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POLITICAL-ECONOMIC ORIGINS OF SECTION 410 OF THE COMMUNICATIONS ACT: FEDERAL-STATE JOINT BOARDS, COOPERATIVE FEDERALISM AND REGULATION OF THE DOMESTIC TELEPHONE INDUSTRY (1913--1971)

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POLITICAL-ECONOMIC ORIGINS OF SECTION 410 OF THE COMMUNICATIONS ACT: FEDERAL-STATE JOINT BOARDS, COOPERATIVE FEDERALISM AND REGULATION OF THE DOMESTIC TELEPHONE INDUSTRY (1913--1971)

Volume I

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ABSTRACT

POLITICAL-ECONOMIC ORIGINS OF SECTION 410 OF THE COMMUNICATIONS ACT: FEDERAL-STATE JOINT BOARDS, COOPERATIVE FEDERALISM AND REGULATION OF THE DOMESTIC TELEPHONE INDUSTRY (1913-1971)

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The Annual Convention Proceedings of National Association of Regulatory Utility Commissioners from 1889 to 1971 have been reviewed to organize and present an historical perspective of the political-economic origins of Section 410 of the Communications Act of 1934. Emphasis has been given to the period from 1913 to 1971 when a Supreme Court opinion and its subsequent influence on the regulation of railroads affected the attitudes and behaviors of state and federal officials who adapted tenets of the public utility paradigm to regulate the performance of telephone companies.

Section 410 endorses the appointment of panels and/or committees of state and federal officials empowered to engage in rule making procedures complementing dual regulation of the nationwide telephone industry. The mechanisms accommodated an intergovernmental relationship known as "cooperative federalism," a model used by scholars who describe the transitional arrangement of multiple spheres of government behavior which emerged in the United States in a period most commonly associated with the 1930s.

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CHAPTER I

STATEMENT OF THE PROBLEM

Introduction

Exercising authority granted by the Commerce Clause of the United States Constitution (sec. 8[3]), Congress adopted the Communications Act of 1934, as amended (48 Stat. 1065, 47 U.S.C. 151 et seq. [hereinafter the Act]). The Act divides power to regulate the nationwide domestic telephone industry between members of the Federal Communications Commission (FCC) and officials of agencies created by legislatures of the several states. Two-tiered division of commerce power is known as "dual regulation." As such, dual regulation of the telephone industry typifies "the greatest constitutional issue of the first half of the twentieth century--the relative power of Congress and the states to control the national economy" (Pusey, M.J., 1951, in Charles Evans Hughes, p. 304). Separate and combined actions of the FCC and state regulatory agencies influence the performance of companies providing interstate and/or intrastate telephone service, and, consequently, the prices the American public pays for using the services.

Because the FCC and the states share congressionally delegated commerce power, Section 410 of the Act provides mechanisms to accommodate dual regulation of the industry.

The mechanisms are generically called "joint boards," functioning sometimes as "cooperative committees" and/or "joint conferences" of federal and state officials who together address particular issues of common concern. Section 410 enables federal and state officials to meet, to investigate, to deliberate about and recommend answers to questions rising from overlapping effects of dual regulation. For example, rate-making rules devised by officials in one jurisdiction may directly or indirectly produce effects for a segment of the industry regulated by another jurisdiction. Therefore, members of the FCC and state agencies are empowered by Congress to consult informally among themselves and/or engage in formal proceedings designed to coordinate requirements of the Communications Act and separate state statutes. The federal and state laws have, as a common purpose, an intention to ensure that only reasonable rates will be charged for local exchange and interexchange services. Those rates are expected to produce revenues which permit maintenance and/or expansion of the nationwide publicly switched network sufficient to satisfy demand for services, while making it possible for those who have risked their money in a public service enterprise to earn a fair rate of return on their investments.

Two provisions of Section 410 adopted in 1934, permit the FCC to appoint cooperative committees and/or joint boards on its own initiative or at the request of one or more of the states. Whether the mechanisms are called cooperative committees or joint boards, the panels of federal and state regulators who are appointed under Section 410 are bound by the rules stated in Section 409 (General Provisions Relating to Proceedings--Witnesses and Depositions) and certain sections of the Administrative Procedure Act (80 Stat. 381-388, 392-393; 5 U.S.C. 551-559, 701-706; and 81 Stat. 54-56; 5 U.S.C. 552).

A third provision of Section 410, adopted in 1971, requires the FCC to appoint federal-state joint boards (FSJBs) whenever it appears that FCC rule-making will impinge upon the lawful rate-making authority of the several states. The chairperson of the federal commission, or a designated federal commissioner, sits as chairperson of the joint board. Findings of a joint board are advisory. They require the support of the majority of the federal agency's commissioners to have the force of an administratively final rule.

In summary, The Communications Act authorizes dual regulation of the telephone industry. Congress has divided commerce power between the FCC and agencies of the several states. Section 410 enables the FCC and the states to engage in consultative meetings for the purpose of facilitating complementary rate-making procedures suited to the reconciliation of separate federal and state rules which apply to segments of the telephone industry. It endorses a unique intergovernmental relationship between officials of the FCC and state regulatory agencies characterized by the appointment of cooperative committees and/or joint boards. (The text of Section 410[a][b][c] appears in Appendix A.)

Purpose of the Study

The purpose of this study is to present an historical view of the political-economic origins of the intergovernmental relationship established by Section 410 with the thought that a perspective of them will be useful to those who are curious about the mechanisms which permit federal and state officials to collaborate and to coordinate separate regulatory activities suited to their respective spheres of delegated authority. The study concentrates on the intergovernmental relationship called into being by two-tiered congressional delegation of commerce power which permits the FCC and the states to regulate the telephone industry in the United States.

To do so, it seemed appropriate to scan documents from 1889 to 1913, when federal and state officials began meeting together annually as they developed a mutual appreciation of the work they were engaged in as regulators of the railroad and other public service industries. However, the principal focus attends to the period of time from 1913 to 1971. In those years, federal and state policymakers shared the common attitude that privately owned telephone companies providing local exchange and interexchange services should be permitted to operate with monopoly power in designated markets. Because government restricts competitive entry into those markets, the company is required to make vital services readily available to all persons willing to pay a fair price for access to and use of the services. The proposed rates for those services have been subject to review and approval by state and federal regulatory commissioners.

Need for the Study

Although there is a substantial body of scholarly work directed to the topic of regulation of the telephone industry, a review of collateral literature reveals that little has been said about Section 410 or about the federal-state intergovernmental relationship addressed by that section of the Communications Act. In 1986, the Supreme Court interpreted aspects of dual regulation of the telephone industry under the terms of the Act. The Court's opinion draws attention to Subsection 410(c), its relevance to the scheme of dual regulation and to the overlapping effects of rate-making rules designed by each of the two tiers of government (Louisiana v. the FCC, 476 U. S. 355, 106 S. Ct. 1890, 90 L. Ed. 2d 369; hereinafter Louisiana). The formal legislative history of the Communications Act reveals little about circumstances associated with Section 410. Academic literature appears to be generally devoid of attention to its political-economic origins. Therefore, it was appropriate to search for and comment upon alternative records which would reveal factors contributing to the development os Section 410.

Limitations of the Study

Because the language of Section 410 confines its reference to members of federal and state governments when it speaks of appointees to cooperative committees and joint boards, the study does not discuss municipal regulation of the telephone industry. (A summary of the relationship of municipal regulation and state regulation can be found in the work of James W. Sichter, 1977, pp. 11-14.) Discussion of business practices of the American Telephone and Telegraph Company (AT&T) and other service providers will be presented only to the degree that it illuminates aspects of the federal-state relationship recognized by Section 410. Research and presentation are necessarily limited by the constraints of time and by knowledge of and/or access to relevant evidence.

Some areas of examination were beyond the scope of the study. For example: (a) This study does not enumerate many of the occasions when mechanisms of Section 410 have actually been employed. (2) An evaluation of the pragmatic efficacy of joint boards has not been attempted.

Research Question

What political and/or economic circumstances contributed to the development of the statutory provisions of Section 410?

Circumstances may be described by a variety of factors: ideas, issues, people and events. Therefore, the basic research question has been further defined by a subset which

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permits the factors to be considered as the evidence revealed by the research is reviewed. According to the purpose of this study, evidence was sought to answer the following research questions:

1. What situations gave rise to the ideas that led to the statutory development of Section 410?

2. What were the explicit and implicit aims of the ideas?

3. Who initiated action affecting the development of Section 410?

4. Which situations were they responding to?

The Relevance of the Study: The Contemporary Regulatory Environment and the Louisiana Case

Associate Justice Oliver Wendell Holmes once commented on the importance of an historical perspective to members of the Supreme Court (cited by Felix Frankfurter, 1937, p. 2):

> [H]istory is the means by which we measure the power which the past has had to govern the present in spite of ourselves, so to speak, by imposing traditions which no longer meet their original end. History sets us free and enables us to make up our minds dispassionately whether the survival which we are enforcing answers any new purpose when it has ceased to answer the old.

The Contemporary Regulatory Environment

There are those who continue to question the functional utility of dual regulation of the telephone industry. It emerged during years when the vertically and horizontally integrated giant parent holding company, the American Telephone and Telegraph Company, controlled almost all of the long-distance message telephone traffic and most of the local exchange interstate telephone service in the United

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States. The original scheme of divided and shared jurisdictional authority to regulate the nationwide industry has remained essentially the same since Congress first wrote the Communications Act. Recent political attitudes have reflected a commitment the to competitive restructuring of the industry. It was political accomodation to a public utility paradigm which protected the monopoly status of AT&T subsidiaries and other companies providing interstate and intrastate telephone service in the period from 1914 to 1971. Since AT&T agreed to divest itself of ownership interests in operating companies providing local intrastate common carrier service (United States v. AT&T, 552 F. Supp. 131 [D.D.C. 1982], aff'd sub nom. Maryland v. United States, 103 S. Ct. 1240 [1983]) recommitment to a competitive industry stucture has radically reformed the regulation of interexchange services.

Federal and state agencies continue to review comprehensive and detailed financial reports of various telephone companies in order to determine the basis of interstate and intrastate rates charged by them. A principal goal of federal and state regulators has been to agree upon the rules which determine how the companies supply the necessary data which permit each of the two tiers of governments to supervise a schedule of reasonable rates. Because the network is technologically integrated and has been, by contractural agreement among the several companies, financially integrated as well, it is highly desirable for

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federal and state regulation to be as uniform as possible. A theme perpetuated by critics of dual regulation is that two-tiered rulemaking creates an unwarranted burden contrary to the goals of economic efficiency and technological innovation in a society committed to principles of competition. Indeed, since AT&T has been divested of its local exchange operating companies, there has been constant pressure to disassemble classic public utility regulation of companies providing interstate interexchange services and intrastate interexchange services, and to remove limits on the line of business activities permissibly engaged in by local exchange companies. Nevertheless, Congress has remained reticent about changing the commitment to a broad scheme dual regulation of the telephone industry written into the Communications Act in 1934.

Congress expresses two continuing commitments in its support of the language of Section 410 (subsections [a][b][c]): (a) a commitment to the States to preserve a scheme of dual regulation and (b) a commitment to formal and informal measures designed to encourage officials of the two tiers of government that they can legitimately confer and/or conduct joint proceedings. The two commitments resemble attributes spoken of by scholars of intergovernmental studies. The concept, "cooperative federalism" embraces those attributes. The term expresses addresses philosophical view of the United States federal system espousing separate but coordinated action between

multiple tiers of government. Chapter II offers an amplified discussion of the ideas associated with cooperative federalism.

Section 410 permits members of two tiers of government to consult among themselves, to design and to recommend rules which can then be adopted, in so far as practical, by agencies in each of the two jurisdictional tiers in order to approximate uniformly coordinated federal and state rate-making standards and practices. The FSJBs appointed since 1971 have been actively involved in the regulation of the economic performance of companies participating in the structural metamorphosis of the telephone industry influenced by the reintroduction of competition and development of new common carrier communications technologies.

The *Louisiana* Case

The Supreme Court, in 1986, commented on the contemporary utility of Subsection 410(c). Because the *Louisiana* decision is so closely associated with the intergovernmental relationship which is the foundation of this study, it warrants further discussion. *Louisiana* inextricably ties Subsection 410(c) to the contemporary policy scene at the same time it refers to the scheme of dual regulation written into the Communications Act. It affirms congressional intent to distinguish the appropriate rate-making prerogatives assigned to the federal and to the state jurisdictions. It does so, in part, by pointing to

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statutory provisions that require formal negotiations to take place among officials of federal and state agencies on those occasions when issues associated with rate making are of common interest to them. If the Louisiana has made contemporary scholars and policymakers aware of Section 410. However, they may have no knowledge of its political-economic origins.

Briefly stated, the facts of the case are as follows: The Louisiana Public Service Commission, twenty-two other states (notably, California, Ohio, and Florida), acting in concert with the NARUC, requested relief from lower court decisions which sustained a preemptive order issued by the Federal Communications Commission (FCC). The basis of their claim was that the federal agency misinterpreted the extent of the commerce power delegated by Congress to the several states under the provisions of the Communications Act. Louisiana challenged the legitimacy of an FCC order which required the each of the several states to adopt the procedures established by the federal agency to calculate the amount of money allowable for depreciation as an element of an intrastate rate-making formula. Louisiana said the FCC's action signalled "elimination of the states' rate setting perrogatives [sic]--over plant [equipment and facilities] assigned to the state jurisdictions in the separations process--[and] is inconsistent with Congressional intent (Reply Brief Opposing Motions to Dismiss or Affirm, No. 84-871, p. 3).

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The FCC did not deny that the federal agency, state agencies, and regulated companies had accepted differentiated state and federal depreciation practices before issuing the order being challenged by the states. The federal agency admitted that seventy-five percent of the nationwide plant and equipment subject to depreciation was associated with facilities providing intrastate service. Yet the FCC asserted that it was within its full statutory authority to arbitrarily determine when it was no longer appropriate to permit the depreciation methods adopted by the states to conflict with the federal agencies methods and goals. Depreciation is an expense representing physical deterioration of the facilities necessary for providing telephone service due to wear and tear, decay, inadequacy, and obsolescence (Lindheimer v. Illinois Bell Tel. Co., 292 U.S. 151 at 167 [1934]). (See Chapter IV, p. 92 for a a further explanation of the elements contributing to the rate-making formula.)

In pursuit of its goal, the FCC had made the following claims: (1) Subsection 220 (b)(1) of the Act foreclosed the states from adopting depreciation rates and procedures different from those the FCC prescribed unless the FCC itself expressly excepted carriers in particular states from its policies. (2) If the statute itself did not directly authorize preemption of a state's depreciation practices, preemption was justified to prevent the several states from frustrating the agency's new rules designed to encourage

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competition within the industry, or wherever its rule making furthers greater efficiency within the marketplace (92 FCC 2d 864 at 875, 877). The federal circuit courts who heard the original appeals by the states upheld the FCC's preemptive authority. (Complete citations for the the relevant FCC orders and circuit court decisions can be found within the full text of the Louisiana case in Appendix B.)

In a clear summary of the five-to-two decision which reversed the decisions of the lower federal courts and upheld the claim of the states, Associate Justice William Brennan described the longstanding, complex policy problem that was brought before the New Deal Congress in 1934 (476 U.S. 355 at 360):

> The Act establishes, among other things, a system of dual state and federal regulation over telephone service, and it is the nature of the division of authority that these cases are about. In broad terms, the Act grants to the FCC the authority to regulate "interstate and foreign commerce in wire and radio communication," 47 U.S.C. [sec.] 151, while expressly denying that agency "jurisdiction with respect to...intrastate communications service...." 47 U.S.C. [sec.] 152(b). However, while the Act would seem to divide the world of domestic telephone service neatly into two hemispheres--one comprised of interstate service over which the FCC would have plenary authority, and the other made up of intrastate service, over which the States would retain exclusive jurisdiction--in practice, the realities of technology and economics belie such a clean parceling of responsibility. This is so because virtually all telephone plant that is used to provide intrastate service is also used to provide interstate service and is thus conceivably within the jurisdiction of both state and federal authorities. Moreover, because the same carriers provide both interstate and intrastate service, actions taken by federal and state regulators within their respective domains necessarily affect

> the general financial health of those carriers, and hence their ability to provide service, in the other "hemisphere."

Louisiana involved a rate-making question: Who, between federal and state governments, has authority to determine the selection among different accounting conventions which would lead to calculations to arrive at charges assigned to telephone facilities and services? (In this instance, depreciation methods were at issue.)

The FCC also argued that "[T]he revolution in telecommunications occasioned by the federal policy of increasing competition in the industry will be thwarted by state regulators who have yet to recognize or accept this national policy" of competition (at 358). The FCC said its rules must dominate in order "to avoid frustration of validly adopted federal policies" (at 362, citing Amendment of Part 31, 92 FCC 2d 864, at 875 [1983]). The Court forthrightly rejected the FCC's arguments by saying that a federal agency may preempt state law only when it is acting within the scope of its congressionally delegated authority. Had the Court accepted the FCC's claims, the states' rate-making role would have been subordinated to the FCC's rulemaking.

The Supreme Court sent notice to the federal commission, the States, the federal court system, and Congress "that the Act denies the FCC the power to dictate to the States" how to accomplish intrastate rate making (at 359). The Court acknowledged that it might be inclined to accept the FCC's argument that state regulation should not frustrate the ability of the federal agency to establish policy if Congress had not written Section 151 and Subsection 152(b) into the statute. Justice Brennan said (at 370; 374):

> [Section 152(b)]...asserts that "nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service"....By its terms, this provision fences off from FCC reach or regulation intrastate matters--indeed, including matters "in connection with" intrastate service. Moreover, the language with which it does so is certainly as sweeping as the wording of the provision declaring the purpose of the Act and the role of the FCC.
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> [A]...federal agency may pre-empt state law only when and if it is acting within the scope of its congressionally delegated authority... [A]n agency literally has no power to act, let alone pre-empt the validly enacted legislation of a sovereign state, unless and until Congress confers power upon it....[T]he best way of determining whether Congress intended the regulations of an administrative agency to displace state law is to examine the nature and scope of the authority granted by Congress to the agency. Section 152(b) constitutes...a congressional <u>denial</u> of power to the FCC to require state commissions to follow FCC...rate making....[W]e simply cannot accept an argument that the FCC may nevertheless take action which it thinks will best effectuate a federal policy. An agency may not confer upon itself power.

The Court gave reference to the role of federal-state joint boards and their expedition of the separations process with the following statement (at 375):

> ...The Communications Act not only establishes dual state and federal regulation of

> telephone service; it also recognizes that jurisdictional tensions may arise as a result of the fact that interstate and intrastate service are provided by a single integrated system. Thus, the Act itself establishes a process designed to resolve what is known as "jurisdictional separations" matters, by which process it may be determined what portion of an asset is employed to produce or deliver interstate as opposed to intrastate service 47 U.S.C. 410(c). Because the separations process literally separates costs such as taxes and operating expenses between interstate and intrastate service, it facilitates the creation or recognition of distinct spheres of regulation. See Smith v. Illinois Bell Telephone Co., 282 U.S. 133 (1930).

Unless Congress legislates otherwise, contemporary policy is likely to be influenced by the results of the Supreme Court's recent decision. The case will ultimately be cited in subsequent lower court interpretations of the Act. Although the language of Louisiana seems to be decisive, a core problem associated with balancing conflicting and competing state and federal policies may remain as long as there is a high degree of overlap in the "real world" between interstate and intrastate common carrier communications. Federal-State Joint Boards function as if they are working symbols of cooperative federalism, to minimize inequities and incongruities which could arise in this field of commerce, and to negotiate methods of separating the conduct and development of nationwide telephone service between intrastate and interstate jurisdictions.

The process of coordinating divided authority among officials at the two tiers of government who will determine economic policies for the industry continues to pose questions for those interested in telecommunications economics and law. The fundamental design of dual governmental authority remains the same whether firms in the industry operate as natural monopolies or sell facilities and services in competitive markets. The Act reserves jurisdictional authority for the states, constrains preemptive power of the FCC, and encourages Federal-State cooperation in the economic regulation of communications services. Louisiana affirms the following strategies devised by Congress: (a) reserved jurisdictional authority of the States, (b) constrained preemptive power of the FCC, and (c) bargaining among federal and state officials to accommodate dual regulation of a nationwide industry. The effect of Louisiana is to instruct the FCC to use FSJBs as the appropriate forums to negotiate interjurisdictional tensions (at 1902) because Congress adopted a federal-state intergovernmental arrangement to supervise the performance of an integrated, nationwide telephone operating system.

Louisiana draws contemporary attention to the relevance of Subsection 410(c). The Court calls on the FCC to respond to the intent of Congress by employing Subsection 410(c) to consult with the states because the federal agency cannot confer rate-making power upon itself. The decision implies that rate-related, interjurisdictional grievances can be more properly reconciled by employing Subsection 410(c) than by the federal courts. Federal-state joint boards appointed si

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since 1971 have their political-economic traditions set in an earlier time when monopoly rather than competition was the industry's structural status quo. It is quite likely that those historical traditions will continue to have some bearing on attitudes and behaviors of more contemporary federal and state policymakers. Although the original scheme of divided and shared jurisdictional authority to regulate the nationwide industry has remained essentially the same since Congress first wrote the Communications Act, the structure of the telephone industry reflects a recommitment to a competition as contrasted to federal and state policies shaped by a public utility paradigm which protected the monopoly status of firms providing interstate and intrastate telephone service in the period from 1913 to 1971.

Organization of the Study

The remaining sections of the presentation of this study have been organized to accomodate the tenets of historical research methods. The research topic has made it necessary to probe multidisciplary sources of academic and professional literature as well as government documents and decisions of the Supreme Court. Therefore, an overview of the study proceeds in the following manner.

Chapter II discusses what others have said about using an historical approach, and how some have described circumstances closely related to Section 410. It summarizes the methods used to assemble and evaluate relevant documents. It presents a simple construct characterizing an intergovernmental relationship applicable to this study. Finally, it introduces a two-part thesis statement comprised of two premises derived from an initial review of the literature and the language of Section 410.

Two chapters present a review of literature organized to offer a conceptuality for qualities of the special federal-state intergovernmental relationship being studied, as well as to provide a limited discussion of certain aspects of economic regulation of the telephone industry from 1913 to 1971. Chapter III integrates a review of academic and professional commentary: scholarly publications, public documents and Supreme Court decisions relating to the development of the federal-state intergovernmental relationship. Chapter IV provides an orientation to people, principles, practices and terms more closely related to economic regulation of the telephone industry.

Chapter V organizes a presentation and analysis of the evidence attending to fundamental elements of the research question. It focuses on a period when federal and state legislation was more attendant to railroad regulation than to matters of the telephone industry (1889-1913). It presents a discussion of the goals of early federal-state cooperation, of how Supreme Court interpretations began to shape dual regulation, the relevance of two Supreme Court opinions written by Charles Evans Hughes, a reaction to them by members of NARUC, and the reported status of federal and state regulation of the telephone industry according to members of NARUC.

Chapter VI comments on the emergence of federal-state cooperative joint boards in a period of years from 1914 and including 1922. It discusses language of the Subsection 13(3) of the Transportation Act of 1920, its intent and reasons for an early failure to apply its provisions.

Chapter VII covers the years from 1923 to 1934 because those were years when Congress gave serious consideration to reassigning federal regulation of the telephone industry to a newly created commission. It gives special attention to two persons, Paul A. Walker who became a charter member of the FCC, having served for many years as an Oklahoma Commerce Commission official, and John E. Benton, NARUC's general solicitor and organizational manager. It describes opinions written by Charles Evans Hughes which are directly related to the subsequent intergovernmental relationship developed after the Communications Act was written. Finally, it comments on NARUC's reactions to proposals to transfer jurisdiction for matters dealing with interstate regulation of the telephone industry from the ICC to a newly created federal commission.

Chapter VIII attends to the manner in which the FCC and the states applied Subsections 410(a) and 410(b) to the interjurisdictional separations process from the organization of the FCC until the Act was amended in 1971 to include Subsection 410(c). It discusses FCC Commissioner

Paul A. Walker's influence on federal-state cooperation, NARUC's appeal to Senate Interstate Commerce Committee when informal cooperation failed. Adoption of Subsection 410(c) meant FCC-state cooperative rate-making proceedings were mandatory.

Chapter IX acknowledges a problem with selective bias in the review of evidence and reconciles the thesis with the findings. Finally, it offers suggestions for additional study related to the efficacy of Section 410.

CHAPTER II

AN HISTORICAL APPROACH AND METHODS, A CONSTRUCT, THE PREMISES AND THESIS STATEMENT

Introduction

Agencies associated with the regulation of public utility industries operate in a governmental system no less complicated by multiple political and economic factors than the industries regulated by them. The study began with a thought that the statutory language of each subsection of 410 had roots in the experiences of federal and state officials who regulated the telephone industry, but it became quickly apparent the intergovernmental relationship exemplified by federal-state joint boards was actually rooted in regulation of the railroad industry. It is plausible that an institutional memory of its origins simply faded with each succeeding generation of policymakers.

In the Louisiana case, Justice Brennan implies that Subsection 410(c) is a logical extension of Congress' intent to provide some means, outside the purview of the federal judiciary, to reconcile the division of authority to regulate the telephone industry. Although the 1980s saw restructuring of the telephone industry, the congressionally approved scheme of dual regulation has not been altered.

Various situations bring officials of the federal and state agencies together to reexamine practices associated with the coordination of separate and/or shared statutory responsibilities. Before it is possible to evaluate the contemporary efficacy of Section 410 it is necessary to understand the political and economic origins in terms of ideas and events which precipitated adoption of each of its subsections.

Chapter II addresses four additional tasks. First it explains why an historical approach was chosen to address the research problem. Second, it summarizes the various methods used to gather evidence, explaining why The Annual Proceedings of the National Association of Railroad and Utility Commissioners (also identified as The National Association of Railroad Commissioners as the original name of the organization, and more lately as The National Association of Regulatory Utility Commissioners; also referred to by acronym as "NARUC") received treatment as the most reliable source of information. Third, it gives a construct appearing to represent characteristics of the federal-state relationship under investigation. Fourth, it presents a two-part thesis statement which includes two premises derived from a review of the literature following in Chapters III and IV.

