reasonable care in its management and operation of the Indian Point No. 2 nuclear facility."[66]

Under similar standards, Philadelphia Electric Company had to absorb $53.2 million in replacement power costs as a result of two outages (in 1983 and 1984) at Salem Unit No. 1,[67] and Utah Power & Light Company's cleanup costs from a toxic waste spill were disallowed.[68] But the Pennsylvania commission permitted Metropolitan Edison Company and Pennsylvania Electric Company to recover their full replacement power costs as a result of events at Three Mile Island, since "the current purchases of power by respondents were direct and immediate costs of providing service."[69]

Transactions among Affiliated Companies.[70] The widespread existence of holding companies results in two important problems in the control of expenditures. Operating companies normally pay either the holding company or a subsidiary service company an annual fee for accounting, financial and legal services. Operating companies also commonly purchase all or some of their equipment, materials and supplies from affiliated manufacturing firms. In addition, other electric and gas utilities own fuel subsidiaries, from which they purchase all or part of their annual fuel requirements. All of these

transactions, because of the absence of arm's length bargaining, require [illegible] scrutiny by the commissions, but they "should not be given any consideration in the absence of evidence of unfair dealing."[71]

With respect to annual service fees, most state commissions have authority over the management contracts that are signed by operating companies. In some states, copies of such contracts must be filed with the commissions. In some states, the contracts must be submitted for approval before they become effective. In other cases, the contracts are subject to approval or disapproval after they have become effective. But in either situation, a commission always has the opportunity in a rate case to question a payment made to an affiliated company.

In general, service fees will not be approved unless the company can show some specific services rendered by the management firm. This requirement follows the principle expressed by the Securities and Exchange Commission (SEC) in a 1943 case:

> Each service company should confine itself to functions which the operating subsidiaries cannot perform as efficiently and economically themselves. These services should be limited to services of an "operating nature" as distinguished from managerial, executive, or policy-forming functions.[72]

At the federal level, the service contracts of electric and gas holding companies are closely controlled by the SEC. In the Public Utility Holding Company Act of 1935, the commission was authorized to approve service companies if it finds that services will be performed efficiently and economically "at a cost fairly and equitably allocated among" operating subsidiaries and "at a reasonable saving over the cost of comparable services or construction performed or goods sold by independent persons."[73] The commission prescribes a standard system of accounts for service companies. Charges are limited to the costs of the services performed; all proposed modifications in service contracts must be approved by the commission.[74]

At the state level, service fees are regularly reviewed in rate proceedings and, on occasion, adjustments are made. Prior to divestiture, for example, AT&T had a general service and license contract with each Bell System operating company. The license contract was for a variety of services, including accounting, legal and financial services; research and development; and advice and assistance in engineering, plant, traffic, commercial and other operating fields. Prior to 1974, the operating subsidiaries paid to AT&T 1 percent of exchange and toll revenues annually. No state commission found it necessary to revise the service charges under the license contract.[75] Between 1974 and 1983, AT&T charged the actual costs of its services to the Bell operating companies on an allocation formula (not to exceed 2 1/2 percent of collectible gross operating revenues).[76] As a result,