Applying an Historical Approach

The Conference on Regulation and Social Sciences arrived at one consensus: The studies of regulation and policy analysis are typically economic studies. The meeting was convened to encourage more direct research on the subject of regulation using knowledge from disciplines other than econmics because the scope of that discipline is often limited (Noll, 1985, p. vii). Much earlier, economist John R. Commons said it is impossible to understand the development of economic policies without historical investigation (Economics of Collective Action, 1950; reprinted in 1970). In Commons' view, economists who confined their discipline to a logical, deductive science were inclined to rule out history as part of the science because history brought in hundreds of conditions and causes which would reduce the alleged validity of economic theories (p. 120). He said (pp. 143, 144):

> [H]istory...is necessary for an understanding of present-day economics....[C]auses and historical conditions must be weighed and balanced against each other in the endeavor to understand how to act on present day economic problems.... [H]istorical developments create modern conditions Investigations are associated with similarities and differences, the working rules of collective action, and the goals to be reached in working relationships.

This study is an investigation of an intergovernmental relationship and the working rules of collective action used by the officials of two tiers of government, each operating within their separate sphere of legitimate authority to regulate the nationwide telephone industry as they attempt to fulfill the obligations of federal and state laws by coordinating their activities.

Samuel P. Hays (1981) and Kenneth J. Meier (1985) agree that there is no simple strategy suited to an inquiry into the history of public regulation of the economy. Roger G. Noll says "a study of regulatory phenomena can be perceived as a legitimate, discrete field of scholarly inquiry" (1985, p. vii). According to Noll, inquiry of the nature of this study requires a multidisciplinary survey and synthesis of information to provide response to research questions. This study quickly grew into a multidisciplinary review of literature to provide assistance in the search for reliable primary and secondary documents relating to federal-state cooperation in the regulation of the telephone industry, and their selection and evaluation. A lengthy independent study preceded the responses to the research questions presented in the first chapter. Although there is a substantial body of academic literature devoted to the discussion of the regulation of public service industries, none can be said to specifically address Section 410.

John D. Stevens and Hazel D. Garcia, communications historians, point out that no clear model applies to social science historical research. Accordingly, there are several ways to organize and present an analysis of historical data (1980, p. 34). Although it may be narrative and descriptive, it should not be confined to a simple chronicle of events (p. 62). Among the ways Stevens and Garcia suggest organizing evidence are (a) as a linear progression, or (b) as discrepancies between principles and practices.

However, it would appear difficult to do the latter unless there was preexisting reason to presume that discrepancies existed.

Gerald P. Berk discusses the role of ideas, culture, the professions, politics, and economics in explaining the evolution of regulatory institutions and policy (in McCraw [Ed.] 1981, p. 202). He says "a discussion of some of them can be subsumed by the role historical conjunctures play in helping to produce certain types of regulatory structures and policies." By conjunctures, Berk means "a confluence of...circumstances which produce crises or major transformations in the economy, in politics, or in social structure" associated with an appointed time in a continuum of historical events.

For example, 1913 and 1914 were years when circumstances caused members of federal and state regulatory agencies to reevaluate the extent of their regulatory authority under the commerce clause. In those early years, the public utility paradigm influenced the way officials of both federal and state governments applied rate-making methods applying to both railroad and telephone industries. In fact, the early history of federal and state regulation of the telephone industry is inextricably tied to traditions related to regulation of the railroads (T. K. McCraw, 1984).

Chapter VI concentrates on a period of time (1913-1933) when reformers earnestly discussed three methods of government control of corporations with monopoly power for the supply of vital public services: (a) by antitrust enforcement, (b) by direct public ownership and management of public service industries, and (c) by government regulation. This paper attends to the third method of control.

Certain decisions rendered by the FCC in the years immediately preceding and including 1971 are indicators of another conjuncture. FCC actions promoted a recommitment to competition in some lines of business which enjoyed protected monopoly status within telephone industry submarkets. The shift from monopoly to competition had profound implications as to how much revenue would be available for assignment to local exchange and interexchange operations by interjurisdictional agreements between federal and state officials. 1971 was also the year when Subsection 410(c) was added to the Communications Act.

Stevens and Garcia say time should be treated as part of the context of the historical study, but should not be elevated to status of an independent variable when evaluating historical transformations in society (pp. 42, 49). This study identifies 1913 to 1971 as years when issues, events and the behaviors of regulators appear to be linked to an idealized American scheme of government and a model of public control of some industries called "the public utility paradigm." The model accomodates a public policy assumption that each of the separate local exchange and interexchange markets would be better served by monopoly enterprises providing vital services at the lower unit costs of production and distribution than would be the case if competitors were permitted to duplicate services in each market. (Chapter IV amplifies the discussion of certain aspects of the public utility model which are applicable to the issues of mutual concern to federal and state reguators.)

Martin L. Lindahl offered a partial description of joint board involvement in issues associated with the dual regulation of the railroad industry. Unfortunately, the full text of his dissertation, submitted in 1933 to complete doctoral requirements for the Department of Economics at the University of Michigan, is no longer accessible. An edited version can be found (absent a methods section or bibliography) in a Michigan Law Review article (33 [3], 338-397 [1935]). Lindahl's citations were clues to the sources which provided a year-by-year record revealing the activities of people who most strongly influenced the way the statutory language of Section 410 developed.

Richard Gabel gave an interpretation of how revenues and costs associated with the nationwide telephone network were separated between the federal and state jurisdictions in the period from 1934 to 1965 with the sort of a historical linear progression Stevens and Garcia speak of. Gabel's text, Development of Separations Principles in the Telephone Industry (1967), is a narration of activities and events revealing that officials of the two levels of government perceived problems associated with the overlapping effects of dual regulation. Gabel hypothesized that AT&T employed a set of strategies which dominated the rate-making practices exercized by FCC and the states (p. 1).

Although independent companies grew to be responsible for exchange service in many local communities, there can be no doubt that AT&T dominated the structure of the telephone industry in the United States between 1913 and 1971. For most of those years, federal and state policymakers attempted to control AT&T's influence on the national economy by treating operating companies who provided local and long distance services status as publicly regulated but privately owned monopolies, according to principles associated with the utility paradigm. The parent corporation and its subsidiary operations were protected from the risks otherwise encountered by companies operating in a competitive marketplace.

Gabel suggests that AT&T's managers were able to increase the profits by manipulating the regulatory process which led to application of ingenious schemes justifying why revenues could be shifted from one submarket to another. Gabel's work furnishes support for the so-called "capture theory" which says bureaucrats place the health of the regulated companies on whom the public relies for service as the foremost interest among all public interest demands (Kahn, 1971, vol. 2, p. 12). Noll claims those who criticize the behavior of regulatory officials as they expound on the capture theory usually overlook substantial benefits accruing to consumer classes at the expense of corporate actors when they enumerate the benefits to the monopolists under the public utility paradigm (1985, p. 25).

Gabel's work is a valuable description of the economic complexities associated with the apportionment of joint operating expenses and revenues associated with the technological integration of the industry's network grid, and the separation of interstate and intrastate categories of telephone service. (See "separations process," Chapter IV, p. 90.) His work provided depth and understanding to concepts and terms. Gabel's work continues to be appreciated as a definitive academic description and anaylsis of the outcome of the separations and settlements processes (Parker, 1986, p. 110). Gabel takes a macro-perspective about the outcomes of federal-state intergovernmental behaviors. His text supplied references which have been helpful in the preparation of this study although Gabel does not discuss the political-economic origins of Section 410.

As Gabel chose to do, J. Warren Stehman (1925), Harry Mac Meal (1934), Paul Walker (1939) and N. R. Danielian (1939) described regulation in terms of the pervasive influence of AT&T on the process. More recently, George D. Smith (1985, The Anatomy of a Business Strategy: Bell, Western Electric, and the Origins of the American Telephone

Industry) and Dan Schiller (1982, Telematics and Government) have presented perspectives of how "big business" telephone suppliers and users have manipulated decision makers at the FCC. James W. Sichter's report discusses the public policy origins of separations procedures (Separations Procedures in the Telephone Industry, 1977). William H. Maher, Jr. provides a summary of cases which have influenced the direction of federal and state regulatory behaviors (Legal Aspects of State and Federal Regulatory Jurisdiction over the Telephone Industry, 1985).

As a contrast to the work of others, this study focuses on the efforts of federal and state officials who attempted to replace intergovernmental conflict with intergovernmental cooperation as the attended to their related jurisdictional rate-making responsibilities. This project is aligned with recommendations of communications historians Stevens and Garcia. They say an analysis of primary and secondary data does not rely on a lock-step progression of events, nor does it propose a causal relationship among variables. Stevens and Garcia say the organization and evaluation of historical data are qualitative, abstract mental exercises.

The basic research question was derived from a personal familiarity with the contemporary activities of federal-state joint boards and the implications of the Louisiana case. The compound thesis statement represents two premises synthesized from a multidisciplinary review of the literature. The subsequent selection and investigation of primary documents from the period should provide evidence permitting the premises to be accepted or rejected.

As they are described in the following chapters, events illustrate a transformation of ideas through give-and-take situational strategy: the interaction of people, whose interests may be common or disparate, as they deal with common issues. They are grounded in time-place orientation inasmuch as time itself contributed to the sequential development of Section 410. An adaptation of the situational strategy model for historical research assumes that ideas constitute efforts to transform the environment (attributed to G. Wise, in Stevens and Garcia, p. 59).

In summary, an historical approach permits a suitable response to the research question and its subsets. A multi-disciplinary study of law, government, political science and economics provided the information which led to the development of basic premises. Special attention was given to literature focusing on the economic regulation of the telephone industry. Therefore, the ideas culled from among credible authors who have contributed to those fields supply the basis for the definitions of concepts and terms applied to this study. Secondly, the information gained by a multidisciplinary search of literature supplied an important contribution to the index of primary documents leading directly to specific evidence revealing which people, ideas and events seemed to have made significant contributions to the development of Section 410 of the Communications Act.

Methods Used in the Study

Research to locate and assemble evidence proceeded with the caveat by Justice Frankfurter (p. 9) clearly in mind:

> [Because]...[t]he intimacies of the conference room...are illuminations denied the historian...[w]e need to be on the lookout against the traps of retrospective interpretation. History is inescapably contemporary history.

This study devotes particular attention to the contemporaneous record developed in the period under investigation. A functional bias associated with archival record availability complicated the research process when it became clear that local access to necessary documents was restricted. It is a bias known as "selective deposit and selective survival (Webb, E. J., Campbell, D. T., Schwartz, R. D. and L. Sechrest, 1968, p. 54). Interlibrary loan proved to be a tedious method of retrieving records. Moreover, the number of documents distributed to depositories was limited in the first half of the century because Congress provided sparse appropriations to pay for reproducing and shipping them.

Many early documents reproduced on microfische have been carelessly copied or stored, making them exceptionally difficult to read. Others, as was the case with Lindahl's original dissertation, were stored with either inadequate reference or destroyed in the course of time. Therefore, it must be admitted that information may have escaped proper examination and evaluation as evidence was gathered to answer the research questions. The testimony presented at the Congressional hearings preceding the passage of the Communications Act offer only minimal explanation of the origins; the same is true for hearings preceding the immediate passage of ech of its subsequent amendments. The indices of FCC Reports and the Commission's annual reports rely on key words which are unreliable references to the occasions when provisions of Section 410 have been employed. If a complete catalog of joint board actions exists, its location is unknown to librarians at the FCC or elsewhere.

The search for the most reliable documents turned to the references of others who wrote about economic considerations related to the application of rate-making principles common to the telephone industry and to legal issues associated with interjurisdictional controversies in relation to the dual regulation of the railway industry as well as the telephone industry. It is well to remember that according to the Act (sec. 3[t]), "commission" is meant to include staff persons who are employees of federal and state commissions as well as those persons who formally hold title to the designation of "commissioner." Section 410 has applied to telegraphy, but its provisions have been more often applied to the regulation of the telephone industry. There may be occasions when provisions of Section 410 may be applied to common carrier-like issues emerging from adaptations of cable television broadband interactive technology.

Some authors use terms such as "joint committees," "joint conferences" and "joint boards" interchangeably, without distinguishing whether or not the interaction between state and federal officials were formal and informal activities. Gabel, for example, does not distinguish between them (1967). Gabel was bent on evaluating the effects of the separations process in terms of the distribution of revenues and costs between jurisdictions rather than the relationship of the federal and state officials participating in the process. Furthermore, his analysis appeals to an audience already familiar with the separations process. Although Gabel's text was finished before Congress was called upon to add the language of subsection 410(c), it is relevant to those who wish to become familiar with the details of problems prompting action which let to its adoption.

One of six strategies employed in the search for a reliable consistent record led to the most comprehensive record of historic information:

1. Traditional primary documents (the Act, its legislative history, executive branch and congressional records, ICC and FCC proceedings, FSJB proceedings, annual and special reports of the two federal agencies, decisions of the federal courts) were reviewed.

2. A comprehensive review of the indexes of the <u>FCC Reports</u> was undertaken. They contain references to joint boards from 1934 to 1940, but direct information about them

drops out until 1969. Each volume from 1934 to 1971 was scanned for the following words and phrases which were then cross-referenced with one another:

Common Carriers	Joint Boards
Commissions	Message Toll Rate Disparities
Committees	Separations
Cooperation	Telecommunications
Division of Revenues	Telegraph
Federal-state Joint Boards	Telephone
Federal-state Relations	Uniform System of Accounts

Section 2, subsections (a)(b)(c)
Section 221, subsections (a)(b)(c)(d)
Section 410, subsections (a)(b)(c)

3. Periodical literature was reviewed, especially volumes of the Public Utility Fortnightly which provided commentary about changing events across the span of time identified for the study. Use of the Fortnightly's annual index was an excellent orientation to problems and theories associated with the regulation of the telephone industry across time. But the system provided only limited information relating directly to Section 410. A search of annual indexes from 1929 to 1989 relied on the following key words:

Cooperation	Monopoly
Federal Communications Commission	Regulation
	States
Federal-State Relations	Rates
Federal-State Joint Boards	Telephones
Joint Boards	Uniform System of Accounts
Legislation	Valuation

4. Scholarly commentary from several disciplines was examined. Attention has been given to those who wrote in the period from 1914 to 1971 in the belief that their

interpretation of events, principles, and issues have relevance to the research question. Where it is appropriate and practical, their views have been compared and contrasted to the views of others before and after the period under study.

5. Richard Gabel and Richard Schultz were consulted (personal communications: 1988, 1987). They confirmed the absence of scholarly work devoted specifically to the history of Section 410 and/or an FCC indexing system which would provide clear access to the activities of joint boards under Subsections 410(a)(b)(c). Schultz spent six months at the FCC and elsewhere attempting to locate information which would permit him to reliably reconstruct a chronological history of the occasions when joint boards have been formed under the law. He was unable to do so.

6. The official transcripts of the annual and special meetings of the National Association of Regulatory Commissioners (NARUC; formerly the National Association of Railroad and Regulatory Commissioners) provided the richest source of reliable data about the origins and applications of Section 410 for the period identified as relevant to this study. Therefore, they have been treated as primary documents. The NARUC's Annual Proceedings include verbatim transcripts of major discussions and addresses on the subject of federal-state cooperation. They also provide comprehensive committee reports which summarize the deliberations of federal and state cooperative committees

who were addressing special problems associated with the regulation of the telephone industry. Across time, the actual texts of the Proceedings changed formats and grew in size from a few hundred to several thousand pages of information. A system of cross-references was devised by matching the published program for each annual meeting with key words and the names of committees fond in the indexes for most of the volumes.

I personally reviewed sections of each volume of the Annual Proceedings published between 1889 and 1973. The rather lengthy process followed development of the thesis statement. Full series of the Proceedings are found in a relatively few locations across the United States. In Michigan, partial sets can be found in various libraries, but the sole owner of all volumes published since 1889 and available for scholarly review is the University of Michigan at Ann Arbor. One needs to plan on special arrangements to have access to the entire series for an extended period of time since some volumes are in protective storage.

Selection of a Construct

"Intergovernmental Relations" (IGR) became a special area of academic focus in the 1920s. The specialty addresses how federalism has been interpreted and applied to the intergovernmental organization of the United States. Federalism, itself, emphasizes national-state relationships. Deil S. Wright said IGR has been extended to recognize several combinations of relationships: "national-state and interstate relations, ...national-local, state-local, national-state-local, and interlocal relations (1978, p. 8).

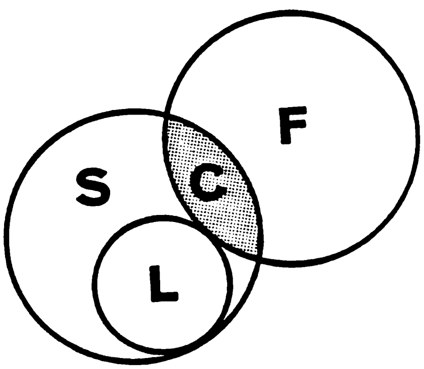
An IGR-type construct incorporates "the rich range of informal and otherwise submerged actions and perceptions of officials" transcending a view otherwise limited to a legal interpretation of legislative history (p. 17). Wright criticizes legalistic studies of federalism for emphasizing the competitive conception of the federal-state relationships, which he says too often "regard the National Government and the States as bent on mutual frustration" (p. 349). Transcending legalism, Wright's IGR models incorporate policy-connected interests. Each represents a more "neutral concept" because an IGR model does not embrace assumptions of hierarchical relationships (p. 30).

Wright's models attempt to simplify a convoluted description of American government given by James Madison in the Federalist Papers (cited in L. J. O'Toole [Ed.] 1985, p. 27):

> The proposed Constitution, therefore, even when tested by the rules laid down by its antagonists, is, in strictness, neither a national nor a federal Constitution, but a composition of both. In its foundation it is federal, not national; in the sources from which the ordinary powers of government are drawn, it is partly federal and partly national; in the operation of these powers, it is national, not federal; in the extent of them, again, it is federal, not national; and, finally in the authoritative mode of introducing amendments, it is neither wholly federal nor wholly national.

The particular pattern of intergovernmental dualism examined and analyzed for the purpose of this study is

illustrated by a schematic representation below. The construct represents the intergovernmental arrangement contemplated by the Communications Act. The language of the statute places local government regulation of communications issues withing the jurisdiction of the states. The enabling stututes of each state, then, determines distribution of regulatory power within its sphere of authority.



F = Federal Government

S = State Government

L = Local Government

C = Intersection of Overlapping Interests Suited to Cooperative Reconciliation of Conflicting Interests

Figure 1

Note. Adapted from "Models of National/State/ Local Relations" by D. S. Wright, in O'Toole [Ed.], 1985, American Intergovernmental Relations, p. 59. (See Appendix C.)

Figure 1 attends to three (3) spheres of authority in the federal system of the United States (U.S.). They represent three (3) tiers of government which have exercised regulatory authority for nation-wide/domestic telephone service.

The three governments are national/federal (F), State-defined by the Act (S), and local (L). In this model, and for the purposes of this study, (L) falls within (S); (L)

does not intersect with (S) because local authority to regulate firms in the industry is subordinate to the authority delegated to it by each State constitution. Where the separate authority of (F), represented by the FCC, and the agencies of the states (S) intersect at (C) there may be overlapping public policy interests which produce interjurisdictional conflicts suited to reconciliation by the mechanisms of Section 410.

Joint boards accomodate the reconciliation of disparate policy practices which arise in area C. They can do so only because they have been legitimized by Congress to serve as intergovernmental forums, under Section 410 of the Act. They are pragmatic forums complementing a scheme of dual regulation of the telephone industry when they are able to reconcile the often separate and conflicting interests of the States and the FCC, resolving interjurisdictional disputes associated with the economic regulation of the industry.

The enabling language of Section 410 permits inter-jurisdictional issues to be reviewed by FSJBs so that firms in the industry are not further hampered by lengthy delays common in instances when an overburdened federal court system adjudicates disputes or renders decisions inimitable to the goals of federal and state regulators or the industry. To accomplish the broad intent of the Communications Act, the FCC and the States should enter into collaboration and/or cooperation. Otherwise, preemptive as

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assertions of the federal agency could be received as unfavorably by Congress or the Supreme Court as Louisiana indicated.

The Thesis: A Two-part Statement of Premises

As one reviews the language of law or the scholarly commentary of others, it is natural to think in terms of hypotheses. For example two premises form the thesis statement. The first premise seems obvious from a reading of Section 410 yet is deserving of investigation and reflection to establish the basis of its truth. The second accomodates the adaptation Wright's description of intergovernmental relationships as it appears in the construct (above) and from collateral conceptualizations of federalism summarized in Chapter III. Although one may wish "to incorporate into research and interpretation everything worthwhile that has been done before" (Schaffer, R. J. 1980, p. 188), it would be folly to declare that the following proposition takes into account everything worthwhile said about the origins of Section 410.

Evidence will support the the following two-part thesis: (a) Section 410 of the Communications Act of 1934 is a provision favoring the appointment of joint boards to facilitate those rate-making procedures associated with dual regulation of the United States' domestic telephone industry, and (b) it symbolizes an intergovernmental relationship called "cooperative federalism" by New Deal era scholars.

CHAPTER III

REVIEW OF THE LITERATURE: CONCEPTUALITY OF THE FEDERAL-STATE RELATIONSHIP

Introduction

> **The question of the relation of the States to the federal government is the cardinal question of our constitutional system....It cannot...be settled by the opinion of any one generation, because it is a question of growth, and every successive stage of our political and economic development gives it a new aspect, makes it a new question.**

(Woodrow Wilson, Constitutional Government in the United States. 1908, p. 173, cited in Clark, 1938, in the Preface)

A conceptual understanding of aspects of the federal-state relationship described in this study can be found among the comments of present and past scholars, and of other authorities. The relationship conforms to a constitutional system which permits Congress to determine how the power to regulate commerce within and among the several states will be apportioned. This chapter has been organized (a) to present ideas relevant to the design of the thesis, and (b) to give meaning to ideas and definition for terms related to the special intergovernmental relationship considered in the research question and in the premises. The chapter has been divided into three subheadings:

1. Governing Power and Regulation

2. The Constitution and Federalism, Dual Federalism and Cooperative Federalism

3. The Supreme Court and the Preemption Doctrine

Governing Power and Regulation

Governing Power

In this study, "power" conforms to legal scholar Arthur S. Miller's description of it (1958, p. 622):

> Power is the key concept in the American decision-making process and in the study of constitutional law. Its meaning is not a settled one in the social sciences....Power is the ability or capacity to make decisions affecting the values of others, the ability or capacity to impose deprivations and to bestow rewards so as to control the behavior of others....In sum, then, power is the capacity to exercise control over individuals by making or influencing decisions of a national scope or importance.

Miller claims the issue of governing power is derived from constitutional theory. Power is the fundamental issue in questions dealing with intergovernmental relationships. It is an essential factor in an inquiry into the decision-making process in the United States (p. 620). Federal and state governments make public policy decisions affecting the private power of firms in the telephone industry.

Political scientist Kenneth J. Meier (1985) says the political organization of governments is predicated on a community of social and economic interests shared by society. The Constitution distributes the power to represent those interests between national and state governments in a manner intended to protect the existence and authority of both. Government scholar Arthur F. Bentley (1908) said: "All phenomena of government are phenomena of groups pressing one another, forming one another, and pushing out new groups and group representatives" (the organs or agencies of government) to mediate the adjustments (in The Process of Government, reprinted in 1967, P. H. Odegard (Ed.) p. 269). By accepting Bentley's proposition that each governing body is a group and engages in activity, and as such has a special group interest (p. 290), one may presume that the FCC and state commissions, across time, have adopted differentiated views of the aims of regulation. Moreover, Danielian (1939) and Gabel (1967) claimed AT&T, as a parent holding company mobilizing the group force of its subsidiaries, manipulated the public policy process to minimize the effects of policies which were contrary to the corporation's private policy goals.

Economist John Commons studied the collective action of individuals and groups seeking to realign public and private power. Commons focused on the creative resolution of economic conflicts in a capitalist society. He directed attention to the behavior of corporations, labor unions, political parties, and public policymakers. Although Commons began his studies in the late nineteenth century, he studied and taught into the mid-twentieth century. He combined a sociologist's field observation methods with his knowledge of classical economics to describe political-economic behavior. His work endures in the theories of organizational behavior, theory, labor and industrial relations, and institutional and industrial economics. In Commons view, the participants of a free society seek ingenious public procedures with which to balance the power of the corporation with the power of the "state."

According to his student, Selig Perlmann (in a reprint of Commons' Economics of Collective Action, 1970) Commons drew upon "the vast treasury of human experience" for suggestions as to possible courses of action that would actually carry civilization forward step by step especially from conflict to mutuality" (p. 12). Commons called the State "the collective action of politicians" who proceed "from the arguments, debates, conferences, compromises, ...meetings, agreements, disagreements, negotiations...when forced or persuaded to consider their common interests" (pp. 23, 28). Commons spoke of collective negotiation and compromise in terms of their nationwide importance (p. 30). He looked at "voluntary" associations as attempts by "pressure groups" to accomplish complementary compromises before the intervention of the courts forced upon them resolutions perceived to be more problematic (pp. 32, 33). Presumably, Commons' comments applied to the partnership of government agencies as well as to the association of private business enterprises.

Commons said "Political economy...deals with human purposes" (p. 91). Commons believed society needed to develop ways to deal with large corporations who had acquired political bargaining power first by promoting efficiency, then with promoting scarcity of the resources they controlled (p. 91). He was concerned about the effects associated with the excesses of corporate monopoly power. In Commons' view, the job of public service commissions (PSCs) was to countervail the economic power of the public utility companies.

In their attempt to do so equitably, the PSCs placed a value on the assets and operations of public utility companies as if private ownership of them were to be transferred to public ownership and operation. Valuation became one of the Commons'complex "rules of the game" falling within the "due process of law" (pp. 87, 88, referring to U.S. Const. amend. V, amend. XIV). Speaking of New Deal legislation, Commons said: "It is to counteract...activities of cartels and corporations... that the American states and the federal government have established the new administrative commissions..." (p. 60).

Commons saw the struggle for power as the motivating force behind the behavior of political as well as private institutions. "I make conflict of interests predominant in transactions. [But]...there are also mutual dependence and the maintenance of order" which result from collective action (Institutional Economics, 1934, pp. 6, 7):

> [C]ooperation does not arise from a presupposed harmony of interests....It arises from

> the necessity of creating a new harmony of interests--or at least order, if harmony is impossible--out of the conflict of interests among the hoped-for cooperators. It is the negotiational psychology of persuasion, coercion, or duress.

Commons views support the idea that cooperation among political units of government became a necessity in the United States industrial society, where the organized power of the corporation began to rival the stand-alone power of the national and state governments.

Regulation

Canadian political scientists, Richard Schultz and Alan Alexandroff say that regulation is not confined to a narrow range of objectives--but "has been employed to pursue almost any public policy goal imaginable" (1985, p. 12). Regulation has been applied to restrain, to prohibit, to protect, to encourage or to promote activities of certain businesses, such as the railroads and public utility companies--including those providing domestic telephone services. Accordingly, Schultz and Alexandroff list fourteen separate definitions of regulation (pp. 2-3). One of the definitions is similar to the meaning Miller gave to the concept of power. This paper adopts the following definition for the term "regulation" (p. 3; n. 12 cites Robert E. Litan and William D. Nordhaus as its authors):

> Regulation refers to "governmental legislation or agency rules, having the forces in law, issued for the purpose of altering or controlling the manner in which private and public

> enterprises conduct their operations. Economic regulation generally refers to the control of entry of individual firms into particular lines of business and the setting of prices that may be charged. In certain situations, it includes the specification of standards of service the firms can offer."

Schultz and Alexandroff say that regulation of the telephone industry operates as a policing function, to ensure the behavior of regulated firms conforms to a range of choices determined by statutes or rules which society deems to be socially acceptable (p. 5). The states were the first to perceive rate-making autonomy as an essential practice in the legitmate exercise of legislative power in relation to the regulation of public service enterprises. Rate making is an expression of "police power," itself a flexible term meaning the authority of federal and state legislatures to enact laws designed to promote health, safety, welfare and order for the general society.

Regulation, then, seeks positive objectives which are modifications of the nationwide economic and social environment. Public utility economist, Harry M. Trebing says those objectives include attributes associated with "equity" considerations--just and reasonable rates, distributive justice, fairness, and interpersonal welfare comparisons (1981, p. 17). However, Trebing is careful to point out that "a positive theory which describes how the public in fact views economic justice is almost nonexistent" (in Sichel and Gies [Eds.] 1981, p. 30).

The Constitution, Federalism, Dual Federalism, and Cooperative Federalism

The Constitution

The Constitution establishes the federal system of separating powers between the national government and the state governments. The national government exercises both "delegated" powers, those listed in the Constitution, and "implied" powers, those reasonably implied by the Constitution. Implied powers give the federal government flexibility to expand its sphere of authority as conditions change. All powers not granted to the federal government and not denied to the states are reserved for the states or for the people. These powers are therefore called "reserved" powers. In some spheres of authority, the federal and state government share "concurrent" powers enabling both to exercise authority. The Communications Act establishes concurrent powers to regulate telephone industry rates by delegating certain commerce power to the several states. In this paper, the terms "central," "national," and "federal" are used interchangeably to modify the terms "government," "authority," and "power."

When the Constitution was written, the modern corporate system of doing business was practically unknown. As the economy of the United States grew and continues to grow more complex, technology and changing business practices create a demand for reinterpretation and altered applications of the supremacy and commerce clauses, bringing into sharper conflict preexistent interpretations of the division of state and federal powers. The two clauses are closely tied to the application of the "preemption doctrine" discussed (below, p. 69). Abbreviated descriptions of contitutional provisions which have from time to time contributed to interjurisdictional controversies, including the supremacy clause and the commerce clause, which have been at the heart of rate-making disputes, follow below:

1. **Welfare Clause:** Article I, Section 8, clause 1 of the Constitution assigns the following power to Congress:

> **To** lay and collect taxes, duties, imposts and excises, to pay the debts and **provide for the common defense and general welfare of the United States**; but all duties, imposts and excises shall be uniform throughout the United States;

2. **Commerce Clause:** Article I, Section 8, clause 3 grants Congress the following power:

> **To regulate commerce with foreign nations, and among the several States, and with the Indian tribes;**

Chief Justice John Marshall wrote the decision which has been the foremost interpretation of the commerce clause. Marshall's words set the precedent for subsequent Court decisions regarding the right of representatives of the federal government to preempt state rule making in matters affecting interstate commerce (Gibbons v. Ogden, 22 U.S. [9 Wheat.] 1, 197 [1824]):

> If, as has always been understood, the sovereignty of Congress, though limited to specific objects, is plenary as to those objects, the power over commerce with foreign nations, and among the several States, is vested in Congress as

> absolutely as it would be in a single government, having in its constitution the same restrictions on the exercise of the power as are found in the Constitution of the United States.

3. **Supremacy Clause:** Article VI, Section 2, the "supremacy clause," subordinates the range of legislation each state may adopt to the Constitution and to laws enacted by the Congress of the United States:

> **[T]he Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the Supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the constitution or Laws of any State to the contrary notwithstanding.**

4. **Delegated Powers:** The Tenth Amendment of the United States Constitution speaks of delegated powers:

> The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

State governments legislate where power has not first been assigned to the federal government by the language of the Constitution, or where the power of the states has been lawfully reserved or enabled by congressional statute. Congress may delegate powers in those fields where the Constitution remains silent to the national government or to the states, and may choose to divide power assigned to federal and state authorities. Historian and constitutional scholar Edward S. Corwin (1933) said the powers reserved to the states under the Tenth Amendment were conditionally reserved, meaning that their powers are subordinate to laws enacted by the federal legislature and interpreted by the federal courts. (In Richard Loss [Ed.] 1981, p. 293) Corwin says:

> [B]y the "supremacy" clause, if a state in the exercise of its "uncontroverted powers" and Congress in the exercise of any of its powers, come into conflict through an effort to control the same subject matter simultaneously, it is Congress whose will has the right of way.

5. **Due Process of Law:** Due process has been fundamental to the development of legitimate rate-making procedures. The Fourteenth Amendment (sec. 1) has been used to strike rate orders. Rates must be "reasonable," may not be confiscatory, and may not result in unjust price discrimination. The Supreme Court protects a corporation, as it does a private person, from the arbitrary invasion or denial of either personal or property rights by actions of the states or of the federal government:

> All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. **No State shall make or enforce any law which** shall abridge the privileges or immunities of citizens of the United States, nor shall any State **deprive any person of** life, liberty, or **property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.**

<u>Federalism</u>

Lawrence J. O'Toole gives a brief description of "federalism" (in O'Toole [Ed.], 1985 p. 2). It is a useful interpretation of the concept as it applies to this study:

> "Federalism"...means a system of authority constitutionally apportioned between central and regional governments....

> In the American system, the central or national government is often called the federal government; the regional governments are the states. The federal-state relationship is interdependent: neither can abolish the other and each must deal with the other.

The importance of the supremacy clause has received these comments by Deil S. Wright (1978, p. 2):

> Federalism implies a heirarchical set of power or authority relationships. The U.S. Constitution contains...a supremacy clause which makes explicit, in cases of last resort, a superior-subordinate relationship.

Wright gives some reasons which explain why there may be conflicting interpretations of federalism (p. 16):

> When the Consitutution was written "federal arrangements" meant what we now mean by confederation: a league formed by compact or treaty among sovereign states....The absence of the intermediate concept between those of _national_ and _federal_ explains why Madison, in _The Federalist_ no. 39, could--correctly for his day--describe the Constitution as "neither wholly _national_ nor wholly _federal_."

Schultz and Alexandroff decribe another aspect of political behavior common to federated nations and manefestly connected to this study. As if they were to have anticipated the arguments set forth by petitioners and respondents in the Louisiana case, they make the following observation about officials operating at various levels of a multi-tiered federal government (p. 143):

> [Where they] perceive that their vital interests...are adversely affected, potentially or actually, they will not automatically defer to the goal setting of others. This is true...both across and between levels of government.

Dual Federalism

Public utilities economist, Martin E. Glaeser (1957) supports the following interpretation of the concept known as "dual federalism" which was a premise associated with the states' rights era of the nineteenth century. It held that state boundaries were the primary determinants of a separation of powers between the state and federal governments. It was a conviction that national and state governments were separate but co-equal authorities, wholly independent in their activities, each with the power to exercise different power over persons who, through their behavior or use of property, came within distinctively different but territorially determined, autonomous spheres of government regulation. O'Toole says a transformation in political thinking at the end of the nineteenth and the beginning of the twentieth centuries began to alter those perceptions about the nature of government in the United States. O'Toole's analysis applies to years being examined in this study (pp. 4, 5):

> [The] tension between the idea of <u>dual federalism</u> (that is, each of the two levels of government operating within its separate sphere without relying on the other for assistance or authorization), on the one hand, and ambiguous overlap, on the other, [became]... evident.
>
> [I]t was not until the twentieth century that the dual federal perspective declined appreciably in significance and American intergovernmental relations developed into a system with sustained high levels of <u>complexity</u> and <u>interdependence</u>. Several political, economic, and social events and trends fueled these developments.

Problems associated with failures of dual federalism and problems confronting a society in transition appeared first at the state level. Each state encountered obstacles when they attempted to regulate businesses. Nationwide holding companies moved their headquarters from one jurisdiction to another to circumvent state laws restricting the extent of their profitable practices. At the turn of the century the giant railroad and telephone corporations, as well as others providing vital public services, commonly engaged in anticompetitive behaviors such as predatory acquisition of competitors (hostile takeovers) and discriminatory pricing to squeeze out competition which had the effect of creating residual monopoly markets. Federal and state officials who wanted to coordinate their actions or to form a federal-state partnership to eliminate unfair industry practices were thwarted by actions of some who held that cooperation would be tantamount to the destruction of a state's regulatory autonomy. Political economists Dexter M. Keezer and Stacy May identified a basic issue confronting state and federal governments in the first decades of the twentieth century (1930, p. 10): "Under the Constitution of the United States, the practical question of whether or not any government control can be exercised over business is inseparable from the questions of state versus federal jurisdiction."

In 1906, Congress attempted to address the question when it gave the Interstate Commerce Commission (ICC) authority to set maximum ceilings to the schedules of interstate railroad rates with the passage of the Hepburn Act (34 Stat. 584, c. 3591; 49 U.S.C. 10102 et seq.). Chapter V describes how the ICC's rate-making authority began to clash with rules set by some state laws. Of a span of years from 1898 to at least 1954 which Glaeser calls the "Monopolistic Epoch," he names a subunit of time from 1905-1923 the "era of state commissions" (pp. 614-615). In those years the state commissions relinquished their former power to regulate intrastate rates for the railroad industry. At the same time they became instrumental in promoting ubiquitous telephone service and qualifying the structure of intrastate rates.

Cooperative Federalism

Daniel J. Elazer, scholar of intergovernmental studies, says the United States is a "noncentralized" system, which means there is no unitary central government. Instead, "[T]here is a strong national government coupled with strong state governments that share authority and power, constitutionally and practically" (1972, p. 4). He says federal-state cooperation has become part of the nation's constitutional tradition. Elazer provides the following description of federal-state cooperative activies (p. 66):

> Formal cooperative activities...are based on contracts and compacts for cooperative action ...[which make] possible large-scale inter-governmental cooperation to achieve common ends.

> Every formal cooperative relationship involves some form of contractural tie....There are contractural relationships for cooperative research, for the division of costs to support shared activities, for provision of exchange of services, for prevention of conflict or misunderstanding, for exchange of personnel, for joint enforcement of laws....

There is no doubt that federal power expanded greatly during the New Deal era. It is less clear that federal intervention into fields of commerce where regulation had formerly been the purvue of state regulation meant that the Congress intended to preempt state regulatory prerogatives. Elazer claims it is entirely possible that "federal intervention could be supplementary and stimulatory rather than preemptive because of the possibilities for intergovernmental collaboration" (p. 51).

An anonymous introduction to a series of papers presented as a "Symposium on Cooperative Federalism" (topic of entire issue of the <u>Iowa Law Review</u> [1938] <u>22</u> [4] at 458) characterizes "cooperative federalism":

> Cooperative legislation is still in the experimental stage and judicial cross reference is still a sub silentio juristic process; but that there is here a middle course of federalism seems reasonably apparent. In a century and a half there has appeared no...state-federal relationship able to command, for more than a limited period of years, the respect of a majority of the citizenry of the nation. Cooperative Federalism is obviously no unifying gospel; it may well constitute, however, a temporarily significant phase in the development of the federal government.

In recent years, cooperative federalism is usually applied to grants-in-aid programs rather than the subtleties

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of coordinated police powers. (See Yale Law Journal, [1983] 92 (7).) Nevertheless, the philosophical perspective of cooperative federalism, a legacy of the New Deal era, applies to government control of business as well as to revenue redistributive policies.

Elazer spoke of "the American partnership" in which the federal principle of the United States is the covenant of uniting separate parties without merging them. He claimed that the national and state governments are equal partners in a system where "independent interdependence" characterizes American federalism (1972, Preface, p. vi). David R. Berman agrees with Elazer's view that the emphasis since the 1930s has been placed on functions to be performed on a partnership basis. More importantly, he says (1981, p. 29): "Congress rather than the Supreme Court has acted as umpire of the federal system."

Cooperative federalism, then, is a normative political philosophy qualified by necessary congressional adaptations to socio-economic conditions of accelerated change converging first on a New Deal congress and moving into the future. It may be that cooperative federalism was actually conceived by framers of the Constitution or in nineteenth century idealism. It was championed by New Deal intellectuals and policymakers impatient with an apparently irresolvable problems inherent in a philosophy of dual federalism. Historian Louis J. Koenig says policymakers found it "possible to consider federalism from another point o

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f view"--one ironically cited by the Court decades earlier 1938, p. 755, n. 12 citing Ex parte Mc Neil, 13 Wall; 80 .S. 236 at 240 [1871]):

> Instead of regarding our two governmental centers as independent agencies, each jealous of any encroachment by the other, we may regard them as mutually supplementary agencies, best performing their tasks through coordinated effort.

In his treatise "Federal and State Cooperation Under the Constitution" Koenig lists several techniques of federal-state coodination. Two techniques in particular appear to be related to the language of Section 410: "the conference," and "utilization of state administrative agencies by the federal government". Those techniques, described originally by Koenig, receive a brief discussion below:

1. **The Conference:** Subsection 410(b) of the Communications Act says that members of the FCC "may confer" in order that the commission can "avail itself of such cooperation, services, records, and facilities as may be afforded by any State commission."

Koenig says the New Deal era ushered in the method of conferences between federal and state officials so that there could be real coordination between the plans and activities of the two spheres of government. He calls the conference "an essential element of federal and state cooperation" (p. 771). He cites the significance of cooperative meetings on labor legislation as successful examples of conferences which stimulated the states to reate laws supplementing federal legislation dealing with arious problems. The conference method served to clarify ssues and problems and "to harmonize different points of iew concerning the highly controversial subject of labor egislation." The record shows that the conference method as only partially successful in resolving the tensions rising from overlapping interests with regard to federal-state telephone rate regulation.

2. **Utilization of State Administrative Agencies by the Federal Government:** Subsection 410(a) says "[T]he Commission may refer any matter arising in the administration of this Act to a joint board to be composed of a member, or of an equal number of members, as determined by the Commission, from each of the States in which the wire or radio communication affected by or involved in the proceeding takes place or is proposed....The action of a joint board shall have such force and effect and its proceedings shall be conducted in such a manner as the Commission shall by regulation prescribe....Joint Board members shall receive such allowances for expenses as the Commission shall provide.

> A recognition of the constant interaction of economic phenomena in the constitutionally separated interstate and intrastate jurisdictions reveals the inadequacy of exclusive state or federal intervention and points to the possibilities of joint or cooperative action. Consequently, a technique of federal-state cooperation has been applied, wherein the federal government utilizes state administrative agencies, by authorizing state commissions to administer federal laws, not in a capacity of state officers

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> and by virtue of the authority conferred upon them by their respective state governments, but rather in a federal capacity and by virtue of authority conferred upon them by the federal government. Hence they become its agents.

Koenig is correct when he says exclusive jurisdiction was recognized to be an inadequate approach to regulation. In his view cooperation among federal and state commissions was "a mutual advantage to the federal and state governments" (p. 775). One cannot dismiss the idea that some scholars thought that state commissions ought to be "divisional-subcommissions which would be subject to the will of the national commissions" (Stehman, p. 257). However, it is incorrect to infer that the state officers were willing or able, in every case, to become agents of the federal government. Louisiana suggests that (a) Congress did not intend to make state commissions divisional subcommissions of the FCC, and (b) state officials, however willing they may be to cooperate, have not been willing to become subordinated "agents" of the federal bureaucracy.

Although there are occasions when state personnel have acted as deputized federal officials (as in the administration of public health programs, or criminal law enforcement) state public utility commission officials were not ICC deputies when they participated in the development of a uniform system of accounts or in valuation studies of the railroad and telephone industries. (See Chapter V.) Koenig turns to the example of the Interstate Commerce Commission using the state commissions in the discharge of their duties no

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as "the most noteworthy success" of the federal-state effort to regulate the "various phases of the railroad industry. (As mentioned in Chapter II, Martin L. Lindahl wrote about ICC-state commission cooperation as the topic of his 1933 University of Michigan doctoral dissertation.)

Koenig correctly points out that there were lingering restrictions on the utilization of state administrative facilities by the federal government (p. 783). Some state constitutions during the New Deal era contained provisions from the post-Civil War period of reconstruction which forbade state officials from conjointly holding a state office and an office of trust or profit under the United States: "[N]o state, however willing its officials may be, can embark on a project of legislative cooperation with the national government, unless constitutionally it is equipped to cooperate" (p. 784).

Section 410 was written with other limitations in mind. Appointees to federal-state joint boards were to "be nominated by the State commission of the State" (sec. 410[a]). In instances where states did not use the commission approach to regulate intrastate telephone service, "the Governor if there is no State commission" could nominate a member to a joint board when the federal agency requested participation.

Koenig was enthusiastic about the prospects of cooperative federalism (p. 785):

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> [C]ooperative effort by our state and federal governments, in its comparatively recent application to social and economic problems, promises to become an acceptable alternative to a highly centralized government with the states as merely passive units....[T]he federal government may be able to realize its program of social and economic legislation by gaining the assistance of state administrative facilities and supervising their activity so that they will be in harmony with the federal program. By exercising their respective powers concurrently, the two governmental centers may increase the sum total of legislative power applicable to a given problem...which otherwise would require constitutional amendment.

Jane Perry Clark devoted her entire text to federal-state cooperation under the New Deal congress: The Rise of a New Federalism (1938). Although Clark made no claim that her book exhausted the subject of federal-state cooperation, she commented on some of the most important forms of cooperation found in legislation and administration and on their constitutional position in the American scheme of government. Of the several scholarly criticisms of her work, most were enthusiastically favorable. G. V. Price, reviewing Clark's work for Social Science, said Clark dealt "with a new-old problem of American government," the difficulty of the "conception of a divided sovereignty." Price said she presented a fresh understanding by showing how the two governments do actually work" and that what Clark called "cooperative federalism" gave "a new conception of government" describing "its unity and integration" (1939, p. 282).

Clark was concerned that the controversy over the respective spheres of federal and state governments tended to obscure other important issues of government in relation to the economic life of the day. Clark thought the terms "centralization" and "decentralization" were so general as to be imprecise. She thought it was improper to equate "state sovereignty" with "states' rights" because the latter had become the obstructionist's theme which denied civil rights to citizens or claim that the national government had a role in the regulation of business and industry. Furthermore, Clark said (p. 3):

> The use of the word "government"...is in a certain sense an over-simplification, for there is a nexus of different governmental interests in both the federal and state "governments" rather than two unified and opposing units.
>
> The noddles of the wise as well as the weak have been sorely puzzled by the manner and form of the respective spheres of federal and state activity and of the relations between the two governments.

Where there is a division of authority delineated by the Communications Act, there is also a nexus of different interests where each government is charged to promote the universal service principle (below, pp. 99-102). The Louisiana case suggests that the "noddles of the wise" are not unanimous in their perceptions of the proper role of federal and state commissioners who are responsible for meeting the implicit social goals addressed by the Communications Act and state legislation.

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Clark commented on the importance of cooperation at a time when the federal sphere of government took to itself greater authority for the regulation of business activities (p. 7):

> Cooperation between the federal and state governments is one solution of the difficulties caused by governmental attempt to regulate the centripetal forces of modern industrial life and the centrifugal elements of state interest and tradition.... Traditional...interests cannot be swept away overnight. There is, nevertheless, need for reconciliation of those who are bewildered by the chaos of...separate governments and administrations acting in similar fields of control and of those who, on the other hand, fear centralization of either authority and administation or both. Cooperation between the federal and state governments offers means for determination of how far uniformity ... may exist side by side with opportunities for experimentation by and within the states.

The Communications Act harnessed the aggregate resources of federal and state regulators in order to promote telephone service and to supervise the development of the telephone industry in a nation where lawmakers continued to appreciate the importance of inherent geopolitical differences. Section 410 speaks to the fact that lawmakers recognized that a nexus of inter-jurisdictional interests requires federal and state agencies to coordinate practices.

The Supreme Court and the Preemption Doctrine

Clark and Koenig were Columbia University scholars who followed closely the attitudes of the New Deal Congress, the executive branch, and the changing character of Supreme Court decisions. Koenig describes why the New Deal no

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legislators may have found the idea of "cooperative federalism" attractive (1938; p. 772)

> A recognition of the constant interaction of economic phenomena in the constitutionally separated interstate and intrastate jurisdictions reveals the inadequacy of exclusive state or federal intervention and points to the possibilities of joint or cooperative action.

Koenig outlines three types of problems individual states, acting in their separate capacities, encountered as the nation grew and the economy became more intricately integrated: (a) problems that were national in scope but where action was denied the national government by judicial intepretation of the Constitution; (b) problems of a regional character; and (c) problems associated with noncontiguous states which competed among themselves in the production and distribution of agricultural and industrial commodities (p. 753). Problems such as these were rife at the beginning of the period identified as germane to this study.

Federal court decisions influenced the choice of statutory language adopted by the New Deal era Congress. Commenting on the period, Koenig says a vacillatory Supreme Court invalidated important social and economic legislation by restraining Congress and the president on the basis that "powers conferred upon the federal government are definitely limited"--a premise of dual federalism. (p. 754).

Constitutional scholar Raoul Berger (1987) celebrated the Bicentennial Era of the United States Constitution by

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revisiting the views of the nation's founding fathers and juxtaposing those to decisions of the Supreme Court. Berger says the concept of federalism is destined to be a lingering debate among scholarly "revisionists" and members of the federal judiciary. Among the questions repeated across the two-hundred year history of the United States is the one which asks if the purpose of the framers was to establish "national supremacy" or "dual sovereignty." When Berger discusses the Supreme Court's record in the first half of the twentieth century, he agrees with one of the period's most noted legal historians, Edward S. Corwin. In Corwin's view, the Supreme court's interpretations of the allocation of power under "federalism" were "shot through with inconsistency, because of competing doctrines at hand which enable the court to go in either direction--to a constitutional "no-man's land" (cited in Berger, p. 4).

Legal scholar Philip B. Kurland (1958) said the states were to first assertively seek congressional legislation if they hoped to reserve a measure of regulatory autonomy because it was at risk if left solely to federal court interpretations of the commerce clause. According to Kurland, the Supreme Court tended to retain for itself the power to allocate authority between the states and the federal government in matters of commerce, relying on "shadowy principles" when it determined whether state regulation does or does not "unduly" burden interstate

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commerce. He cites Associate Justice Stone (in Healy v. Ratta, 292 U.S. 263, 270 [1934]; at p. 293):

> Due regard for the rightful independence of state governments, which should actuate federal courts, requires that they scrupulously confine their own jurisdiction to the precise limits which the statute has defined.

Reflecting on the way in which federal legislation delegates power between the national and state governments in the New Deal era, Kurland said: "Congress has learned how to implement its views on this subject by legislation" (p. 290). In Kurland's view, the New Deal members of the federal legislature recognized that the courts complicated the process of curbing the private power of big business. "Congress is the better forum for determination of the propriety of state regulation of interstate commerce" (pp. 290-291).

The Preemption Doctrine

Writing an analysis of the Supreme Court decisions under Chief Justice Warren J. Burger, Elaine M. Martin (1985, p. 1234) offers a concise definition of the "preemption doctrine:"

> [F]ederal law can preclude the operation of contrary state law....Preemption can occur whenever a state attempts to regulate in an area where the federal government has the power to act.

Although Associate Justice Brennan delivered the majority opinion for the Court in Louisiana, two of the many qualifying attributes of preemption Martin offers give a po

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greater meaning to the distinctions considered in that decision (pp. 1236-1237):

> 1. **Conflict preemption** [arises] when a state law, although not in actual conflict with the federal law, poses "an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." In such cases the court must interpret the federal statute to ascertain its objectives and then determine whether the conflict preemption allows the court the discretion to determine initially what the federal objectives are and then whether the state law poses an obstacle to those objectives.
>
> 2. **Occupation of the field preemption** results when the Court concludes that by passing a federal regulation, Congress implicitly intended to preclude the state regulation in the same area....[T]he Court requires that this intent be "clear and manifest" [p. 1236 at n. 20 cites Rice v. Santa Fe Elevator corp., 331 U.S. 218 at 230 (1947)]. This insistence offsets the comprehensive effect of the occupation of the field preemption.
>
> Occupation of the field preemption is the most comprehensive type of preemption because a state law can be preempted although it does not actually conflict with a federal law in any way [n. 23].

Changes in telecommunications technology and public policy issues have caused the Court to respond to questions of federal preemption of state authority somewhat differently across time. Jeffrey A. Robinson (1983) and Richard McKenna (1985) comment on the federal-state jurisdictional relationship set forth in the Communications Act. In an article antedating the Court's Louisiana

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decision, McKenna, a corporate communications attorney, argued persuasively in support of the FCC's preemptive claims asserting that states' rate-making procedures must yield when they conflict with those of the federal agency. McKenna's article is a comprehensive summary of views held by others who have been prepared to accept the federal agency's preemption of the states' rate-making authority.

McKenna said: "Federal regulations consistent with Congressional intent have no less preemptive effect than federal statutes. The court's inquiry must consider the relationship between state and federal laws as they are interpreted and applied, not merely as they are written" (p. 7, n. 8 citing Jones v. Rath Packing Co., 430 U.S. 519, 526 [1977], reh'g denied, 431 U.S. 925 [1977]). He added a caveat to his point of view by saying the federal agency ought to establish "a plausible case that preemptive action is necessary for the implementation of congressional objectives" (p. 62). In McKenna's view, the FCC would be upheld when it claimed the right to preempt certain the states independently determined formulas for calculating depreciation for rates within their jurisdictions. According to Louisiana, the FCC and McKenna misjudged the intent of the Communications Act in this instance. (McKenna reflects upon the preemption doctrine in the aftermath of the Louisiana opinion in a second article, written in 1987.)

Robinson, an editor of the Brigham Young University Law Review deferred to the traditional rate-making role the

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states have tenaciously held to. He said the separations procedures which were the classic practices which permitted a division of revenues between interstate and intrastate jurisdictions had permitted the industry, through state rate regulation, to promote subscription to basic telephone service (p. 379). In Robinson's view, "Allocation of authority within the jurisdictional partnership was delineated by an apparently bright line clearly granting the FCC control over interstate traffic, while reserving to the states rule-making authority for intrastate traffic" (p. 387). Robinson appreciated the overlapping effects of dual regulation as he wrote: "There is no technological bright line dividing the telephone network into separate compartments at state boundaries....[I]nterstate calls have historically accounted for only approximately three percent of the total traffic transmitted over equipment shared by intrastate and interstate callers" (p. 391).

In Robinson's view, Congress should use more specific language to clarify the states' authority. He looked at the trend of decisions from the Federal Circuit Courts, where the FCC usually found juridic support for its preemptive strikes against state rate-making interests. Referring to other federal court decisions, Robinson says (pp. 396, 401 and 406):

> The Act can be viewed as having permanently fixed the allocation of jurisdiction in place as it existed in 1934, reserving to states jurisdiction over future develoments arguably local in nature [at n. 122 citing <u>North Carolina</u>

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> Utilities Commission I, 537 F.2d at 796-99 (Widener, J. dissenting)]. However, this view is contrary to the court's willingness to interpret the Act as an expansive congressional mandate which may, within limits, respond to new developments in the telecommunications industry.
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> As an absolute minimum, it is clear that the Act was intended to prevent federal preemption of intrastate rates on the ground that intrastate rates discriminated against interstate users under the Shreveport ruling....Congress intended to grant state commissions the de facto authority over local telephone service that the commissions then enjoyed.
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> .....
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> [B]y narrowly focusing on the insterstate/ intrastate dichotomy, attention is diverted from the more fundamental question of which regulator is in the better position to administer a particular aspect of telecommunications policy, to the unproductive inquiry of whether a service or facility substanitally affects interstate communications....Because of federal supremacy, state jurisdiciton is likely to continue shrinking as long as the states, the Commission, and the courts continue to conceptualize state and federal jurisdiction as two separate spheres of plenary authority.

Robinson called upon Congress to write clearer language delegating authority to the states for intrastate rate-making practices. He said: "Federally centralized policymaking on matters of national concern, accompanied by substantial delegation of administrative authority to states could provide a stable balance between the state interest in responsiveness to local needs and the federal interest in uniform policies uniformly administered" (p. 408). Mr. Justice Brennan, in Louisiana, clarified congressional intent with regard to the states' rate-making authority,

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reminding the FCC that a federal agency may not confer power upon itself. However, Robinson and McKenna were depending on the trend of lower federal court decisions which had consistently affirmed the FCC's assertions of primacy in the regulation of jointly-used telecommunications services and facilities.

Colorado Public Service Commission Chairperson and professor of economics Edyth S. Miller said Louisiana "should be viewed from the perspective of a long line of FCC preemption decisions and a previously almost unbroken series of judicial affirmations" beginning in the 1970s (1986, p. 15). Miller's analysis of those lower court opinions was similar to those cited by McKenna as he had attempted to predict the outcome of the Louisiana decision before it was rendered by Mr. Justice Brennan. She says the federal courts consistently had confirmed the FCC in its preemptive actions based upon one or both of the following rationales: (1) a finding that the federal and state telecommunications systems basically are inseparable (meaning the same systems provide both inter- and intrastate services and therefore should not be subject to incompatible treatments) and/or (2) even where separability could be demonstrated, on the ground that the action was necessary to advance a valid federal goal (p. 16). Louisiana made it clear that where there is separability, states have authority to determine how each element of the intrastate revenue requirement will be calculated. According to Miller, the FCC may not preempt fe

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the states to further an ideological interpretation that the industry must return to free markets. To do so, suggests Miller, the restructured industry may take on the characteristics it had at the turn of the century...ruthless competition for market segments, predatory acquistition, or a new configuration--a coordinated oligopoly exercising private power as an unregulated monopoly.

Chapter IV introduces the public utility paradigm, principles, practices, social and economic goals, and people related to regulation of the telephone industry during the period under study. The Shreveport case mentioned by Robinson will be discussed at much greater length in Chapter V because it one of the most notable cases addressing interjurisdictional conflict associated with separate federal and state rate-making practices. Evidence indicates that Section 410's origins can be traced to actions which followed the Shreveport opinion.

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CHAPTER IV

REVIEW OF THE LITERATURE: THE PUBLIC UTILITY PARADIGM AND REGULATION OF THE TELEPHONE INDUSTRY

Introduction

Ruthless competitive practices created a turn-of-the-century marketplace where the public welcomed regulation in order to bring about price stability and reliable telephone service. By 1913, policymakers adopted a premise that the "natural monopoly theory" applied to the telephone industry, meaning that only one enterprise should be certified to provide services for a given geographic market because service delivery and expansion requires enormous financial commitments. Natural monopoly theory is closely related to a model of regulation known as the "public utility paradigm." Many of the rules applicable to industries providing essential services commonly referred to as public utilities have origins in the early regulation of transportation services and facilities, especially the railroad industry.

Although the study focuses on the intergovernmental relationship characterized by Section 410, this chapter introduces principles, practices, social and economic goals, and people related to regulation of the telephone industry di

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during the period under study. Therefore, the following subheadings attend to that purpose:

1. Imperfect Competition, the Natural Monopoly Theory, and AT&T as a Parent Operating Company

2. The Public Utility Paradigm, Costs and Prices for an Integrated System, Elements of the Revenue Requirement, and Separations

3. Social and Economic Goals of Regulation, and Universal Service

4. Separations, and the Revenue Requirement

5. Public Utility Commissions, Their National Organization and Its Membership

Imperfect Competition, Natural Monopoly Theory, and

AT&T as a Parent Holding Company

<u>Imperfect Competition</u>

The virtues of ideal competition rely on the conditions presupposing that suppliers and consumers engaged in the exchange of goods and services are so numerous that the behavior of one supplier or one consumer cannot unbalance an efficient and equitable balance of exchange for other players who wish to enter or leave the marketplace. Perfect competition assumes an optimal allocation of society's resources, or a balance between supply and demand. Circumstances which distort those conditions create varying degrees of "imperfect competition". Imperfect competition represents a departure from standards associated with the perfectly competitive marketplace, or an imbalance between supply and demand.

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"Economic regulation of the telephone industry is a response to imperfect, real-world conditions rather than the workings of a perfectly competitive environment. (See Owen and Braeutigam, The Regulation Game, 1978, pp. 195-237.) When distortion exists in the marketplace, it is common for some participants to issue demands for relief from injury created by the imbalance. In a range of possible behaviors considered to be anomolies of the marketplace, monopoly power represents an extreme distortion.

Extreme monopoly power may be said to exist only when a single seller, or when a number of sellers, acting in unison through formal or tacit agreement, control the entire supply of a commodity or a service. The Annual Reports of the Interstate Commerce Commission indicate that local exchange operations were operated as monopoly enterprises by AT&T-Bell companies or by other independently formed companies by 1913. J. Warren Stehman, professor of economics (1925), indicated that AT&T controlled ninety percent of intrastate and interstate toll message interconnections by 1918 (p. 240, n. 1). Government and industry collaboration perpetuated monopoly control of local exchange and interexchange sevices from 1913 to 1971. Today, local exchanges continue to be regulated as if they were "natural monopolies" although competition has been permitted in some specialized submarkets.

Natural Monopoly Theory

Addressing Atlantic Monthly readers in 1913, AT&T's president, Theodore Vail, promoted the idea of integration of the nationwide telephone network as a "natural monopoly" (p. 318):

> The public...has begun to appreciate and believe that the telephone service is a 'natural monopoly'...that one telephone system is sufficient, and more than one a nuisance....

In comments first submitted to the Senate Interstate Commerce Committee investigating competition and monopoly in American industry in 1940, economist Clair Wilcox expressed the period's political-economic thinking about industrial concentration of economic power when he said, "There are but a few areas in which it is clear that the public interest can be better served by monopoly than by competition." Wilcox named the telephone industry as one of them, adding "the nature of the function performed is such as to demand coordinated development under common control" (Investigation of Concentration of Economic Power, 76th Cong., 3d Sess. Monograph No. 21, p. 15).

Wilcox identified several advantages of monopoly, calling them the converse of the disadvantages of competition in those fields where the most efficient scale of operation can be attained only if a single firm is permitted to produce the whole supply (p. 16):

> Monopoly can avoid wasteful duplication of production facilities. It can simplify and standardize its products. It can minimize

> expenditure on advertising and salesmanship. It can command essential information and cut the cost of bargaining and negotiation. It need not shroud its technology in secrecy; it can apply the discoveries resulting from research to the entire output of a trade. The monopolist is under no competitive pressure to give short measure or to adulterate his goods. He is not driven to depress the standards of labor. If he wishes, he can so conduct his business as to serve the common interest. But, in the absence of effective public regulation, he is under no compulsion to do so.

Wilcox's statements were an uneasy accommodation to the status quo, not a defense of monopoly practices. Quite the contrary; he was willing to condone monopoly only to the extent that it came under the careful scrutiny and control of government. Even in those instances, Wilcox said monopoly control was likely to sacrifice progress to stability, acquire extensive property holdings at an excessive price, obstruct adaptation of economic change, and to assume debts too high to remain an acceptable risk to investors.

Wilcox claimed that an unregulated industry dominated by one supplier posed an inevitable threat to the "existence of free and representative government" (p. 18). Wilcox was persuaded that concentrated economic power was the root of concentrated political power, and would become "the death of capitalism and the genesis of authoritarian government." Wilcox said telephone industry performed most efficiently as a single system with rates necessarily subject to public control (p. 83).

Wilcox looked at regulation of monopoly-like public utility industries as a trade-off. He reasoned, in those situations where the society's idealized marketplace fails, government must control the monopoly enterprise so that society will benefit rather than become endangered by its corrupting influence on representative government. Regulation was an alternative to other forms of control with consequences potentially harmful to a technologically integrated communications system: (a) antitrust action which would break up the monopoly (eliminating its alleged benefits) and (b) government ownership of the enterprise (the antithesis of capitalism).

AT&T as a Parent Operating Company

In their classic text, The Holding Company, James Bonbright and Gardner Means called AT&T a "parent operating company" because it was both a holding and an operating company" (1932, pp. 141-142). A holding company is organized to buy and hold securities of subsidiary corporations. AT&T became the archtype of a successful parent company because it owned subsidiaries providing research and development facilities, manufacture and leasing of equipment, interstate transmission interconnection services, and intrastate operating companies at the same time it managed all the interrelated contracts among the subsidiaries. The parent supplied specialized and expert legal, engineering, accounting, purchasing services, and financial assistance to expand or streamline operations by charging an annual fee from its subsidiaries. David Lilienthal (1929) said holding companies such as AT&T were "parents and proprietors,...managers...making decisions, sharing responsibility, and in constant touch with the properties which serve the public" (p. 408).

Bonbright and Means called AT&T "one great, independent company [controlling] all but a small fraction of the entire service throughout the United States" (p. 141). In their view government should demonstrate concern for "the <u>consumer</u> who has a special need for protection against the unrestrained action of a public utility, since he and he alone is at a disadvantage in the hands of an unregulated monopoly" while the risks taken by AT&T's investors ought to be relegated to a lesser concern (p. 151).

The states were without power to require the parent company to submit reliable information demonstrating the actual costs of the equipment and services supplied and rendered to its operating companies because AT&T operated as a <u>nationwide</u> corporation. Historian Richard Hofstadter said state governments, long the central agencies of political action, were outdistanced by the business interests of the large, nationwide holding companies because the courts had ruled that they operated beyond the reach of state control. If the states asked the federal government to intervene in the investigations as a "last resource for the control of business," meant the states were also "ironically lending support to another step in the destruction of that system of local and decentralized values" in which they believed (1955, p. 231). AT&T's corporate structure created a regulatory dilemma. The parent corporation refused to cooperate with state commissioners who asked for validation of the actual expenses associated with contracted services listed as categorical costs by Bell operating companies.

Rate making, the essence of government regulation of the telephone industry, is predicated on verifiable information. Although state and federal courts denied regulators access to records held by the parent company, commissions were required to supply proof of expenses to demonstrate the fairness of the rate schedules they approved for exchange and interexchange services. State commissioners complained openly of their inability to regulate telephone rates effectively because the service contracts were not open-market transactions; they were set at costs determined by the parent and by demand of its subsidiaries (Bonbright and Means, p. 143).

Therefore, Bonbright and Means issued the following public policy proposal (p. 185):

> [A]ny holding company or service company which performs services for an affiliated operating company should be required to open its books to the public service commission in order that the commission may determine whether the prices charged for the services exceed the reasonable cost of rendering them. It is not enough, however, that the accounts be available to

> a commission. A further essential is that the accounts be constructed in accordance with a uniform system of accounting, which will make it possible for a commission to allocate properly the overhead costs of the holding company.

Until Congress passed more substantial legislation in the 1930s, the state and the federal governments were without power to verify the information reported by AT&T's operating subsidiaries as the agencies attempted to determine a fair assemssment of the value of the assets or the cost of doing business in their separate jurisdictions.

The Public Utility Paradigm, Costs and Prices for an Integrated System

The Public Utility Paradigm

Public utility economics is a subspecialty of "industrial economics"--itself related to microeconomic theory describing competition as the optimal force of a society whose destiny is controlled by its marketplace. Of his specialty Martin E. Glaeser said the field of study could be aptly identified as the investigation of "monopoly economics" (1957, p. 404).

The public utility paradigm became an amendment to neoclassical economic theory. It was designed to address deviations occuring in the public utilities marketplace where goods and services are deemed so vital to the political-social goals of society that government intervenes on behalf of its primary constituents--users of the nationwide telephone system. The following comments are a summary of the public utility paradigm (Fowler, M. S., Halprin. A. & Schlichting, J. D. [1986] pp. 151-152):

> Under the public utility paradigm, it is thought to be both more efficient and more fair for government to grant an exclusive franchise to one company than to let market forces reign.
>
> [T]he public utility paradigm strictly controls entry and exit, closely regulates both the prices and the conditions of service, and imposes an obligation to serve all applicants under reasonable conditions. The use of governmentally granted market power to leverage other markets is prevented by setting prices for regulated services and by severely restricting the utility's participation in competitive markets.
>
> Telecommunications services--both local and long distance--traditionally have been included among the core of industries falling within the public utility paradigm.

As one contemporary industry economist succinctly puts it: "[T]he very nature of competition is for one company to attempt to take business from another" (Monson, C.S., 1989, p. 19). After the expiration of the early Bell patents, and into the early twentieth century, competition in the telephone industry was fierce.

Stehman's text described the expansion and unification of the Bell System under the aegis of AT&T (pp. 77-164). He mixed admiration with reservation as he wrote of the early twentieth century competitive activities of the parent corporation. Writing some sixty years later, Peter Temin and Louis Glambos (1987) seemed to echo Stehman's ambivalent regard when they describe the emergence of AT&T's Bell System. There is general agreement that AT&T engaged in monopolization of densely populated geographic markets by its affiliated companies through consolidation of equity ownership, binding management contracts among operating companies, and other hostile competitive practices. In some instances, communities served by independent exchange companies were denied access to the developing AT&T-owned interexchange network.

The public utility paradigm with its formula for rate-base regulation seemed to make accomodation to monopoly more palatable. The model rests on a general proposition that a single entity, rather than multiple suppliers, provides better service at lower costs. Accordingly, government acquiesces to monopoly when it issues the right to do business in a given market to one company, through an exclusive franchise. The franchise prevents others from competing for a share of the same business in the market.

A company accepting the protection of a government franchise in any given market as a public utility accepts an obligation to provide reliable service and facilities to all who wish to be served and who are able to pay a price which will meet the legitimate costs and expenses of producing the services in exchange for enabling the investors in the company to earn a fair profit. Southwestern Bell Corporation's director of strategic marketing, Dennis L. Weisman describes the model as a "regulatory contract," joining agents of government and industry as principals, with a premise and a promise that all prospective customers within a franchised service territory will be provided with an option for service at a "just and reasonable price" (1989, p. 17). Weisman says (pp 18, 19 citing Victor P. Goldberg):

> [T]he "regulatory contract" has historically served as the means by which the risk of large up-front capital outlays was shared between the utility and its customers. The regulator acted as an agent for the customer base (or principals) in negotiating the terms of the contract with the utility. In granting the utility the exclusive franchise to serve, the "regulatory contract" virtually guaranteed a one-to-one mapping between the option of use and the actual use of the customer base. In the absence of the regulatory contract, the utility would presumably have acted as if it were a competitive firm and entered into explicit legal contracts with customers desirous of service.

The terms of the regulatory contract under the public utility paradigm permit the companies bound by it to recover their expenses, earn a fair return on their investment, profiting from alleged efficiencies associated with government sanctioned monopoly practices and sound management.

Costs and Prices for an Integrated System

A technologically integrated telephone network, accessible to the public, operated by several companies, makes the process of setting prices for multiple service categories distributed among several jurisdictions extremely complex. According to the rules of a competitive marketplace, the long-run average costs of producing services should determine the prices of the various services. Free marketeers hold the viewpoint that the cost of providing services must be the controlling factor in setting prices--telephone rates should not be less that the directly assignable operating costs in each of the telephone service categories. If cost is the sole consideration, it follows that subscribers to the smallest telephone exchanges would have the highest rates because theory also holds that the cost of providing services decreases as the number of units of service production increases (assuming there are no comparable substitutes for the services provided).

In the period from 1913 to 1971, an opposite position influenced the way prices were differentiated. "Value of service" became the basis for justifying most of the pricing decisions during the period considered in this study. The concept was related to a Court opinion which said prices ought to be tied to the public perception of the fair value of the service (in a railroad rate case, Smyth v. Ames, 169 U.S. 466, 42 L. Ed. 819 [1898]). The premise, as applied to the telephone industry, meant that each additional subscriber added to the network increased its value to other subscribers. Furthermore, it was used as the justification for pricing business services differently from those of residential customers within any given local exchange calling area.

Regulatory officials must determine, by choice or discretion, which practices and procedures will accomodate politically acceptable pricing formulas to be applied by officials of the separate jurisdictions. In the period chosen for this study value of service was an idea that meant the price charged for providing service should be influenced by the number of telephones any subscriber can contact through his own telephone without incurring a toll charge. It was assumed that business subscribers placed a higher value on a larger pool of telephone subscribers than residential subscribers did because they stood to profit from telephone transactions. Message toll service was perceived to be a luxury for residential customers and a necessity for business users.

The complementary assumptions associated with pricing services have been that local exchange service, especially among residential and small business subscribers is relatively "price inelastic," meaning that those subscribers, having no comparable substitutes for vital communication, are less likely to disconnect from the network when prices for services increase. Use of toll service, however, is assumed to be "price elastic," meaning that use of message toll interconnections increases as prices decrease, with commensurate expectations that use drops off as prices increase. Based on assumptions of price elasticity-inelasticity, pricing under the public utility paradigm was influenced by costs of providing services to various user categories as well as by the value-of-service concept.

Separations, and the Revenue Requirement

Separations

J. R. Rose, professor of public utility economics, made a distinction between "cost of service" and "value of service" when he discussed factors involved in pricing decisions (1950, p. 252). Rose's commentary helps us understand why federal and state officials engage in bargaining under the provisions of the Communications Act (pp. 253-255):

> Factors other than size of an exchange [number of subscribers] influence cost in exchange areas. Variations are clearly due to location, topography, density, and other environmental features of the exchange. In addition, customers' habits in using the service and type and age of the plant must be considered.
>
> There is a difference...between the cost of operating an exchange and the cost of the local exchange service--each exchange furnishes three services: local, intrastate toll, interstate toll. It is necessary to separate the cost of these toll services to determine the cost of local exchange service.
>
> Toll services [are] treated separately from the local exchange service for rate making purposes. But the situation is one of joint supply because it is cheaper to produce the toll and local services together than separately....Any method of allocating joint cost is inherently arbitrary....The only valid test possible of any method of apportioning joint costs is the pragmatic one: What results does it produce?

"Separations" describes a process developed to allocate and assign costs and prices associated with the integrated network between interstate message toll service (MTS) customers and intrastate toll and local exchange customers. From 1913 to 1971, state regulatory commissioners set rates using formulas designed to increase the number of subscribers to the telephone network while federal commissioners have been interested in increasing the use and enhancing the utility of interstate message toll services.

The separations process developed as a modification of the public utility paradigm. Accounting practices determining each element specific to the aggregated revenue requirement entered into the formula apportioning revenues and costs between federal and state jurisdictions. They, in turn, were tied to engineering studies designed to "test" the costs of providing local and long distance services, and further refined to represent the revenues allocated for intrastate and interstate business operations. Richard Gabel's text presents an account of the political convolutions of the process, with the claim that AT&T manipulated it to maximize the parent company's profitability at the expense of the ratepayer. Gabel's analysis of statistics supplied by the United States Census Bureau and by the FCC indicated the overwhelming number of completed business and residential telephone calls were made within a local exchange service area. From 1913 to 1971 interstate toll calls comprised less than three percent of the aggregate number of nationwide interconnections. Furthermore, all interstate messages depended on the local exchanges for end-point connections.

Gabel described several methods which were utilized to apportion aggregate interstate and intrastate long distance revenues to support the high cost of providing local services because it was thought that toll connections were supported by capital investments made by local exchange companies. Since 1971, federal policymakers have adopted another policy position. It is now held that competition in the interexchange service markets is desireable. Therefore, many of the intricacies of early separations formulas no longer apply. Nevertheless, the basic elements of the revenue requirement remain as essential to rate making today as they did when the public utility paradigm dominated public policy decisions associated with the telephone industry.

<u>Elements of the Revenue Requirement</u>

As Nevada Public Service Commissioner Stephen Wiel indicates, utility companies have been rewarded for increasing sales (1989, p. 9). He notes that the basic formula of the regulatory compact which determines what rates for services will be has changed little over the years. Wiel cites the <u>Bluefield Water Works</u> as the case which established that a commission could set any value on a utility's rate base, any depreciation schedule, and any authorized rate of return as long as the approved revenues produced a rate of return which was not confiscatory and allowed the utility to maintain a credit standing sufficient to attract capital allowing it to maintain and expand service according to the demands of the market (262 U. S. 679, 692-93). Weil says (p. 12):

> From the beginning of regulation, commissions have recognized the right of utilities to recover their operating costs through their utility rates....
>
> Over the years, regulators' and the courts' interest in rate making has focused on the proper valuation of the utility's property which is used and useful in public service and on the rate of return the utility should earn on this investment.

The "revenue requirement" represents the overall value of the investment and the cost of providing services each company contributes to the nationwide publicly switched network. Under the public utility paradigm, the aggregated revenue requirement must equal the cost of providing service for local exchange and/or message toll service (MTS). Calculation of each element of the formula becomes a matter of public policy review, subject to deliberations among federal and state regulators and industry representatives.

Economists Paul Garfield and Wallace Lovejoy (1964) set out the basic elements of the revenue requirement. It is the classic rate-base formula applied to the public utility paradigm (pp. 44-45):

$$RR = E + d + T + (V - D)R$$

RR = Revenue requirement
E = Operating expenses
d = Depreciation expense
T = Taxes
V = Gross valuation of the property serving the public
D = Accrued depreciation
R = Rate of return as a percentage of investment
(V-D) = Rate base (net valuation)
(V-D)R = Return amount, or earnings allowed on the rate base

Every configuration of interjurisdictional separations has required an allocation of costs which takes into account the revenue requirement formula. The statute now requires the FCC to consult the states at any time the federal agency modifies rules which will substantially effect changes for the intrastate allocation of costs. Thus, the adoption of Subsection 410(c) perpetuates and supports the federal-state intergovernmental relationship. Whether under the public utility paradigm or under a scheme of regulated competition in submarkets of the telephone industry, allocation of costs and revenues to the interstate and intrastate markets alters the prices established for each service category and customer classification. Federal and state officials have sought to keep the prices paid for interstate or intrastate service categories as low as possible, and have therefore sought revenue requirement allocative methodologies designed to meet the goal of the lowest possible prices.

Garfield and Lovejoy pointed out that courts accepted "differential pricing" as a lawful and economically desirable form of "price discrimination" as far as regulated public utilities are concerned (p. 135). Their classic text says that differential pricing involves (a) classifying customers into groups; and (b) charging different prices to each group as long as the same schedule or schedule of rates are available to all customers in a group (p. 22). In the regulation of the telephone industry, prices have been further classified by service categories, such as (a) local exchange service, (b) intrastate message toll service, and (c) interstate message toll service.

Social and Economic Goals of Regulation, and Universal Service

Social and Economic Goals of Regulation

Regulation of the telephone industry seeks positive objectives which are modifications of a nationwide economic and social environment. Political scientist Kenneth J. Meier says regulation is a reflection of the values generally held among members of a society. He points to instances when government is concerned with safety, health, and fairness among its constituents as "social" regulation. Meier says social regulation is likely to be forced on an industry in response to nonindustry pressures, taking on the characteristics of "economic" regulation when public laws influence the price, entry, exit and service of an industry (1985, p. 3).

Economist Edward E. Zajac lends support to Meier's premise (in Trebing (Ed.) 1981, pp. 94-108). Zajac says whether the industry operates under the public utility paradigm or a competitive industry model, "a comprehensive descriptive theory of economic justice makes a policy maker's job especially difficult" (p. 107). He claims society, as a consequence of the democratic political process, regards telephone service as a fundamental "economic right" (p. 102):

> The case for making telephone service an economic right grows stronger as our economy grows more complex and intertwined [because] families are widely dispersed.

As convoluted as the process of goal setting may seem to be, Katherine E. Sasseville, as Chairperson of the Minnesota Public Service Commission, expresses the following outlook of it (in Trebing (Ed.) 1981, p. 115):

> The process of redefining social goals and modifying institutions that serve them is part of the political genius of the American system and goes on continuously in every aspect of our economic, legal and social life as a nation.

In her view, proscriptive regulation disallows "the subsidization of <u>private</u> interests by a captive public," but prescriptive regulation upholds "the legitimacy of subsidies for <u>social good</u>, that is, when in their absence the public health and safety would be endangered" (p. 116). Sasseville says ordinary people speak differently about "fairness" and "justice" than do neoclassical economists. In Sasseville's opinion (p. 113):

> Human lives, the public safety, the national security, and private property rights are what is protected by the universality of basic communications services. There is a social good or benefit entailed therein which goes far beyond the <u>quantifiable</u> benefit to any given user [emphasis added].

Meier agrees with Sasseville. He says political goals are usually shaped by social goals (p. 6). George C. Eads and Michael Fix (1984) view the relationship of social goals to economic goals in a similar way. According to them, economic regulation has used "differential pricing to achieve universal access to telephone service--clearly a social objective" (p. 12). In Meier's view, economic regulation is subordinate to social objectives which drive the political reasoning affirming government intervention in the affairs of an industry.

Schultz and Alexandroff argue that regulators must balance the interests of the regulated firms and their customers. They are often bipolar expressions of the public interest: Rates and prices which are "just and reasonable" must apply to the benefit of both parties (1985, p. 19). To determine what is a fair rate of return on behalf of the regulated firms, to achieve just and reasonable prices for the customers of the firms, and to set appropriate standards of service for all users of an interconnected telephone nework, regulators must enter into "bargaining and logrolling...to satisfy a sufficiently broad coalition of affected parties" (p. 20). Economic regulation operates to ensure that the behavior of regulated firms is confined to a restricted range of choices determined by statutes or rules which the society deems to be socially acceptable (p. 5).

It is common for neoclassical economists to declare that the concept of fairness includes a quantitative attribute called "efficiency." For example, a proponent of deregulation, Alfred Kahn, has said fairness occurs when prices are just equal to marginal costs of producing goods and/or services (1971, vol. 1, p. 56). In the instance when the prices paid for a service equates the cost of producing the service, the neoclassicist says efficiency, an economic ideal, has been achieved. Efficiency is equated to a social goal: All goods and services of society are allocated to their optimal use. With circularity, equity-related goal (fairness) dissolves into the economist's ideal (efficiency). The reasoning presupposes a perfectly competitive environment, where nothing interferes to cause deviations of performance, and where all producers and consumers have full knowledge of and access to the mechanisms of exchange in the marketplace.

Meier claims that economic efficiency is seldom mentioned in the legislative history of statutes enabling the formation of regulatory agencies (p. 6). He admits, however, that early regulation was generally perceived to be "economic" regulation. There is a consensus that the economic goal associated with the regulation of the tele

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telephone industy is to maximize the use of the local exchange and the message toll interconnection facilities in such a way as to maintain the financial and technical integrity of the subunits of the nationwide network grid. The economic goal is coupled with a qualitative social goal known as "universal service."

Universal Service

In general, policymakers, academics, and members of the industry refer to Section 1 of the Act as an enunciation of a principle called "universal service." While interpretations of this concept differ, most authorities agree that these qualities apply to it: (a) access to point-to-point interactive voice quality communications (b) to all the people of the United States, (c) at reasonable charges, (d) through a nation-wide interconnected network. The concept has emerged as an expression of the public interest. The House Committee on Energy and Commerce, recommending legislation, reported a recommitment to those attributes as the Act's policy goal with regard to telephone communications (Universal Telephone Service Preservation Act of 1983, H.R. 4102, 98th Cong., 1st Sess.; Report No. 98-479).

The House Report indicated special concern for maintaining low cost local telephone service in rural areas (p. 20). The report said it was an appropriate role of a federal-state joint board to apportion the cost of jointly used long-distance and local facilities in such a way as to guarantee universal service "as a national goal" (p. 21). The majority report offered the following conclusions (p. 50):

> Our national commitment to universal telephone service is no less important today than it was 50 years ago when the Communications Act of 1934 was signed into law. This basic principle of the Act has served the people of this nation well, and has benefited all users of the public communications networks--large and small, business and residential, urban and rural alike. Universal service has bonded our people and country together, and has become an essential cornerstone of commerce.
>
> The cost of providing telephone service in rural America is often substantially higher than in other parts of the country. The low subscriber density and small exchanges, among other factors, have contributed to the high cost of telephone service in rural areas. These higher costs have been historically shared by all users of the communications network to help keep service rates in rural and other remote areas reasonable so all parts of the country can communicate with each other.

Mary D. Hall, writing as a member of the Washington Utilities and Transportation Commission (1984), took exception to the idea that universal service is a stated policy goal. In her opinion, it is a symbolic rather than an actual national policy goal in communication, defined as "all society should have access to plain old telephone service (POTS) at reasonable charges. Alternatively it has been defined as the penetration rate of POTS" (p. 88). She posed a new definition of universal service, adapted to the reintroduction of the competitive industry model and the integration of computer technology with telephony. She defined universal service in the Information Age as the following (p. 106):

> [It is] a total communication system which would permit flexible transmission and processing of information to and from anywhere, and provide information resources that will make available-to all society - any amount or type of knowledge; an information network system or something akin to it.

Hall's views represent contemporary thinking of some scholars, while the majority report quoted above represents the views of others.

Martin T. Farris and Roy J. Sampson have called good communications the "social overhead capital" of the United States, meaning communications services are essential for economic growth and development (1973, p. 3). In their view, the telephone is so much a part of the American way of life, to do without it is "unthinkable." The federal judge who has exercised great influence on the interpretations of the responsibilities of the telephone industry since the divestiture of the associated Bell operating companies from their parent organization, AT&T, Judge Harold Greene offered his view of universal service (U.S. v. Western Electric Co., Inc., and A.T.&T, et al., 583 F. Supp. 875, n. 123 [1984]:

> ...[T]elephone service is no longer a luxury, but is an essential service not only for conducting business but also as a link to the world for the elderly, the poor, the ill, those living in sparsely settled areas--in brief, **everyone** [emphasis mine].

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Theodore N. Vail used the term "universal service" as a corporate goal seeking "to secure a single, universal, nation-wide system of communication and to eliminate direct competition" (Glaeser, p. 109). In Glaeser's view, Vail achieved a monopolist's intention behind a slogan calling for universal service by 1915 (p. 110): "One System, One Policy, Universal Service." The presence of telephone service seems somewhat unspectacular because it has been generally available to several generations of Americans.

Assuredly, meaning of a concept which may have seemed obvious when legislation was first written sometimes blurs across time. Where the language of the Act is vague, Congress may have purposefully chosen the wording in such a way as to permit flexible interpretation. In those instances where Congress selects precise language, the precision is likely to be sustained in subsequent judicial interpretations. In the period from 1914 to 1971, most policymakers seemed satisfied to promote maximum penetration of POTS among American households, believing interactive voice communication to be vital to economic development and social cohesion.

Public Utility Commissions, Their Organization and Its Membership

Justice Robert H. Jackson made the following observation in 1950 (Federal Power Commission v. East Ohio Gas Company, 338 U.S. 464, 489, 94 L Ed. 268, 286):

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> **Long before the Federal Government could be stirred to regulate utilities, courageous states took the initiative and almost the whole body of utility practice has resulted from their experience.**

Public Utility Commissions

The states were the first to legitimize special administrative agencies to deal with issues of government protected monopolies (McCraw, 1984). Legislation developed from the conviction that government has a duty to protect the public against private monopoly, especially in those instances where government confirms the existence of a monopoly by granting exclusive privilege to operate within a given market area. The commissions carry out the broad policies laid down by the legislative branch of government. Their activities are subject to review by the courts to protect, under terms of national and state constitutions, the personal and property rights of individuals affected by the agencies' decisions. (For purposes of this study, agencies empowered to regulate public-service monopolies are referred to as public utility commissions (PUCs), public service commissions (PSCs), regulatory commissions, and/or commissions interchangeably.)

The national government created the Interstate Commerce Commission in 1887 to deal with the problem of private monopoly power exercised by railroad companies (24 Stat. 379. c. 104; ICC). In part, the ICC was formed as a congressional response to a Supreme Court decision which

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nullified efforts states had made to regulate the railroads (Wabash, St. Louis & Pacific Ry Co. v. Illinois, 118 U.S. 557, 7 S. Ct 4, 30 L. Ed. 244 (1886)). The Court said (30 L. Ed. 244 at 249):

> It cannot be too strongly insisted upon, that the right of continuous transportation from one end of the country to the other is essential in the modern times to that freedom of commerce from the restraints which the States might choose to impose upon it, that the commerce clause was intended to secure. This clause, giving to Congress the power to regulate commerce among the States, and with foreign nations, as this court has said before, was among the most important of the subjects which prompted the formation of the Constitution....And it would be a very feeble and almost useless provision, but poorly adapted to secure the entire freedom of commerce among the States which was deemed essential to a more perfect union by the framers of the Constitution, if, at every stage of the transportation of goods and chattels through the country, the State within whose limits a part of this transportation must be done could impose regulations concerning the price, compensation, or taxation, or any othr restrictive regulation interfering with and seriously embarrassing this commerce.

The Mann-Elkins Act of 1910 (36 Stat. 544) authorized the ICC to regulate telegraph, telephone and cable company rates under the Interstate Commerce Act. The ICC's authority in those matters was reiterated in the Transporation Act of 1920 (41 Stat. 474; the Esch-Cummins Act). The Willis-Graham Act of 1921 (42 Stat. 27) authorized the ICC to approve consolidations and mergers of the telephone and telegraph companies when they were found to be in the public interest.

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Although Congress delegated federal authority over interstate telephone services to the ICC in 1910, that agency, preoccupied with the complexities of railroad and telegraph regulation, maintained passive interest in the developing telephone industry on the premise that interstate telephone traffic was proportionately insignificant by comparison to intrastate promotion and use of the technology. The ICC played a minimal role in the regulation of the telephone industry before 1934, when Congress transferred its authority to the Federal Communications Commission with stipulations reserving certain powers to state governments.

According to Paul Rodgers the Communications Act of 1934 consolidated the ICC's authority over telephone and telegraph companies, the Federal Radio Commission's authority over braodcasting, and the Postmaster General's authority with respect to telegraph operations. (Rodgers is the general counsel for the National Association of Regulatory Utility Commissioners--the NARUC). The FCC's regulatory authority over telephone and telegraph companies was significantly increased beyond the ICC's earlier authorization. Rodgers said (1978, p. 28):

> As advocated by the NARUC, the Act expressly negated the application of the Shreveport Doctrine and preserved State jurisdiction over intrastate calls and local exchange calls....[47 U.S.C., Secs. 152(b), 214(a)(1-3), and 221(b)] The Act also authorized the use of State joint boards and Federal-State cooperation [47 U.S.C., Sec. 410].

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States with powerful railroad commissions were the first to adopt statutory provisions reassigning what had been telephone regultion by local municipalities to the inclusive authority of state public service commissions (New York in 1905; Wisconsin in 1907). According to government scholar Finla Crawford, forty-seven of forty-eight states extended general powers of supervision over utilities by 1931. (Transmission of electricity and telephone were not under control of commissions in Delaware, Florida, Iowa, Kentucky, Minnesota, Mississippi, South Dakota and Texas. Iowa and Texas commissions claimed jurisdiction over transmission lines outside cities; Crawford, 1931, pp. 423-424.) In general, public utility/service commissions have been empowered by their state legislatures to establish price and performance standards for firms in industries assigned to their supervision.

Each subscriber to the nationwide telephone network has dual citizenship: The consumer is an intrastate constituent and also a likely interstate constituent. This situation gives Congress further reason to require the representatives of the two tiers of government to negotiate the terms which will influence the prices for consumers using the network for each type of service category. Because each member of Congress is elected by intrastate constitutents, members of the House of Representatives and the Senate can be expected to be concerned about the results of the federal agency's actions have on local telephone communications.

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A National Organization and Its Membership

Thomas M. Cooley was the ICC's first chairman in 1887. He had been a Michigan Supreme Court justice prior to his federal appointment. Although Cooley believed that the U.S. Constitution restricted the power of the states to exercise power over commerce, he appreciated the states' roles as partners in pragmatic regulation of the nationwide railroad industry. After all, regulation of the railroad industry, whether by weak or strong independent commission, had begun in the individual states. Cooley urged officials of the state railroad commissions to pool their knowledge and expertise in a coordinated, cooperative effort to promote the welfare of the the public and to countervail the abusive private power of business combines who collaborated to control distribution and prices for railroad traffic in the United States.

With Cooley's encourgagement, The National Association of Railway Commissioners, (now commonly called NARUC) was formed in Washington in 1889. Cooley readily recognized a division of commerce power between the federal government and (1889 Proceedings, p. 1):

> ...We are all engaged in kindred work...in a large degree in the same work. You have your respective spheres of action, limited in territory and by legislation, and we have ours which is intended to be...distinct and separate....[T]he Railroad System...is an illustration of unity in diversity such as it would be difficult to find elsewhere in the world....

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He also recognized that the states had been engaged in the practical effort of regulating the railroad industry far longer than the federal government (p. 2):

> Many of you have been in this work very much longer than we have....[We, of the ICC, are... ready and willing to cooperate in your conference...our attitude on the whole will be that of learners rather than participants.

George M. Crocker, of Massachusetts, addressed Chairman Cooley, saying (p. 61):

> ...[T]he subject as I understand it...is...to see what what can be done...to secure greater harmony in the laws of the respective States compared with each other...[and...to harmonize the laws of the States with the provisions of the Interstate Commerce Act and the work of your Commission.

Cooley presided at the fledgling association's meetings from 1889 to 1891. State commission officials have been NARUC's chairpersons and presidents since then. ICC members served as either secretary or assistant secretary on NARUC's executive board until 1922, when each executive officer has been a member of a state commission. The name of the organization was revised to be more inclusive of its actual membership, the "National Association of Railway and Utilities Commissioners" (in 1917); since 1967, it has been the "National Association of Regulatory Utility Commissioners."

NARUC was organized to become a cooperative association of federal and state regulators where they could meet and exchange ideas and information which would lead to the more efficient regulation of railroads and public utilities

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industries. Within the committee structure of the association, NARUC's cooperative endeavors have been voluntary and informal. The Association has been called a collective organization of state agencies, but its membership has always included federal regulatory officials.

The active membership of NARUC includes only the members and one chief counsel or attorney of each of the federal and state agencies (commissions or boards) who by law exercise regulatory control in matters of railroads, other carriers and public utilities. Associate, non-voting, membership is extended to all staff persons employed by member agencies of NARUC. (The organization extends an invitation to attend each annual convention to state commission members who have retired, and personnel from Canadian commissions with duties similar to United States counterparts.)

The sheer weight of voting power of its active members, however, recommends that NARUC's resolutions and political activities are more representative of the attitudes of the members of state agencies than those of the federal government. Therefore, an assessment of the federal-state intergovernmental relationship which is predicated on an evaluation of the transcripts of NARUC's Annual Proceedings must admit a bias formed from information weighted by the interests of the several states commissions.

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CHAPTER V

FEDERAL-STATE COOPERATION FROM RAILROADS TO TELEPHONES (1889-1913)

Introduction and Summary

Introduction

This chapter begins to identify circumstances which contributed to the development of the statutory provisions of Section 410. The chapter's narrative extends from NARUC's first convention in 1889 to its twenty-fifth annual meeting in 1913. Federal and state legislatures delegated commerce power to independent regulatory commissions for the purpose of exercising government control for railroad transit. Railroad commissioners attended annual meetings to discuss common problems encountered by officials of each jurisdiction as they attempted to exercise regulatory authority within the framework of Constitutional and Congressional requirements.

Primary evidence has been drawn from NARUC's Annual Proceedings. They were published as verbatim records of the discussions and debates, committee reports, resolutions, and special addresses conducted and/or presented at each yearly meeting. Where appropriate, collateral evidence comes from

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the text of Supreme court opinions and commentaries of scholars who were contemporaries of the period.

Summary

The chapter summarizes objectives from the nineteenth century that were commonly held by state and federal members of NARUC to affect their behavior for several decades of the twentieth century. The record indicates the early commitments to dual regulation held by federal and state regulators illustrates the sort of questions which would be applied first to regulation of the railroads, and then to regulation of the telephone industry, differentiates between the salient issues addressed by Supreme Court Associate Justice Charles Evans Hughes in the Minnesota Rate Cases and the Shreveport Case, discusses the immediate response of members of NARUC to Shreveport, introduces the early assessment by commissioners who recognized that the informal cooperative arrangements between the state and federal regulators were inadequate to address the increasing interjurisdictional rate-making complexities, and summarizes the status of early telephone regulation by federal and state commissions. In its presentation of initial commerce power questions related to dual regulation, cited testimony reveals the depth of the impassioned sentiment shared by federal and state commissioners who were recurrently reminded that their developing intergovernmental relationship was an unique and important experiment in pragmatic constitutional federalism in the United States.

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Until 1913, few state commissions were empowered with rate regulation for companies representing the telephone monopolies. Interstate telephone rates received nominal congressional attention until the first great World War ended. The chapter gives a background for the issues of commerce power and dual regulation as a prelude to the requests from federal and state commissioners who recognized a need for a formal joint board mechanism which would reduce the likelihood of interjurisdictional conflict arising from dual regulation of the railroad industry. That mechanism would be a model to be imitated when Congress wrote Subsections 410(a) and 410(b) of the Communications Act of 1934.

ICC and state commissioners who approved or disapproved of rate schedules for interstate and intrastate rail traffic worked to achieve interjurisdictional rate-making harmony through the informal auspices of the NARUC. Regulation of railroad rates had been challenged for more than thirty years. Associate Justice Charles Evans Hughes delivered two significant opinions in 1913 for the Minnesota Rate Cases and the Shreveport Cases. Minnesota upheld state rate-making prerogatives indicating they depended upon Congressional discretionary delegation of commerce power to the states. Hughes' Shreveport decision precipitated a crisis in the status quo of informal interjurisdictional rate-making cooperation when he made it clear that no unjust de facto discrimination against interstate commerce would be tolerated by the Court whether or not it was predicated on a schedule of reasonable or unreasonable intrastate rates.

The _Shreveport_ decision made it apparent that informal annual meetings of NARUC provided worthwhile but insufficient opportunities for intergovernmental reconciliation of intrastate and interstate rate-making issues. _Shreveport_ became a reason why federal and state commissioners lobbied for legislative approval for formal cooperative proceedings at a time when they were delegated certain obligations associated with the regulation of telephone monopolies as well as the railroad industry. Proofs of the summary appear in chapter subsections which proceed as follows:

1. Goals of Early Federal-State Cooperation
2. Early Cooperative Projects
3. The Supreme Court: Relating Commerce Power to Dual Regulation
4. Charles Evans Hughes and the _Minnesota Rate Cases_
5. _Shreveport_: A Crisis for Intergovernmental Harmony
6. ICC-NARUC Responses to _Shreveport_
7. Regulation of Telephone Companies by Federal and State Commissions
8. Joint Boards: Preliminary Commentary

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Goals of Early Federal-State Cooperation

The small number of officials who formed the early National Association of Railway Commissioners (NARUC) held offices by virtue of various state and federal statutes. The commissioners recognized that their organization could influence the direction of legislation. Several state railroad commissions "heartily approved" of the suggestion for a general meeting at the invitation of the ICC's first chairman, Thomas M. Cooley of Michigan. Cooley listed "Railway Legislation, how to obtain harmony in" as a foremost item to be "properly considered" (1889 Proceedings, p. v.). George G. Crocker, of Massachusetts, appointed chairman of the Committee on Railway Legislation spoke about the status of railroad law in his state (1889 Proceedings, p. 61):

> It is certain that as far as the State of Massachusetts is concerned, the laws there could be very much simplified and improved. They have been the result of a growth year after year, with a patch here and a bump there, and it is often difficult even for the wisest lawyers to avoid being misled by some of the details of the operation.

The early rules of commercial conduct prescribed by the states were little more than declarations of broad principles. As such, they were imperfect guides for more specific rule-making. The tasks of perfecting each states' code of public interest laws to meet the demands of its different localities, and of securing federal legislation delegating workable rate-making authority to federal and

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state officials were important goals of regulatory officials.

They adopted a resolution on the topic at their third convention (1891 Proceedings, p. 125):

> RESOLVED, That uniformity is desirable in Congressional and state legislation on the subject of rates, to the end that public regulation of rates may be practically reached by the active co-operation between State and Interstate Commissions.

Work engaged in by railway commissioners pertained to a field of activity upon which federal legislation had only recently been adopted. Prior to 1887 Congress had made no comprehensive effort to regulate commerce among the several States. Its plenary constitutional power in this direction had never been exerted, and consequently never tested. The Interstate Commerce Act of 1887 inaugurated a fledgling federal scheme to regulate commerce in the United States

South Carolina Commissioner M. L. Bonham described the classic problem of the day. Some railway lines regulated by his commission meandered a few miles into North Carolina to return to South Carolina, while another entered the State of Georgia to return again. A third line ran directly through the heart of the state. State courts said those who exited and reentered the state carried interstate traffic (1889 Proceedings, pp. 62, 63). Said Bonham:

> ...[B]oth Interstate law and our State railroad laws should be more definite as to what is Interstate Commerce and what is State Commerce.

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In later years, similar frustration would be expressed by subsequent generations of commissioners about commerce matters relating to a variety of transit, energy, and communication industries.

Common law recognized that the means of public transportation sustained peculiar and distinct relation to social order, thereby requiring its nature and uses to be clearly separated from other forms of private enterprise. The application of steam power to drive locomotives made it possible for rail transportation to develop with such rapid expansion in the last half of the nineteenth century that its rights and obligations to the general public were uncertain. If rail transportation accelerated the development of intrastate commerce, it had a revolutionary effect on the conduct of business, social relations, and the economic development of the entire nation in the post-Civil War era.

Reflecting on the significance of the railroads, ICC Chairman Martin Knapp advocated further public policy inquiry into the integration of the affairs of the railroads and the affairs of the nation (<u>1899 Proceedings</u>, p. 67):

> The railroad of to-day [sic] is not only the chief instrument by which land commerce is carred on, but its influence is so powerful and its relation to every phase of activity so intimate and vital that its true place within the sphere of government control presents an inquiry of the gravest import.

The railroad companies exercised multiple abuses against shippers which the states had been powerless to

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correct because of lax and inefficient provisions of local statutes under which carriers were organized. Railway commissioners, whether elected or appointed federal and state officials, wanted to substitute social and economic justice for abusive competitive practices engaged in by the railroad (and later telephone companies) in markets served by them. In doing so, they addressed fundamental questions which would challenge the resources made available to the federal and state commissions, and would test the bonds of interjurisdictional statesmanship in the twentieth century:

1. How to secure the most efficient and most equitable service at the lowest reasonable cost from carriers?

2. How to promote the development and increase the usefulness of common carriers while preventing their abuse of concentrated economic power?

3. How to combine the facilities of the various companies into a unified grid without incurring the risk that public rights would be impaired or public welfare imperiled?

4. How to harmonize conflicting interests of such vast proportions and place?

5. How to provide equal advantage and protection to the carriers and the users of a nationwide railway system?

The railroad and telephone industries were constructed and operated on the theory that they were public enterprises. In his discourse on the administation of railway law, Knapp continued (p. 67):

> **It is quite plainly perceived that the great business of public carriage is a function of government** which, for reasons of expediency, is

> not performed by direct agency, but **delegated mainly to corporations created for that purpose. The belief that those who are entrusted with the performance of this function are rightfully subject to public control is now so general as to have almost the force of political axiom. The right to just and impartial treatment in all that pertains to public transportation is seen to be an inherent and inalienable right, the very essence of which is equality.** The injustice and disaster which attend the deprivation of that right are always obvious, and often alarming. **The opportunities for abuse** are so manifold, and the evils resulting **from excessive construction,** reckless financiering, dishonest management, **and the unrestrained competition** of rival lines **are so widespread and startling that the best efforts of legislation are needful to protect the public in the equal enjoyment of an indispensable service. So laws have been passed in most of the States and by the National Government for the regulation of railway carriers, and most of the members of this convention are charged with the duty of administering and enforcing those laws"** [emphasis mine].

Who among federal and state officials would be vested with rate-making power? The question was the crux of the nationwide political problem raised before state and federal courts time and time again, pressing the dictum that state commerce power was made subservient to the legislative determination of Congress. In respect to the focus on rate schedules, regulation of the telephone industry shares common ground with economic regulation of the railroad industry. The record shows one political attitude held by state officials has endured across time: If dual regulation is to survive as a practical representation of the intergovernmental scheme of the United States, then states must retain rate-making prerogatives in those markets where

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there are high entry barriers restricting access to multiple suppliers of vital services.

Although the Texas legislature was among the last to assign telephone rate supervision to a statewide regulatory agency, Texas Railroad Commissioner Allison Mayfield's perception about his functional role as a regulator could be applied to state officials who regulated the telephone industry in later years. Mayfield said (1899 Annual Proceedings, (p. 146):

> **As I understand it, the railroad problem--from the standpoint at least on which I am called upon to consider and treat it--involves the question of...rates. Eliminate that question and the business in which I am engaged, my occupation, is gone** [emphasis mine].

Early Cooperative Projects

Development of uniform procedures was the goal of the earlies federal-state cooperative projects. They were organized to gather information which could be used for complementary market-by-market comparisons of railroad operatons by state and federal regulatory officials. Rate regulation begins with assessing the information submitted by each firm and arriving at an appraisal of the value of the investment in plant, facilities and equipment (the "valuation" process), correlated to an audit of overall annual expenses associated with the operation of the business. Ideally, the statistics gathered become a source for comparing and contrasting the reports filed by public service operating companies doing business in comparable

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markets for the industry. Statistics also facilitate the analysis, on a case-by-case basis, of the economic efficiency and performance of each company filing a schedule of rates to meet its proposed revenue requirment.

State officials appreciated the importance of general uniform standards for financial accounting, but contended that rate analysis must take into account variations which are specific to local factors which alter the comparables for multiple markets in the several states. For example, the geography, climate, and distribution of population have been geopolitical considerations which convince state officials of the necessity of assigning a range of telephone service categories to properly reflect the local demand. Therefore, the movement toward nationwide regulatory uniformity in the rail and telephone industries required some flexibility to experiment with valuation and/or rate-making methodologies to satisfy the demands of the local markets within each state's jurisdiction.

In the period from 1889 to 1913, officials of the federal and state agencies used the auspices of NARUC to negotiate settlement of their disagreements by using informal mechanisms: joint committees or joint conferences of state and/or state and federal commissioners. Certain uniform accounting procedures were adopted by the various states and the ICC. They facilitated the application of a standard revenue requirement formula. As Jane Perry Clark noted (1938, p. 18):

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> **...For many years joint action was grounded in no recognized legal status and was largely dependent on good will, but it served to bring about coordination in the important fact-gathering and statistical work of federal and state commissions and to secure uniformity in accounting and reporting by transportation agencies to both sets of commissions** [emphasis mine].

The ICC approved the first Uniform System of Accounts (USOA) to be applied to railrod and telephone industries in 1913 (27th ICC Ann. Rep.). Lindahl attributes the success of the task to an "impartial and scientific spirit" which prevailed because the state and federal interests were not in serious conflict (1935, p. 343). It served as the first major cooperative venture (regulatory in terms of requiring firms in an industry to prepare their financial reports in a prescribed manner for review by the regulators) designed to supply uniform information from which the separate jurisdictions could begin the valuation and rate-making processes. The ICC's USOA was the product of effective cooperation coordinated through efforts of state and federal commissioners (Milo R. Maltbie, of the New York's Public Service Commission, and Balthasar H. Meyer, of the ICC). The process of devising and amending USOAs for a variety of public service industries has continued quietly across time by similar teams of federal-state officials as an example of the cooperative intergovernmental relationship encouraged by NARUC since its inception in 1889.

In 1913, commissioners from Massachusetts, Maine, New Hampshire and Vermont invited the Interstate Commerce

Commission to experiment with an informal regional investigation of intrastate and interstate rate schedules filed by the Boston and Maine Railroad Company. The results of the cooperative effort led to a mutually agreed upon schedule of freight rates filed with the ICC (27 ICC 560). Development of the USOA for railroads and telephones, and the amendments to the Boston and Maine's rate schedules were practical proofs that intergovernmental cooperation could provide resolution of interjurisdictional rate-making issues.

The Supreme Court: Relating Commerce Power to Dual Regulation

The Granger movement played a prominent part in the political organization of "western" states (Illinois, Wisconsin, Iowa, Minnesota, Nebraska and Kansas) after the Civil War. In that era, the states grew with unprecedented speed, hundreds of miles away from the great "eastern" centers of cultural and economic development. The economy of the Granger states was dependent on farm production and distribution of agricultural commodities. Commerce in the eastern states increasingly relied on manufacture and distribution of finished goods from the inputs of agricultural and natural resources received from the west. Capital, invested and managed in a manner for which common law and governmental institutions had little experience, provided the means of exchange of goods and products by rail.

The legislatures of the Granger states ingeniously framed laws designed to give shippers of agricultural commodities political standing to participate in the determination of what they should pay for the use of the railroads which had become the principal means of transit to and from eastern and western markets (Adams, C.F., 1878). They did so by creating strong railroad commissions with the authority to accept or reject the schedule of prices charged by the railroads to transport passengers and goods. A series of opinions known as the "Granger Cases," affected the conduct of railroad and/or public service regulation by state commissions for the next thirty years. (See Munn v. Illinois [94 U.S. 113 [1877]) as the most comprehensive and frequently cited of the Granger opinions.)

Chief Justice Waite adopted a construction of commerce power first enunciated in Cooley v. Board of Wardens (12 How. U.S. 299 [1851]). The Court's interpretation of the Constitution was that until Congress chose to occupy a field of commerce with its exclusive power, a state could, in the absence of contravening federal statutes, exercise control in commercial matters perceived to be local in character even if the effect of the regulation incidentally reached beyond the boarders of the state (Peik v. Chicago & N. W. Ry. Co., 94 U. S. 164, 177-78 [1876]).

Following the Granger decisions, it became increasingly common for states to create railroad commissions to supervise railroad safety and rates for passengers and freight. Writing in 1914, legal scholar William C. Coleman said the Granger Cases had the effect of overruling a fundamental tenet of federal supremacy in commercial matters enunciated by Chief Justice John Marshall. Paraphrasing Gibbons v. Ogden (Harvard L. Rev. 28, 34; citing 9 Wheat. 1 [1824]): The power of Congress was exclusive in national matters requiring uniform commercial regulation whether or not Congress chose to exercise its exclusive power.

The Court tenuously reconsidered the consequencs of the Granger decisions ten years later. Associate Justice John Marshall Harlan, in Smythe v. Ames (69 U.S. 466 [1898]) reconfirmed the power of a state to regulate transportation rates which were wholly intrastate, but denied the exercise of state commerce power in matters which were clearly interstate in character. Justice Harlan iterated the Court's position affirming the states' plenary authority to supervise the terms of intrastate rates. It would be another decade before the Court examined more closely the effect of intrastate rates upon interstate rates.

Smyth v. Ames is better known for setting forth consideration of factors which were meant to ensure that regulation would not equate confiscation of private property used in the public interest. As a regulatory contract, the railroads were to perform certain services in exchange for a certain measure of compensation. To determine what must enter into the consideration of just compensation Justice Harlan enumerated several "evidences" of value, such as original cost, cost of reproduction, capitalization, the value of stocks and bonds, and so forth. Smyth v. Ames meant state and federal regulators were required to predicate approval or disapproval of the revenue requirement proposed by the public service supplier on a demonstration of factual evidence before determining a schedule of "reasonable" prices the public would be required to pay for access to and use of the services.

In Coleman's view, two factors altered the character of Court decisions by 1913 (p. 59). The first was the trend in cases associated with interrelated or overlapping rates which tended to discriminate unfairly between intrastate and interstate shippers. The second was a major change in the membership of the Supreme Court. It fell upon President Taft to appoint a chief justice and five new associate justices who were more inclined to assert federal dominance rather than dual sovereignty in matters of commerce.

Charles Evans Hughes and the Minnesota Rate Cases

Newly appointed Associate Justice Hughes wrote two major opinions delivered in 1913 stating the extent of powers delegated to the ICC. In doing so, rate-making practices engaged in by some state agencies were severely curtailed. The first opinion, Simpson v. Shepard (also known as the Minnesota Rate Cases, 230 U.S. 352) enunciated a simple rule with great potential for the role of state railroad regulation. The Court affirmed the power of the state to fix intrastate rates by any manner which was not confiscatory until and/or unless Congress determines that the proper regulation of interstate commerce requires a federal commission to also exercise power over intrastate rates.

Hughes intended to make clear that ICC preemption of a state commission's order which directly interfered with a rate system designed to accommodate a multi-state region was justified; Congress designated the field of interstate rail transit to the ICC's sphere of authority. (See "occupation of the field" preemption; above, p. 70.) In what was a treatise on the history of constitutional delegation of commerce power in the United States, Hughes said (at 399-400):

> ...There is no room in our scheme of government for the assertion of state power in hostility to the authorized exercise of federal power. The authority of Congress extends to every part of interstate commerce, and to every instrumentality or agency by which it is carried on; and the full control by Congress of the subjects committed to its regulation is not to be denied or thwarted by the commingling of interstate and intrastate operations. **This is not to say that the nation may deal with the internal concerns of the state, as such, but that the execution by Congress of its constitutional power to regulate interstate commerce is not limited by the fact that intrastate transactions may have become so interwoven therewith that the effective government of the former incidentally controls the latter. This conclusion necessarily results from the supremacy of the national power within its appointed sphere...**[emphasis mine].
>
> ...It has repeatedly been declared by this court that as **to those subjects which require a general system or uniformity of regulation the power of Congress is exclusive. In other matters, admitting** of diversity of treatment according to **the special requirements of local conditions, the**

> **States may act within their respective jurisdictions until Congress sees fit to act; and, when Congress does act, the exercise of its authority overrides all conflicting state legislation...**[emphasis mine].
>
> **...[T]he States cannot under any guise impose direct burdens upon interstate commerce...**[emphasis mine].

The Minnesota Rate Cases opinion laid down a basic rule: There should be federal regulation for interstate rates and state regulation for intrastate rates, but no intrastate rates would be permitted to impose direct burdens on interstate commerce. Hughes pointed out that Congress could assign exclusive jurisdiction over intrastate rates to the ICC through legislation expressly doing so (Wyman, B., Harvard L. Rev. 27, 545, 548 [1913]). Dual regulation was lawful would remain a fact until Congress chose to delegate sole responsibility in a field of commerce to agents of the national government.

Minnesota is an illustration of how throroughly familiar Hughes was with dual regulation as it applied to state regulation of public service industries. In his private law practice, Hughes represented railroad and electric companies. Hughes' national reputation as a regulatory reformer began when he directed a public inquiry into rates charged for gas and electric services in 1905 and 1906. He challenged the right of the to price services on the basis of inflated valuations and expenses. Hughes called for legislation compelling gas and electric companies in New York State to operate as public utilities supervised by a public service commission (Pusey, M. J., 1951, vol. 1, pp. 132-139).

Before his first appointment to the Supreme Court in 1910, Hughes was a Republican governor of New York. His election was popular affirmation of a public utility reform platform. The governor intended to deal a powerful blow to the corrupt influence exerted by political bosses and industry upon public utility regulation. He was instrumental in abolishing the former Board of Railroad Commissioners, the Commission of Gas and Electricity, and the Rapid Transit Board of New York City. Hughes wanted them segregated into two public service commissions, each with broad authorization substitutes: "one to operate in New York City and the other in the remainder of the state, with ample power to control utility corporations in the public interest" (Pusey, p. 183). Hughes was elected governor the year Congress adopted the Hepburn Act (1906; see below). During his tenure as governor, the state legislature adopted a strong commission structure, with rate-making authority which complemented equally powerful state reform legislation in Wisconsin. Hughes, an advocate of public service commission nonpartisanship, was careful to divide appointments among Democrats and Republicans (1915 Proceedings, p. 183). Therefore, the opinions Hughes wrote in his first as well as his second term on the the Supreme Court were not without knowledge of the practical problems associated with state commission regulation of public service industries, or of the complexities of dual regulation.

Shreveport: A Crisis for Intergovernmental Harmony

Coleman says Hughes' opinion in Minnesota "pointed to the destruction of state power" by declaring that the power over the states in matters of local rates was supreme only until Congress acts. Coleman criticized the Interstate Commerce Commission for being "ever zealous for greater authority." Shreveport came before the Court by a petition of railway companies who protested a decision by the ICC (Houston, East & West Texas Railway Co. v. U.S., 234 U. S. 342 [1913]).

Transportation economists Eliot Jones and Homer B. Vanderblue (1925) said railroad companies typically brought cases such as Shreveport to the Court to test the legal authority of the ICC. The industry had a lengthy history of price discrimination which permitted some traders to benefit by rate structures which would obviously cause injury to other traders. The Hepburn Act, in 1906, supported by state members of NARUC, was designed to augment the Interstate Commerce Act by giving the ICC greater latitude to intervene in rate-making matters, and to determine whether or not the railroads were applying "just rates" (34 Stat. 584; 49 U.S.C. 10102 et seq., 10301 [June 29, 1906]).

Coleman said Justice Hughes virtually gave the ICC (in Shreveport) what he had said (in Minnesota) could only be claimed through congressional enactment: authority to set

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aside rates for intrastate traffic determined by a state regulatory commission (pp. 72, 73). His assessment of the impact of Shreveport proved to be reliable with regard to state regulation of the railroads. Strains in the informal federal-state relationship came quickly in the aftermath of the Shreveport decision.

According to Coleman, the vital political question was whether the Interstate Commerce Commission exceeded the authority given to it under the Interstate Commerce Act, as amended (c. 104, 24 Stat. 379 [1887]). He depicts the Court as sweeping aside, "with a mere wave of its hand...the controlling proviso in Section I of the act, expressly excluding intrastate commerce from its jurisdiction. Coleman said (p. 78, citing the Congressional Record, 49th Congress, 1st Sess., vol. 17, 3722, 4404):

> ...The whole history of the debates over the passage of the act, which the court cautiously avoids, would seem to show that it would never have been passed had it been believed to be capable of the construction which the Supreme Court has now placed upon it. Clearly, this is judicial legislation.

Coleman summarized the two arguments used by the railroads to challenge the ICC's orders (p. 74):

> First, that Congress is impotent to control the intrastate charges of an interstate carrier, even to the extent necessary to prevent injurious discrimination against interstate traffic. Second, that if it be assumed that Congress has this power, still it has not been exercised, and hence the action of the [federal] commission exceeded the limits of the authority which has been conferred upon it.

The original complaint brought to the ICC in 1911 by the Louisiana Commission alleged that the Texas & Pacific Railway Company, the Houston, East and West Texas Railway Company, and various other carriers charged freight rates out of Dallas and other Texas points into eastern Texas much lower than rates they charged from Shreveport into Texas. Shreveport competed with both Houston and Dallas for trade along the intervening routes. Comparing freight and distances, the difference in rates was substantial and injurious to trade from Shreveport. Louisiana contended that the Texas Commission had intentionally set a rate schedule intented to favor Texas traders (<u>1913 Proceedings</u>, pp. 102, 103):

> ...The Texas Commission makes a state rate with avowed and declared purpose of favoring the Texas jobber and shipper...in as far as the Texas shipper competes with the shipper of any bordering state.

The ICC ordered maximum rates by freight classifications out of Shreveport to Texas points which were substantially the same as the class of rates fixed by the Texas Commission for freight traveling similar intrastate distances. The federal commission held that the application by the railroads of special class of commodity rates from Houston and Dallas as they were fixed by the Texas Commission constituted an unjust discrimination against Shreveport in favor of the Texas commercial trading points (<u>Meredith et al., constituting the Ry. Com'n of Louisiana v. St. Louis S. W. Ry. Co. et al.</u>, 23 ICC 31 [1911]).

The ICC hedged on declaring the Texas rate orders as intentionally unreasonable per se. The Commission determined that the railroads would be required to demonstrate that the cost of carrying intrastate Texas traffic warranted an increase to match the interstate rates charged interstate traders, or to lower the schedule of interstate rates to match the Texas schedule. In a four-to-three decision, ICC Commissioners James S. Harlan, Judson C. Clements and Charles C. McChord dissented. It was their premise that the order meant that an ICC denied state rate-making authority, and that the Interstate Commerce Act did not empower the federal commission to do so, however desirable the action might be.

Coleman said Minnesota meant that commerce power was divisible to the extent that federal and state commerce powers were equally plenary (conclusive) within their respective spheres. Thus, argued Coleman, rates representing the completely internal commerce of a state ought to be reserved to the states themselves (p. 77). Coleman's view was shared by most state members of NARUC in subsequent years. They, as Coleman did, often ignored the intersection where the spheres of federal and state rate-making obligations overlapped. (See the IGR construct which applies in situations such as this describes (above, pp. 40, 41.)

Coleman offered a rhetorical alternative to the opinions Hughes wrote (p. 77):

> Why did not the Supreme Court in both the Minnesota and Shreveport Cases [sic] face the sitution squarely and admit that amendment of the Constitution, difficult as it is of attainment--and rightly so--is the only true remedy?

Perhaps Coleman's intention was to imply a proposed amendment would be difficult to attain because the Civil War left residual regional acrimony not fully resolved during reconstruction of the Union. Financial panic in the 1890s drew general attention to extensive political and economic abuses. The nation struggled to reconcile the juxtaposition of massive corporate power with calls for public control of industrial wealth. State and federal governments were challenged by rapid changes occuring in each subset of the nation's social, political, and economic institutional structure.

Coleman and others who have referred to <u>Shreveport</u> in recent years have emphasized those statements which they claim have the effect of stripping plenary power from the states in the matters of commerce. In doing so, they rely on Hughes' words (p. 350, 359-60):

> ...It is unnecessary to repeat what has frequently been said by this court **with respect to the complete and paramount character of the power confided to Congress to regulate commerce among the several States.** It is of the essence of this power that, **where it exists, it dominates.** Interstate trade was not left to be destroyed or impeded by the rivalries of local governments. The purpose was to make impossible the recurrence of the evils which had overwhelmed the confederation and to provide the necessary basis of national unity by insuring 'uniformity of regulation against conflicting and discriminating state legislation' [emphasis mine].

....

...We are not unmindful of the gravity of the question that is presented when state and federal views conflict. But it was recognized at the beginning that the nation could not prosper if interstate and foreign trade were governed by many masters, and **where the interests of the freedom of interstate commerce are involved, the judgment of Congress and of the agencies must control** [emphasis mine].

Hughes was referring to attributes describing "conflict preemption" (above, p. 70). That he did so recommends that his discussion of what it means to engage in unjust pricing deserves equal if not greater attention than the issue of preemption. Carriers were not going to be permitted to manipulate rates by claiming that constituents of one state must pay a higher price for doing interstate business because the laws of another state required them to do so. His opinion mirrored a statement made to the 1912 NARUC Convention in the opening address by Chairman Charles A. Prouty of the Interstate Commerce Commission who said (1912 Proceedings, pp. 4, 5):

...You are State commissioners; we are Federal commissioners. In that fact many people see confusion, disaster, discord. I do not, myself, feel any apprehension of conflict or disaster. But it certainly is possible that there may be most serious confusion...

...In the conventions which led up to the ratification of the [association's] constitution no serious question was made...[except by one state] over that clause which gives a Federal Congress control over commerce between the States and with foreign nations.

...The Interstate Commerce Commission and all the activities of the Interstate Commerce Commission are based upon that clause of the

> constitution. It seems to me that it must finally come to pass in some way or other by additional legislation or by judicial interpretation that **the Interstate Commerce Commission, the Federal commission, must have power to prevent any manipulation of freight rates which will give to the citizens of one State a commercial avantage over the citizens of another State. To that extent the authority of the Federal commission must finally be supreme** [emphasis mine].

Hughes intended to make clear that no entity, private or public, was within its authority to engage in unjust price discrimination under the commerce clause and the federal statutes of the United States.

Hughes said (at 351, 356):

> ...The fact that carriers are instruments of intrastate commerce, as well as of interstate commerce, does not derogate from the complete and **paramount authority of Congress** over the latter or preclude the Federal power from being exerted **to prevent the intrastate opeations of such carriers from being made a means of injury to that which has been confided to Federal care** [emphasis mine].
>
> ....
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> **...There is no exception or qualification with respect to an unreasonable discrimination against interstate traffic produced by the relation of intrastate to interstate rates as maintained by the carrier.** It is apparent from the legislative history of the [Interstate Commerce Act] that the evil of discrimination was the principal thing aimed at, and there is no basis for the contention that Congress intended to exempt any discriminatory action or practice of interstate carriers affecting interstate commerce which it had authority to reach [emphasis mine].

ICC-NARUC Responses to Shreveport

The 1913 Proceedings indicate that state commissioners were beset by the the uncertain implications of the Minnesota and Shreveport cases. Hughes' Minnesota opinion was known; there were no findings that orders of one state resulted in unjust discrimination against another. Sheveport however was pending; the arguments set forth received full coverage in a trade press which followed closely challenges to state and federal regulation of the railroads.

Laurence B. Finn, Chairman of the Railroad Commission of Kentucky gave a substantial address in response to NARUC's rhetorical question (pp. 83-96): "Shall Congress extend the Power and Authority of the Federal Government relative to the regulation of Intrastate Rates?" Finn concluded that the seven-member ICC, charged to regulate interstate commerce, were given "with the most complicated task and gigantic undertaking that has ever been delegated to government employees," and that their duties were already "so multifarious" that their tasks "would be multiplied many times and the additional appointees of the commission would number thousands and be located in every State in the Union" if intrastate rates were added to their workload (p. 84).

Said Finn, implying that he was speaking of special interest groups (p. 87):

> ...There will always be able, shrewd champions advocating a strong or a weak Federal or State government just as they see in either the best opportunity for success. **Those who would have benefited, if exclusive Federal jurisdiction had been recently established, have on other occasions disputed the right of the Federal authority altogether in such matters.** Since Federal regulation cannot be escaped, their powerful influence may be expected to be wielded

> to escape State regulation under the policy of exclusive Federal jurisdiction [emphasis mine].

Finn acknowledged there were "well-meaning patriots who believe in centralizing the power of government." He said it "is the burden of thought of the Nationalists" when speaking of federal supremacy to be "apparently unmindful of the sovereign rights of the States" (p. 87). Finn criticized Hughes' Minnesota opinion for failure to give full attribution to the extent of the states' commerce powers.

In Finn's view, Hughes ought to have given greater attention to the following considerations, which he declared gave ample opportunity for reconciliation of rate conflicts which might arise between the nation and the states (p. 90):

> **...It is true, that the establishment of a reasonable intrastate rate may necessitate the change of an interstate rate, but surely, this is not an "irreconcilable conflict;"** for it frequently happens that the establishment of a reasonable interstate rate, by the Interstate commerce Commission, necessitates a change in other rates...[emphasis mine].
>
> **...If the intrastate rates fixed by the State Commission are confiscatory, still there can be no "irreconcilable conflict" for [under] the terms of the Federal Constitution, the Fourteenth Amendment, an ample remedy is afforded the complainant.** Neither is it possible to confuse the respective jurisdictions, State or Federal, relative to any rates which may be in controversy; **for before the shipment is made a contract is entered into between the shipper and the carrier, which contract, itself, determines the jurisdiction** [emphasis mine].

Finn's statements embodied a sentiment which would be espoused when federal and state officals considered dual regulation of the telephone industry in the next decades. His address concluded with the following admonition (p. 96):

> It will require the full strength of the authorized authority of both State and Federal governments, exercised with wisdom and vigilance, to cope with the ever increasing strength, power and wealth of the public service corporations.
>
> ....
>
> With a heart filled with love for the sacred traditions of our Nation, with an anxious soul fearful that the liberty we enjoy as a heritage from the Fathers will be lessened when the strongest government is fartherest [sic] from the people and the local government impotent to deal with its domestic affairs. I, for one, pray that the evil day of the centralization of governmental powers shall not be permanently visited upon me, my posterity or my fellow-countrymen.

At the 1913 Annual Convention, NARUC extended honorary membership to members of the Board of Railway Commissioners of Canada (1913 Proceedings, p. 96). The two Canadian visitors would briefly comment on the extent of their commission's authority before they listened to a passionate discussion which followed a resolution introduced by Finn with regard to federal regulation of intrastate rates (p. 99):

> RESOLVED, That it is the sense of the National Association of Railway Commissioners that the grant in the Federal Constitution to Congress to regulate commerce among the states is plenary and complete, and that said authority should be exercised by the Federal Government without hindrance from the authorities of the several states; and that the reservation of power not delegated to the Federal Government but reserved to the states authorizes each of the several states to as fully and completely regulate commerce carried on wholly within each state, and that said authority should be exercised by each

> state government without hindrance from the Federal Government.

President O. P. Gothlin, of Ohio, hastily called for an affirmative voice vote signifying approval of the resolution. But the ICC Commissioner John H. Marble wanted to hear some discussion of the resolution from members of the state commissions because he doubted if anyone in attendance was sure what it might imply. Marble thought to transfer all power to regulate commerce to the Washington tribunal would be a fatal flaw of government. Having said that, he seemed to speak from the depths of sentiment (p. 100, 101):

> The states have their part...as much as the national government. We ought also to remember than nothing is more certain in human affairs than that human institutions will change, and that they will be changed by growth, by adaptation of that which is, rather than by any wholesale destruction or any wholesale theoretical reconstruction. **The state commissions...are permanent factors in the scheme of regulation. But...you are going to grow to be something different from what you are now. In the back of my mind always is the thought that as this regulation of the means of communication is after all one work, we will some day have one system of regulation for the entire country. We must preserve what is good in the separate systems that we now have. But what are we going to do with the conditions brought about by the separateness of these systems?...I suggest that as a difficulty with which we have all got to deal.** I am a citizen of a state as much as I ever was. I do not speak as a part of the Federal Government, any more than you are all parts of the Federal Government. This is our game, at which we must all play, and the question is how we are going to have the effectiveness that comes from harmony and uniformity?...
>
> **...We must keep in harmony by consultations such as this, by acquaintanceship, by a general understanding of each others minds, or else by**

> **some establishment of power somewhere, to keep us in harmony** [emphasis mine].

W. M. Barrow, counsel for the Louisiana Commission was not conciliatory to his brethren in Texas. He said the Texas Commission issued rate orders with an "avowed and declared purpose of favoring the Texas jobber and Texas shipper, overcoming advantages which the Texas Railroad Commission say exist, in so far as the Texas shipper competes with the shipper of any bordering state" (p. 102). Therefore, Barrow was implying that the Texas rates were "unreasonable" per se. Barrow, who claimed to be uncertain about the implications of Finn's proposed resolution, was definite in the following opinion (p. 103):

> ...[U]nless there is some remedy and some power in the Interstate Commerce Commission to correct that condition [of unjust, unlawful discrimination], large states like Texas will eventually make the rates for the entire southwestern territory.

Barrow firmly believed that the ICC was empowered to remove the orders of a state commission if findings indicated that its rates resulted in unjust discrimination against neighboring states. George A. Henshaw, of the Oklahoma Commission was not as sure that the ICC should preempt a state rate even if it were to cause problems for traders of an adjoining state's border town. He said (p. 107):

> **If a state rate is not reasonable, it is the duty of the railroad company in Texas to contest that rate, the same as they do in Minnesota, Oklahoma and Missouri....I say that if the rate in the state is too low, let the railroads contest**

> it....While I am on the Oklahoma Commission I propose either to convince the Interstate Commerce Commission that their rates are too high, or I propose to put the state rates in line with them....**If I understand the substance of that decision [Shreveport], they say to the railroads: "you must correct the discrimination. Either extend your Texas rates over into Shreveport, or else contest your Texas rates in the courts of Texas and get your Texas rates raised." The alternative is upon the carrier....I say they must not destroy our entire national fabric** [of dual **regulation**] **on that proposition** [emphasis mine].

Commissioner John M. Eshleman of California thought Finn's resolution was harmless. Eshleman introduced a note of gregarious levity among his peers as he assessed the resolutions's implications: "It merely says that the Federal Government shall keep its powers, and the states shall keep their powers, which of course they will do" (p. 107). Another said the resolution was ambiguous. He not want it to to be construed as "a declaration of war by the states upon the National government" (p. 108):

> **What we need today is cooperation between the state commissions and the Interstate Commerce Commission, to see if we cannot work out some kind of a method which give us the practical advantages...and not to look...for opportunities for conflict** [emphasis mine].

The original motion was tabled by a divided convention on a count of 20 ayes and 19 noes among the active members in attendance and voting.

Regulation of Telephone Companies by

Federal and State Commissions

In a speech before independent telephone operators in 1912, President-elect Wilson's words were received with pleasure because he extolled virtues of competition: "The business of the United States must be set absolutely free of every feature of monopoly" (cited in Mac Meal, p. 196). By 1913, AT&T had completed a vigorous period of acquisitions and mergers which gave the parent holding company control of eighty percent of the telephone subscriber stations operating in the United States (Danielian, 1939, p. 14). Its financial resources, equipment and distribution network were so superior as to bar potential competitors from local and long distance service markets.

Shortly before Wilson took the oath of office as president, the independents would see outgoing President Taft's chief law enforcement officer for the United States, accept AT&T's proposal that its Bell operating companies sustain monopoloy control of the nation's most densely populated and immediately lucrative markets. In 1913, Attorney General George Wickersham accepted a letter from AT&T's vice president, Nathan C. Kingsbury, agreeing to report the company's intentions to acquire independent operating companies to the ICC for the federal commission's advice and directions with regard to accounting procedures, to receive the approval of the ICC with regard to mergers and acquisitions involving independent companies, to facilitate message toll service interconnection for independent companies, and "to respect the rulings of local tribunals." (See Harry B. MacMeal, 1934, The Story of Independent Telephony, pp. 203-232.) In exchange for the

"Kingsbury Commitment" the Justice Department accepted AT&T's monopoly power. The holding company and its subsidiaries were released from threatened federal antitrust prosecution.

Although AT&T's monopoly power was contrary to society's general commitment to competition, state and federal government officials looked upon competing companies as burdening the public by creating business uncertainty. Multiple exchange operations were financially unstable, provided duplicate, often supplied unsatisfactory transmission quality, and were seen as an unnecessary public inconvenience. Emergent legal policy began to be driven by a conviction that technical considerations made the integration of research, equipment manufacture, and the management and distribution of facilities and operations a desireable inevitability. Furthermore, the widespread use of the telephone in the United States was a triumph of private investment and sophisticated business organization in contrast to the experience of government ownership of facilities in Europe.

NARUC began to look in earnest at the issues of telephone rates and service in 1910, with the passage of federal legislation assigning the interstate jurisdiction for telephone and telegraph service to the ICC (Mann-Elkins Act of 1910). The Association's president, Martin S. Decker of New York, wishing to promote closer relations between the state and federal commissions, recommended a special committee to report on telephone and telegraph rates and service (1910 Proceedings, p. 12). Most legislatures had not yet assigned telephone rate-making supervision to state commissions, but the Supreme Court ratified the states' rights to do so (Home Telephone and Telegraph Co. v. Los Angeles, 211 U. S. 265 [1908].) The only state commission reporting jurisdiction and rules over telephone rates and service at that time was Louisiana (1911 Proceedings, p. 213). Legislative reformers, led by states such as Wisconsin and New York, were expanding the work of the state commissions, while they empowered them with greater and broader administrative authority, including rate regulation for an increasing number of public service activities.

A. P. Watson of the Oklahoma Commission delivered a report for the Committee on Telephone and Telegraph Rates and Service (1912 Proceedings, pp. 381-394). In his summary, Watson gave colloquial examples of the difficulty of determining reasonable rates for telephone service as compared to intrastate railroad freight rates in the new State of Oklahoma. His remarks, however, indicate that the commissioners assembled for the convention probably thought the railroad issues were of greater importance (p. 381).

Said Watson of the Oklahoma Commission's recent experience regulating telephone rates and services (pp. 381-383):

> ...[W]e have used all of our energy, as best we could, to prevent two systems in the same town....[W]e find that it is more economical to

the people of our towns and cities to have only one system in a town, and the corporation commission regulates the rates of those [emphasis mine].

...[In some towns and cities where rates have been complained of]...we have to go in and take a valuation of the entire property of that town...[and we]...count off depreciations that were necessary...in view of the fact that **sometimes we have electrical storms, sleet, etc., that break up...lines to a considerable extent. Unless you allow a fair depreciation they can not well build those lines every few years,** as sometimes those unavoidable accidents may occur two years in succession and then again may not occur for four or five years [empahsis mine].

....

...If there are **two or three telegraph systems in a town** we do not find that they **are** of any disadvantage, because it is **not a burden on the people like the telephone business** [emphasis mine].

...When we came to fix the rates...we had to fix the system of the State as a whole, from the fact that we did not know where to draw the line on the operating plant in one city between that of another city....[W]e have under consideration yet, and have not fixed a rate upon the long-distance service. As a matter of fact, we have not finished up that investigation to the satisfaction of the commission sufficietly to fix a rate [emphasis mine].

In fixing rates for telephones we find a great deal of trouble. It is different entirely from the railroad business, because there are no two plants of the same valuation or the same investment. Hence you have to take every system of every plant in each town as a separate one and fix rates for that one line [emphasis mine].

...**I would rather have two railroad systems** like we have in Oklahoma **than the telephone business in the State so far as fixing rates.** It takes a great deal more time and more trouble... because...**you can not fix a blanket rate and do justice to all telephone systems in the State** [emphasis mine].

The formal report of the committee noted that competition had not brought about the beneficial results which its advocates prophesied for it (p. 384). Estimates suggested that at least 250,000 subscribers in communities with competing phone systems were forced to use the service of both companies (p. 385). Companies were required to file for "certificates of convenience and necessity" on the premise that the public benefited from lower prices supplied by a monopolly operation which would eliminate the economic waste occasioned when competition would duplicate an investment in facilities, service, and overhead costs. The report said one unanswered question remained (p. 385):
Would the monopoly find some excuse or subterfuge for absorbing the saving and adding to it surplus and dividends when it filed proposed rate schedules?

The 1912 report continued (p. 386, 387):

> **The evidence in hearings**...in various States **shows** conclusively **that rates have not been built up on any hard and fast rules or strictly scientific basis with reference to cost of service, investment, or the various classifications of the service, but rather have been the outgrowth of adjustments which in the judgment of the companies gave promise of the best results for expansion of business...**[emphasis mine].
>
> **The value and cost of service have necessarily entered, but have not been the controlling features....The dominant factor seen always to have been expansion** [emphasis mine].

The report continued with a series of questions as they might be presented in a notice of inquiry for formal rule making in subsequent years (p. 388):

1. What proportion of present rates shall be considered as an equitable charge for readiness to serve new subscribers?

2. What shall be the measure of difference in the value of service, and how shall it be defined?

3. How shall we segregate the exchange from the toll service?

Of the questions, the special committee acknowledged: [T]o solve them satisfactorily will require much time and patient research (p. 388). The questions are asked today in much the same form as they were asked in 1912. Methods would have to be devised to solve them before any definite conclusions could be reached aboutthe reasonableness or adequacy of rates generally. Rate-making methodology became a substantial source of controversy as the financial stakes grew exponentially across time.

With a measure of optimism, the committee report commented on the ICC's proposed uniform system of accounting (USOA) for telephone companies, saying it reflected a most thorough study and analysis, as well as full comprehension of the needs of the commissions. The report concluded (p. 394):

> **Nothing will more readily aid in the solution of the various problems referred to than a proper accounting system, uniform so far as varying conditions of the country and size of reporting companies**....[emphasis mine].

Joint Boards: Preliminary Commentary

As it has been said in the earlier subsections of this chapter, NARUC's theme was federal-state cooperation. The Association relied on the informal conference method, augmented by organizational committees to study common issues. Recommendations of its committees and conferences, however, had no standing in law. Their effectiveness depended on a mutual commitment to the organization's goals and the persuasiveness of professional peers. However, experienced federal and state commissioners began to realize that the expanded rate-making authority of the ICC after 1906 and the apparent trend in court decisions would lead to more frequent challenges to the states' rate-making practices and greater conflicts between the independent jurisdictions. NARUC's President, Charles C. McChord of Kentucky, laid out this scenario, predating the ICC's Shreveport proceeding, to his colleagues (1908 Proceedings, pp. 11, 12):

> **While this idea of cooperative and concerted action has been so long advocated, it must be admitted that in many respects very little along practical lines has ever been done to put these plans into operation. Until the passage by the Congress of the Hepburn bill...the public was fast reaching the conclusion that regulation of the railroads by the Interstate Commerce Commission was a failure...Now that these additional powers have been conferred and as the intrastate regulation of railroads is so closely allied with that of interstate regulation, it is but natural that the state commissions are looking to the Interstate Commerce Commission for closer**

> **cooperation in the struggle they are making...in their efforts to regulate the railroads of their respective States.** On account of the blind policy pursued by many of the States in failing to properly equip their railroad commissions with sufficient clerical force and expert assistance to aid them to intelligently analyze the result of the operation of the railroads, the average state commission, when it attempts to make rates without such facilities for ascertaining the facts so necessary to be known before a proper conclusion can be reached, is in the most hopeless and helpless condition imaginable in endeavoring to cope with the trained experts of the railroads [emphasis mine].
>
> **...While uniformity of legislation is desirable and important, it is of equal importance that there should be harmony and cooperation among the commissions charged with the duty of administering the laws of the several States and the United States, for it is manifest that if each commission is to be governed by a purely selfish policy and each State is determined to obtain for its own citizens the lowest rates and best service possible without reference to the effect upon rates and service in other States, and without reference to the effect upon carriers of similar regulations by other States and by the Untied States, government regulation will, in the end, prove a failure and both the carriers and the people will ultimately find refuge in government ownership,** which would present problems of much greater difficulty than those which now present themselves for our solution [emphasis mine].
>
> **Interstate and intrastate rates are so closely related that it is almost an impossibility to change an interstate rate without necessitating a corresponding change of some intrastate rate, and a change of an intrastate rate often makes necessary a change of interstate rates...**[emphasis mine].

McChord continued with a sketch of a proposed plan of action for more formal cooperation between the states and the federal government in the regulation of rates (p. 12):

> ...[A] practical and feasible plan of cooperation would be that when complaint has been filed with the Interstate Commerce commission and a copy served upon the defendant carrier, and it is cited to appear and defend at a time and place fixed, the commissions of the States affected by that complaint should be furnished with similar copies and notices and be granted leave to intervene for the purpose of introducing testimony or submitting argument in support of or against the relief sought by the complainant, and, in a similar way, when complaint has been filed with the State commissions which would of necessity affect interstate rates, a copy of such complaint should be furnished the Interstate Commerce commission, and both State and Federal commissions should feel free to call for such information as each may possess bearing upon the subject-matter under investigation. **In short, if the State and Federal commissions are to cooperate in this important work, and if there is to be preserved to the State commissions their present usefulness and the limited powers yet left to them, something tangible along these lines should be agreed upon by this association and should be carried out without further delay** [emphasis mine].

McChord did not dodge the issues of jurisdictional sovereignty in matters of commerce. He was mindful of Chief Justice Marshall's discussion of the dual form of government in the United States, and his admonition in Gibbons v. Ogden 22 U.S. [9 Wheat.] 1, 204-206):

> In our complex system, presenting the rare and difficult scheme of one general government, whose action extends over the whole, but which possesses only certain enumerated powers; and of numerous State governments, which retain and exercise all power not delegated to the Union, contests respecting power must arise....
> **Congress, in that spirit of harmony and conciliation which ought always to characterize the conduct of governments standing in the relation which that of the Union and those of the States bear to each other, has directed its officers to aid in the execution of these laws;**

and has, in some measure, adapted its own legislation to this object, by making provisions in aid of the States [emphasis mine].

McChord continued (pp. 12, 13):

We are accustomed to boast that each of our sovereign States is able to take care of itself in all controversies and that each State must be permitted to regulate its own internal affairs without the interference of the National government. This is all right in theory, but when it is attempted to be applied to the making of...rates and when an order is entered by a State commission that does not suit the railroad manager the State commission soon finds itself in the grasp of the strong arm of the Federal court with at first a temporary restraining order...followed in most instances by permanent orders of injunction restraining the enforcement of its order. Hence it is best that we look the situation squarely in the face, and, whether we desire it or not, we must realize that under our dual form of government the State commissions are at last at the mercy of the Federal authorities in the enforcement of their orders making intrastate rates. Therefore I am firmly of the opinion that the Federal and State commissions should get together in the beginning of these investigations, and by mutually cooperating and assisting each other be in better position to maintain in the courts their respective orders when made [emphasis mine].

While much has been done toward bringing about uniformity of legislation regulating railroad rates and service, much remains to be done in that direction. **Proper cooperation among the various commissions along the lines indicated would do much to cure the evils arising from lack of uniformity of legislation, but to make such cooperation fully extensive it is essential that the powers of the various commissions should be coextensive...**[emphasis mine].

NARUC's Committee on Legislation took McChord's address under serious consideration. Ira B. Mills, of Minnesota, who had attended NARUC meetings since 1893, delivered the following comments to another annual meeting saying (1910 Proceedings, p. 57):

> **The relation of state rates to interstate rates** on the same commodity or class of traffic over the same line of railway **is constantly giving rise to difficulties...[T]he Minnesota rate cases** recently reported **have once more brought this question acutely...before...the public** [emphasis mine.]
>
> ...**[W]e believe that cooperative arrangements can be devised by means of which substantial uniformity in decisions with reference to rates can be achieved on the part of the respective state commissions and the federal commission** [emphasis mine].
>
> ...**[T]he committee believes it should be discussed** exclusively from the point of view of administrative expediency and necessity and **not from the point of view of the many important aspects which the analogous and corresponding political and constitutional questions might raise.** We are dealing with questions of practical work **and not with theories of state and federal jurisdiction and the relative merits of different structures of government** [emphasis mine].

The report continued with suggestions of how more formal coopertive conferences might take place (p. 58):

> ...**[W]e respectfully submit the suggestion that the Interstate Commerce Commission delegate competent persons to cooperate with the respective state commissions in all important rate controversies which involve both state and interstate rates.** Possibly an agent or delegate of the Interstate Commerce Commission might be designated for a particular system or systems of railways...[emphasis mine].
>
> **By having joint sessions** in which the state commissions interested are represented, as well as the representative or representatives of the federal commission assigned to the territory in question, **it will be possible to discuss facts and evidence bearing upon a particular case** in the light of both state and interstate business **and to**

> **suggest changes in rates**, if any, which will establish just relations between state and interstate rates and which will be just to the railways as well as the public. **The committee is inclined to believe** that in the great majority of cases, after a careful examination of facts has been made, **all the participants in the conference will be of substantially the same opinion**, and **that it will necessarily follow that the respective state commissions interested in the case and the Interstate Commerce Commission will promulgate officially the rates suggested by the conclusions of such conference session. Each** State should still be free to approve or disapprove of such conference rates, and the Interstate Commerce Commission likewise **could promulgate or refuse to promulgate such rates. It is suggested, however, that if in any case a state commission or the Interstate Commerce Commission, for reasons sufficient to itself, refuses to promulgate such conference rate or rates, the grounds for such refusal shall be stated in its official opinion disposing of such rate question** [emphasis mine.]

The recommendations of the Committee on Legislation were suggesting federal-state joint rate case hearings, with the implications that the hearings would result in rate orders binding on the carriers, or, at the very least, a body of jointly reviewed evidence which might be used to determine the outcome of a legal challenge to rate-making methodology.

ICC Commissioner Judson C. Clements rejected implications that the existing informal annual NARUC conferences were insufficient to deal with inter-jurisdictional complexities (p. 84). But, it is well to note that two of the committee signatories would subsequently serve as distinguished chairmen of the ICC

(Balthasar H. Meyer, a University of Wisconsin academician who was also chairman of the Wisconsin Commission, and attorney Clyde B. Aitchison was Oregon's only commissioner).

"There ought to be some bond of connection between the state commissions and the National Commission." Although the Committee on Legislation, a year earlier, had eschewed the constitution issues, ICC Chairman Charles A. Prouty did not. He spoke as if the jurisdiction, state and federal, operated with distinct sovereignty in the matters of divided commerce power, saying (<u>1912 Proceedings</u>, p. 5):

> **I have myself often considered whether it would not be possible by law to supplement the one commission with the other, but without any satisfactory results** [emphasis mine].
>
> **...[I]t certainly ought to be possible by agreement to establish some bond of connection, some working arrangement between the State commissions and the National commission, which would at least permit the free discussion of these questions--of the understanding by various State Commissions of the conditions in different parts of the United States, and of the same understanding as the National Comission--so that we might, when a conclusion is reached, act at least intelligently** [emphasis mine].

The Texas and Louisiana Commissions did not send delegates to NARUC's 1911 convention as they had in the recent past. The ICC was in the midst of the ICC's deliberation of Louisiana's petition for relief against rate discrimination brought about by the orders of the Texas Commission. The <u>Proceedings</u> imply that the "old days" of collegial, informal cooperation were irrevocably changing as the states and the nation moved pell-mell into the political-economic turbulence of the next two decades generated by the experiences of Shreveport, war, and a post-war reconstruction of government control of industrial power.

CHAPTER VI

EARLY FEDERAL LAW APPROVING JOINT PROCEEDINGS

(1914-1922)

Introduction and Summary

Introduction

This chapter is the second of four annotated summaries of evidence found in NARUC's Annual Proceedings which can be said to support the thesis statement. It covers the years from 1914 to 1922.

Summary

Attention of the 1914 NARUC convention centered on Shreveport. At the same time state commissions were assuming responsibility for public utility regultion of the telephone industry, they were fending off major attacks on state rate-making autonomy. Interpretations of Shreveport, federal control of the railroads and telephone companies during World War I, post-war legislation, and the behavior of the ICC created a dynamic, sometimes hostile atmosphere with regard to the intergovernmental relationship of federal and state regulatory commissioners.

Working toward restoration of an intergovernmental spirit of cooperation injured in the aftermath of Shreveport, NARUC members petitioned Congress for formal approval to hold joint conferences and proceedings designed to reconcile jurisdictional differences in the approach to regulation of rail transit rates. Legislative activity toward that end was complicated by the idea that the federal government should acquire ownership of nationwide telephone service.

When the United States went to war, President Wilson centralized control of the railroads and assigned federal control of all wire communications to the Postal Service. In the post-war period, Congress took up the unfinished business of consolidating greater federal control of common carrier industries. Federal legislation neutralized the independent authority of the states to determine intrastate railroad rates with the passage of the Transportation Act of 1920.

Nevertheless, Congress supported federal-state joint proceedings (41 Stat. 474 at 484 [1920]; 49 U.S.C. sec. 13[3]). Subsection 13(3) of the statute was written to address railroad questions which vexed the ICC and the states. It was as if by doing so, Congress hoped to lessen the functional damage done to the concept of dual regulation which pre-dated Shreveport. However the Transportation Act of 1920 extended the ICC's authority. By 1921, the federal commission was beset railroad revenue applications, and with Shreveport-like petitions from common carriers determined to slip away from state rate-making jurisdiction to the chaotic jurisdiction of the ICC.

Evidence presented in this chapter has been organized according to the following outline:

1. NARUC in 1914: The <u>Shreveport</u> Doctrine

2. Movement Toward Centralized Control of Public Service Industries: Railroads and Telephones

3. NARUC and Telephone Rate Regulation

4. ICC Chairman, Balthasar H. Meyer and NARUC: Restoring Federal-State Cooperation

5. Subsection 13(3) of the Transportation Act of 1920

NARUC In 1914: The <u>Shreveport</u> Doctrine

The implications of Justice Hughes' <u>Shreveport</u> opinion were the focus of the Twenty-sixth Annual Convention of NARUC, held in Washington, D. C. (see <u>1914 Proceedings</u>, pp. 189-241; 294-360). ICC Commissioner Clements opened the convention saying (p. 2):

> ...[I]t **seems to me there has been no time since I have been an attendant upon these conventions when there was so much need for co-operation as at this time.** I do not mean co-operation so much with respect to the form, or the formula in which procedure may be had, but with respect to the fundamental principles which underlie and must guide our action in respect to concrete principles [emphasis mine].

He used a hypothetical example of a situation not unlike the <u>Shreveport</u> case to say that he was "appealing for co-operation and frank and fair discussion" in order that the federal government and the states might reach some basis of concurrent agreement and uniform action for the elimination of inconsistent jurisdictional rate-making policies even though legislation in each jurisdiction spoke of the attainment of reasonable and just rates as a statutory goal. Implicitly speaking of Shreveport, Clements said (p. 3):

> ...So long as **these inconsistent and conflicting policies dictate the action which shall be taken, one in one State and another in another,** resulting in a situation which must be dealt with by the Federal government, **we will have complexities and difficulties and discriminations and discontent. In my judgment the time has come when earnest consideration should be given to this situation, to the end that causes of complaint due to discrimination and difficulties and embarrassments of this sort may be taken hold of and dealt with in the most vigorous way** [emphasis mine].

Clements, who had attended NARUC meetings since 1892, was agitated. He chided (p. 5):

> **The whole end and purpose of all regulations, as all will recognize, is to promote the ends of justice, avoid unjust discrimination, give a fair return to the carriers for the service they render, and make a fair distribution of the burdens among those whom they serve...**[emphasis mine].

President Laurence B. Finn of Kentucky followed Clements. Perhaps Finn thought his remarks would keep the convention convivial if he set the tone (p. 12):

> ...**The debates which occur in this Convention are never characterized by acrimony** but they are not lacking in that candor which marks conviction. Sufficient publicity of the proceedings which occur here inspire a measure of effort which is praiseworthy; but the occasion affords no forum for the demagogue. **The** basal **principles,** underlying the policy of regulating transportation companies, **are political in their very essence** and yet in this Convention political parties are neither championed nor decried...[emphasis mine].

Finn was certain to set forth the conviction (p. 19):

> ...[C]onflict between the separate jurisdictions **can be eliminated by recognizing the jurisdiction of either Commission in its proper sphere** and its orders binding until set aside by judicial decree.
>
> Waiving any contention that Federal control of intrastate rates is contrary to the Federal constitution, **it is certainly an admitted fact that, as a matter of public policy, the State's interest in the reasonableness of intrastate rates is equal to that of the Nation's....[T]here is nothing novel in the policy of State and Federal governments having concurrent jurisdiction over the same subject matter...**[emphasis mine].

Alluding to those engaged in the business of railroading, Finn recalled (pp. 21, 25):

> **...Captains of industry, leaders of...great commercial undertakings, high officials in great banking institutions and lawyers...have in times past distinguished themselves by bitterly opposing national policies on the grounds that such policies might jeopardize the Nation's honor.** Others have discoursed vehemently against communism and proclaimed with lucidity the noble inspirations incident to the sacred rights of private property. **It now develops that their solicitude concerning the Nation's honor was so overwhelming that they were unmindful of their own; and their chief interest in the sacred rights of private property was to acquire it for themselves** [emphasis mine].
>
> ....
>
> **Charges constitute the most vital element of all transportation problems....A large majority of the public neither own railroad securities nor contract for transportation; yet their interest in transportation charges is the all important feature connected with this great subject. The public buys from some one who pays the freight. The public sells to some one who pays the freight** [emphasis mine].

William D. Williams, a Texas commissioner, introduced a resolution which was intended to become NARUC's formal answer to what was fast becoming a popular interpretation of the Shreveport opinion. He began by citing the trade press for its promotion of what was rapidly becoming known as "the Shreveport doctrine" (at p. 189: The Traffic World, June 13, 1914, p. 1208):

> **In substance the opinion holds: that the Interstate Commerce Commission has power to fix the relation which should exist between a state and an interstate rate, and that when this has been done, the state rate must be adjusted according to the relation so fixed** [emphasis mine].

Patrick J. Farrell, counsel for the ICC who had presented the federal commission's position to the Supreme Court said "the railroad people are putting an unwarrantable interpretaion upon the decision...in the Shreveport case" (p. 301). Farrell suggested that clarification of the status of dual regulation was in order (p. 301):

> **...[I]f it be true that the Shreveport decision does give the Interstate Commerce Commission the control over State rates** that I understand has been contended for by certain carriers, **then I feel certain in my own mind, as a result of my experience, that the Interstate Commerce Commission would heartily join the members of this Association in favoring a law which would bring about a change** [emphasis mine].

Clifford Thorne of Iowa, who would be NARUC's president in 1915, corroborated Williams' view of the situation, however. He said (p. 310):

> Mr. Farrell suggests to your mind that perhaps we are exaggerating the effect of the Shreveport principle as laid down. I hope he is correct, but it is a legal proposition of profound importance to you and to me and to the whole country. **The railway attorneys** and counsel of the Untied States **are insisting that the effect of**

> **that doctrine is that the Interstate Commerce Commission is an appellate court of review for the State Commissions, that they have power to fix State rates, that the effect is to wipe out State regulation;** and it has been followed by cases brought in Minnesota, Nebraska, Florida, Arkansas and other States during the past few months. **If they are able to establish that principle, it means that State regulation is practically dead...**[emphasis mine].

Thorne added (pp. 311, 312):

> ...**The Interstate Commerce Commissioners** are as honest, honorable, able men as you find anywhere; but they **are swamped with work. They have not the power to give one-tenth of the attention to the investigation of the State rates** in Nebraska and Iowa that those State commissions have. **You are having** an examiner out at Sioux City, **a clerk in the employ of the Interstate Commerce Commission, assigned to hear this great case....We do not know what that examiner will report to the Commission. I am not so anxious to have our State schedules wiped off the map with haste and speed...**[emphasis mine].
>
> ...[I]f this so-called Shreveport doctrine goes through, these interstate rates will automatically force the State rates up....**If I was a railroad man I would stop all expense immediately and get an interstate rate fixed, and then invoke the so-called Shreveport doctrine...** [emphasis mine].

Williams condemned the effect on the states' rate-making power which seemed to take place as soon as there was public knowledge of the Shreveport opinion (p. 190):

> **You may as well, as men, face the alternative which confronts** you right now, **of resigning your power to regulate State railroads in any respect** [emphasis mine].

Said Williams, the Court had created a situation certain to cause more conflicts than were solved by the Shreveport Case. He denied that there was any reason why for an interjurisdictional "row between Texas and Louisiana, as if it was a bear-baiting or a bull fight" (p. 191).

Williams went on to propose an amendment to the Interstate Commerce Act which would require a court of competent jurisdiction to declare any state-made rate, rule, regulation to be unreasonable before the ICC could set aside a state rate schedule (p. 198).

Williams claimed the railroads designed a strategic plan to work against the ICC as well as the states. He said, "To use cow-camp parlance the railroads put one over, and got themselves in such shape that if the case went either way they secured an increased rate" (p. 193). Williams told the commissioners that the Houston to Shreveport rates were common to almost all Texas routes. Many of them had been by agreement betwwen the state commission and the railroads in 1898, well before Congress emowered the ICC to order and enforce interstate rate schedules. Williams said the problems might have been reconciled between the two states if Louisiana had chosen to confer with Texas. Instead the ICC listened to arguments made by the Louisiana Commission and the railroad companies. Texas had not been invited to make a response. Therefore, the credibility of the Texas Commission and of state rate regulation had been injured by unfair proceedings (p. 207).

Williams contended that the ICC was ignorant of state-by-state rate-making environments (p. 193):

> Now, I say that **the Interstate Commerce Commission needs help.** It needs it badly. It needs it so that it may localize itself if it is to go on, **so that it may to some extent aquire information and local knowledge so necessary in these traffic matters.** [emphasis mine].

A somewhat acrimonious procedural discussion and debate of the merits of William's resolution took place, with a counter resolution offered by the chairman of the Louisiana Commission, and amendments to resolutions submitted by others. Said Mr. Barrow of Louisiana (p. 204):

> Naturally, **while there is no personal feeling between the Louisiana commissioners and the Texas commissioners**, or between the people of Louisiana and the people of Texas, **we still feel that we are here** not primarily to discuss a question of State rights, but **to perpetuate a decision which absolutely abolishes the greatest State wrong that has ever been perpetrated by any State of the Union upon another in so far as the regulation of commerce is concerned.** That frankly expresses the position of the State of Louisiana in the Shreveport rate case...[emphasis mine].

Barrow claimed Williams' resolution was designed to benefit the State of Texas by undoing the Shreveport decision (p. 205).

John Benton, of the New Hampshire Commission urged caution if the members of the convention intended to make an appeal to Congress. He said (p. 231):

> **...[W]e want very clearly to avoid...the expression of our views on costitutional law...at the same time we want to make a practical suggestion to Congress which may come to some practical result....**At the present time under the Shreveport decision a State-made rate may be stricken down without a finding from anybody that it is unreasonable or unjust in any respect. The Interstate Commerce Commission may simply find that discrimination exists, and order the discrimination to cease, and ipso facto the

> carriers are absolved from conforming to the State-made rate and I think we all agree that that is wrong [emphasis mine].

Benton's statement, sympathetic as it was to the plight of state rate regulation, emanated his political sensitivity to Washington's congressional community. He advocated a two-part strategy throughout his lengthy tenure with NARUC: (a) Refrain from lecturing Congress on constitutional law, and (b) offer the federal legislature a practical compromise when there is a troublesome interjurisdictional issue.

Charles E. Elmquist, of Minnesota, said it was premature to take the resolution to Congress where it would be likely to work against the states if it degenerated into a replay of the Shreveport rate hearing. His motion to postpone action on Williams' resolution for another year failed (p. 307). The NARUC convention suppored the Texas resolution. It did not prevail in Congress. Promoted by railroad trade press and legal community, the alleged Shreveport doctrine became the de facto law of the land:

Movement Toward Centralized Control of Public Service Industries: Telephones and Railroads

At the end of 1914, Postmaster General A. S. Burleson sent a letter to the Senate Committee on Post Offices and Post Roads which would be perceived as a threat by the telephone industry, and a threat to state rate control of telephone rates. Burleson, who was a strong advocate of government ownership of telephones and telegraphs, offered the opinion that communications services must be under government control if the nation were to engage in war. He made his position a source of public controversy when he included it in a letter of transmittal accompanying a departmental report (Government Ownership of Electrical Means of Communication, S. Rep. No. 399, 63d Cong., 2d Sess. [January 31, 1914]).

Although the convention took no formal resolution on the matter, Burleson's view was the topic of the report delivered by the Committee on Telephone and Telegraph Rates and Service when NARUC met again in San Francisco the following year (1915 Proceedings, pp. 135-165). A discussion of the relative strategies state commissions used to enforce telephone rate and service orders followed a general acknowledgment that the question of government control of the nationwide grid would be promoted in some political circles for several years to come (pp. 165-184).

AT&T's President Theodore N. Vail spoke at the 1917 convention's banquet (pp. 445-454). He commended the state officials for their work, saying the future of control and regulation of public service industries depended upon them. Vail understood that while President Coolidge assiduosly proclaimed his intention to keep the United States out of a burgeoning European conflagration, some members of the national government were giving thought about what it would require to mobilize the nationwide public service industries for what would one day be known as the "First World War."

After <u>Shreveport</u>, a general attack was launched against state regulation of public utilities. It was embodied in testimony presented before the "Newlands Committee," jointly appointed by the Senate and House Committees on Interstate and Foreign Commerce. A resolution sanctioning an investigation of government control and regulation of the transportation and communications industries was introduced by Nevada's Senator Francis G. Newlands (S. J. Res. 60, 64th Cong., [July 20, 1916]; text in <u>1916 Proceedings</u>, p. 15). NARUC's president, Robert R. Prentis noted his alarm as he addressed the members, saying (pp. 15, 16):

> **The adoption of this resolution** by the Congress **indicates the** very great progress which has been made in the country in the **deliberate and concerted effort to destroy the State commissions as regulating bodies**, including the taking over by the Federal government of exclusive jurisdiction to regulate intrastate rates.
>
> **The movement has been** under way for several years, and is **inspired by the great railway organizations** of the country...[emphasis mine].

The Association adopted a resolution authorizing the Committee on State and Federal Legislation to appear before the Newlands Committee at the first hearing, November 20, 1916, in Washington. (See a summary of the subjects considered by the Newlands Committee: <u>1917 Proceedings</u> at pp. 114, 115.)

NARUC's President Max Thelen appeared before the Newlands Committee to demonstrate that the testimony of the counsel of the Railway Executives' Advisory Committee was designed as a concerted drive against the authority of the states to "regulate and supervise the purely <u>state</u> rates, service, facilities, equipment, and safety of operation, of all railroads which in any way engage in interstate commerce" (p. 116, citing testimony delivered on December 6 and 9, 1916). The Newlands Committee adjourned without taking action.

Commissioner C. M. Candler, of Georgia, rose to speak to his fellow commissioners, saying (p. 119):

> **It used to be said that there was a twilight zone between the authority of the State commissions and the authority of the Interstate Commerce Commission, or between the State and Federal authorities. I think that was true; but I think in the last two or three years that twilight zone, as far as the State Commissions are concerned, is being larely** [sic] **converted into one of absolute darkness....[I]f the State** commissions are reduced to the position where ...the intrastate **rate is...to be measured solely by the interstate rate, the State commission becomes nothing but a rubber stamp. It can no longer inquire into what, in its opinion and judgement, is a reasonable and just rate. Yet our law compels us to prescribe just and reasonble rates for each carrier in the State** [emphasis mine].

Commissioner Walter A. Shaw, of Illinois noticed that in three years since Commissioner Williams prophesied a trend in federal preemption of state rate-making power, his predictions about the effect of the <u>Shreveport</u> decision had come "true to a large extent." Shaw urged closer working relations between the state and federal commissions if in fact the state commissions were to continue their existence.

As NARUC's president, Max Thelen of California noted when the association met in Washington, state officials wondered to what degree state rate regulation would be set aside in the national interest in the event of war, and what problems would they be left to solve at war's end (1917 Proceedings, p. 15). Although the Newlands Committee was slated to reconvene in December, 1917, the hearings were recessed until January 3, 1919, because war intervened. President Wilson received extraordinary war powers from Congress. Operation of the railroads was consolidated under one of the provisions which became known popularly as the War Powers Act (An Act to Provide for the Operation of Transportation Systems..., 40 Stat. 451, c. 25 [March 21, 1918]). By joint resolution, Congress authorized the President in time of war to supervise or take possession and assume control of the electronic communications system (40 Stat. 904, c. 154 [July 16, 1918]). Burleson's wish to experiment with control of wire communication began on July 31, 1918.

War introduced situations unique to national mobilization of the transportation and communications industries. They were outside this discussion of classic federal-state intergovernmental regulatory relationships. The state commissions were involved to the extent that they supplied information and support to the National Railroad Administration, and listened to the complaints of constituents who discovered disruption in normal rail and telephone service and rates (see statement of Commissioner Charles B. Hill, New York's Second District in 1918

Proceedings, pp. 245-247). The question of how Congress would rate-making authority of the states under the armistace and post-war reconstruction of the economy would remain unsettled until 1920.

It is worth noting that Burleson spoke to NARUC at its 1918 convention one hundred days after he assumed control of telephone and telegraph properties for the duration of the war, and two days after an armistace ended the hostilities (1918 Proceedings, pp. 192-194). When his speech ended, it seemed obvious that Burleson planned to extend the Post Office Department's authority beyond the truce. Burleson did not equate a signing of the armistace with the ratifications of a treaty of peace. Instead, Burleson intended to act upon objectives he described at the convention into a period of "peace and reconstruction" of the industry which he may have surmised would extend for years (p. 193):

> ...The government has no purpose or desire to manage these properties so as to make money out of them. The controlling consideration with the Government is to give the largest and the best service possible at the least cost....It is our purpose in the management of these systems to unify them, to consolidate them, and so to adjust the rates as to be able to take care of the increased volume of business, and when that has been done it is our earnest hope that we will be able so to adjust these rates as to bring about a substantial reduction of them....When we enter upon this program--and we are not at the point where we are going to begin to move--I expect to call on the State commissioners for all the assistance that they can render. I want your co-operation. I want your earnest, sincere and courageous co-operation, because I do not assume to myself the attributes of divinity....I have

> **appointed a commission of the ablest experts at hand to deal with the subject. I want to add to that commission one of the State commissioners on the matter of fixing of telephone rates...**[emphasis mine].
>
> **I want to add another word....You have done splendid work in the past....I want to repeat, it is my purpose in the immediate future to enter upon work in connection with these wire systems that will affect the people of the United States whom you represent. I want to ask your earnest co-operation and your assistance, and while I have not called upon you heretofore because of the character of the work we were engaged in you could not be of any paraticular assistance to us, in these important steps that are now to be taken you can be of assistance to us, and I want to assure** you that **I am not going to hesitate to call upon you, and I believe there will be a response on your part...**[emphasis mine].

NARUC's President Charles A. Elmquist of Wisconsin, graciously afforded these parting words to Burleson (p. 194):

> ...I pledge to you not only the patriotic, but whole hearted assistance of these commissions in the work which you have to do. **There may be differences of opinion which will come up. We hope they may be satisfactorily adjusted. We take your words in the spirit in which they are uttered, and we offer you our willingness to help** [emphasis mine].

Burleson gratuitously presupposed that the states were relegated to subservient status, to perform as required by the federal agency. His tactless statements effectively said: "I am in charge. You have no place yet in this scheme until I say so."

It is doubtful that Burleson understood at that moment the extent to which NARUC's "patriotic" members held "differences of opinion" with demagogic advocacy of centralized control of telephone service and rates. A day earlier, Elmquist told NARUC's membership that Burleson's assumption of rate-making power went beyond the intent of the congressional resolution designed to mobilize industrial power under supervision of a variety of federal agencies. For example, said Elmquist, Burleson usurped authority when he initiated changes in telephone rates without the review of either the ICC or state commissions (p. 35).

Elmquist and other state officials had in mind certain policy adjustments which would restore their pre-war regulatory prerogatives. They believed "federal control of telephone and telegraph properties [would] automatically cease to exist with the coming of peace," and that the "old order [would] soon be re-established" But, in the event that federal control should be extended, NARUC intended to secure legislation which would "admit no dispute" to state authority over local rates and service (p. 35). Elmquist pointed out (p. 36):

> **The reasons for preserving State regulation are even stronger...in the case of telephone... than in the case of the railroads, for telephone service at least, except for the long distance lines, is distinctively local in character...**[emphasis mine].

Elmquist recognized that issues associated with effecting economies for the distribution of telephone service and standardizing rates would occupy the foreground of the federal-state intergovernmental relationship in the near future.

The 1918 convention ended its discussion of federal control by approving the following resolution:

> WHEREAS, it is apparent that the ends sought to be attained by Federal control of telephone and telegraph lines as a war measure have already been satisfied as far as possible, and it is not conceivable that under existing conditions it is desirable that further Government control be exercised pending the return of such properties to State control;
>
> AND WHEREAS, during the short period of such control and operation by the Federal Government there has been practically no interference or change in the corporate organization, management or properties of said telephone and telegraph companies;
>
> AND WHEREAS, pending the natural termination of such Federal control, **the State commissions are embarrassed by the assumption by the Postmaster General of exclusive control over rates** [emphasis mine],
>
> THEREFORE, BE IT RESOLVED, that this Association respectfully recommends to the Postmaster General that the Federal control of the telephone and telegraph lines cease as soon as practicable and military necessity therefor shall have ended.

Telephone regulation would return to the pre-war statutory authority of the ICC and the states on June 30, 1919. The Postmaster General's administration of the operating companies did not increase rates to correspond to the rising costs of the war and post-war years (Stehman, p. 216). AT&T invested heavily in additional toll lines even though newly introduced technology enabled substantially more telephone conversations to be carried on twisted pair wires. For whatever the companies provided, the demand for toll and local interconnections exceeded the supply. Since

Burleson did not raise rates to cover the costs of meeting the demand for wartime services, it fell upon the state commissioners who resumed control under pre-war laws to grant increases in tariffs which would be sufficient to replenish the reserves for maintenance and expansion consumed during the war stimulated expansion. Furthermore, the companies and the commissions would be required to assume the financial reconciliation brought about by higher wage demands and a general post-war inflation.

NARUC and Telephone Rate Regulation

The ICC had been given vague authority to supervize the development of accounting procedures for common carriers which would presumably lead to an estimate of the aggregate value of each of them. The federal agency allocated almost all of its resources to reviewing the accounts of railroad companies, leaving meager resources for telephone investigations. (See 28th--43d ICC Ann. Reports [1910--1920].) Although the Department of Justice had tacitly acquiesced to AT&T's natural monopoly power in the service territories it chose to develop, it fell upon each of the states to apply the requirements of the public utility paradigm and its implicit public service contract. By 1914, many states began to require the companies to file applications for certificates of public convenience and necessity which permitted them to do business as the sole providers of local exchange service in a designated community or along assigned intrastate routes but protected them from the threat of competition in those markets.

The ICC monitored interstate transmission, but limited its involvement with rates to publishing a "Uniform System of Accounts" (USOA) intended to begin to untangle the financial reports of the interstate carriers and large intrastate operating companies, and the variety of local exchange companies, numbering in the several thousand by 1919. NARUC's assistance with the development of the telephone USOA was essential. The state commissions provided experienced staff to accomplish the task.

The USOA promulgated by the ICC for interstate telephone rates, was based on methodology cooperatively drafted in 1913, and refined in 1922. Wheat noted that the methods were generally adopted by the states (p. 847, n. 5). Economists Farris and Sampson attribute the details of the USOA to work done through NARUC's informal federal-state committee structure. They say the 1922 refinements were accepted and adopted in 1925 by forty state commissions (1973, p. 215).

In this period, the ICC seemed to be willing to have the states apply and experiment with the enforcement of the public utility paradigm. For example, in 1913 the federal commission denied a petition to rule against alleged price discrimination in a Pittsburgh petition for review. New local exchange subscribers were required to pay a schedule of rates based on local measured service (based on the number of outgoing calls made to various locations within an extended service area of their local central switching station) while old subscribers were permitted to continue flat rate service (based on unlimited access to all subscribers within the extended service area). Saying there was no discrimination with respect to interstate transmission, the controversy fell outside federal regulatory jurisdiction (Local Commercial Telephone Service in Pittsburgh, Pa., 27 ICC 622).

State commissioners became familiar with the rate-making problems common to regulation of the telephone industry during this period. Excerpts have been selected from a sample of Annual Proceedings to introduce the ideas NARUC members considered as they reviewed the schedule of rates within and among their distinctive jurisdictions. They describe complexities considered by state officials as they designed the basic principles which would be used to approve or disapprove the exchange and message toll tariffs submitted to the state commissions for review.

1914 Proceedings

Rate cases seemed to center on the question of how much a company should earn on the cost of the property invested for the public use. NARUC's Committee on Telephone Rates and Service said it was necessary to develop a system of telephone cost accounting so that monthly reports of the companies would show the actual expense of providing exchange service separately from toll service (p. 361).

Oklahoma's A. P. Watson, speaking for the committee comprised solely of state officials, proposed ascertaining the actual toll and local expenses, then adding to each of them a proportion of the joint or common expenses to represent proper compensation for the cost of connecting and supplying customer terminals to the local network.

The following excerpt of the committee report represents the essential propositions which would drive the issue of separations for twenty years or longer (pp. 361, 362):

> **The matter of a proper compensation for terminal service is one which involves an appreciation of the fact that without the terminal** service, that is, **local exchange service,...toll [service] would be reduced to a minimum;** without the convenience of direct connection from the present day office or residence, toll traffic would be reduced to a negligible quantity. **The ascertainment of a proper compensation for originating the traffic or furnishing the final terminal therefor will finally dispose of that most frequent complaint of the independent companies for what they consider a proper proportion of toll traffic. The matter of rendering decisions in local telephone rate cases will be facilitated by this division, and it is therefore most essential that the accounting orders of both the interstate and state commissions require a separation between toll and exchange expense** [emphasis mine].
>
> **Too much emphasis cannot be placed upon the matter of the necessity of this separation.** It is undoubtedly true that without a proper accounting and a true compensation many local exchanges will show losses from operation....Can it be said that the branch or feeder lines are economic losses?...If the terminal, which originates the telephone traffic or furnishes its final terminal is properly compensated for, or, if the branch line is given credit for its practical monopoly of securing or furnishing the destination for traffic, these superficial losses will be

> obviated. **The proper compensation for a terminal service will relieve the necessity of increasing the local exchange rates when the exchange grows larger, for the reason that additional toll revenues alloted the growing exchange will return a relatively greater amount of revenues to be applied to the increased investment.** It will be remembered that the larger companies have **succeeded in bringing before the public mind both through rate cases and through advertising that the rate must increase practically proportionally with the increased number of subscribers** and any argument in opposition to this idea is bound to draw fiery criticism [emphasis mine].

Some toll service providers said toll connections were worth as much to the local exchange as the exchange is to toll or long distance lines, making it unnecessary for the local exchanges to be compensated. To refute the claim, the committee described a town where one pay station with accesss to toll service earned 800 per cent of the aggregate receipts of 75 local exchange subscriber lines not yet connected to toll. Watson read (363):

> It is the idea of the Committee that in addition to the proportion of expenses, taxes and interest upon that portion of the exchange investment used for terminating or originating toll messages **the local exchange should receive an additional compensation as a profit for its practical monopoly in securing and terminating toll traffic** [emphasis mine].

The committee's report ended by saying reduced rates, adequate service, and remunerative return were the necessary steps to be required by state laws if the tide of sentiment supporting government ownership of the telephone companies was to be stopped.

1917 Proceedings

When they met in 1917, state and federal commission members adopted a change in the official name of their association: "The National Association of Railway and Utilities Commissioners," (and therefore its more familiar acronym: NARUC). The organization had long been discussing subjects pertaining to regulation of other public service corporations as well as railroads. Only one of the member agencies continued to identify itself as a "state railway commission" (1917 Proceedings, p. 303).

When NARUC gave general notice of its intent to be more inclusive of a broader range of public service issues, it divided the discussion of telephone questions among functionally designated committees: (a) Public Utilities Rates, (b) Service of Public Utilities, (c) Safety of Operation of Public Utilities, (d) Statistics and Accounts of Public Utilities, (e) Valuation, and (f) Capitalization and Intercorporate Relations. In doing so it characterized the degree of specialization which was becoming common to the tasks associated with telephone issues as well as matters associated with several other public service industries.

Those attending the first day's session at the 1917 convention heard a comprehensive address treating the topic of the special problems associated with pricing telephone services: "Telephone Rates and the Method of Their Construction." It was given by Guy H. Pratt, speaking as if he were a rate analyst. (The 1917 Proceedings fail to say whether he was a state staff member or a company representative.) Mr. Pratt invited NARUC to examine rate schedules for a number of integrated factors having direct bearing on rates and rate making. He said (p. 31):

> **It is the paramount duty of any public service to produce the greatest good to the greatest possible number.** This involves, in the telephone case, the **giving of the best possible service** to the greatest possible number of people **at a price that will yield a profit to every subscriber** who uses it **and at the same time afford a reasonble return on the value of the property devoted to public service, after deducting operating expenses and setting aside sufficient [reserve funds] to maintain the property in good condition in perpetuity** [emphasis mine].
>
> ....
>
> ...**[R]ates themselves are not revenue and that they are merely a measure of the sums to be paid and to be received if, and when service is actually sold. It is the application of rates or charges to a specified amount of service, when actually sold, which determines the revenue.** I mention this merely to show that rates in themselves, without the operative consideration of other factors, fail entirely as regards the production of necessary income [emphasis mine].

Pratt gave detailed descriptions of factors he thought were critical to rate-making decisions. He did not accept a premise that telephone service rates should be based on either cost of service to each individual user, or a premise that value of the service should dominate structure of rates. Instead, he said it was necessary to get a proper picture of how both cost and value enter into a careful consideration of tariffs (p. 32).

Pratt sketched a landscape of correlated cost and value considerations as part of the rate-making process. He began by dividing basic service categories into exchange service and toll/or long distance service. He said exchange service covers the requirements of a substantial proportion of the users located within the exchange base rate area, which is usually the city limits or a stipulated meleage radius from the central office (p. 32). He then characterized most intrastate interexchange use as toll service of less than forty miles (also called "short haul" toll service).

Then Pratt used an example of how rate making blurs in those instances when the base rates charged telephone users incorporate service to areas beyond the typical local exchange to an extended service area (EAS). He gave the results of an analysis of the traffic between central offices in a city with a population of 100,000 and a community five miles away, of 25,000 persons. 2 1/2 percent of the subscribers made 70 percent of the average 3,000 interexchange calls per day. Only 9 1/2 percent of the total number of subscribers made use of interexchange service at any time. Said Pratt of EAS (p. 33):

> From these figures it becomes apparent that to impose a charge for exchange service which would produce a sufficient revenue [to design an EAS rate structure], it would be necessary to add to the charge of 90 per cent of the subscribers in order that the other 10 per cent might continue to secure a service which, although of great value to them, has no value to the great majority required to pay for it.

He noted that the value of toll service was related to the time of day. Furthermore, he explained the reasons why costs for the physical facilities providing toll services were distance and volume sensitive, as well as sensitive to user categories. Some routes required high capacity trunk lines, others with a smaller volume of traffic could be supplied with branch lines. An assessment of traffic needs by volume and direction was essential to the efficient distribution of toll facilities. The actual intrastate rates themselves represented aggregates determined from the study of toll line routes and traffic. He noted that the public was already accustomed to evaluating toll prices on distance measured in air miles (pp. 39, 40).

Pratt gave three general classifications for users: business, residential, and rural. In doing so, it is here that Pratt exercised judgment supporting value of service at the same time he was "keeping especially in view the effect of rates on service and prevention of wasteful use" (p. 36). He said the volume of use and the value of service within each major customer classification were key elements of pricing a scarce supply of available service. He described subsets within each major class of telephone users but, he said, the comparatively small amount of time a residential station occupied the network accounted for less value contrasted to a high volume business station with its potential for generating income. He described stations which were in fact business private branch line exchanges

(PBXs) instances where tariffs ought to reflect added value.

Pratt spoke about other important factors affecting the rate schedules: (a) general economic conditions of a service area or territory, (b) the specific conditions of nearby exchanges, and the general distances between local exchanges. In doing so, Pratt was alluding to the attention given to promoting widespread telephone subscribership and use in as many localities as possible in the United States.

He said (p. 38):

> The final test of all rate schedules is that they secure necessary revenue and **enable the sale of the maximum amount of service** [emphasis mine].

Pratt closed his address to the 1917 convention having given the basic assumptions which would be adopted as guiding principles to complement the application of the public utility paradigm when state and federal regulators spoke about the allocation of costs and revenues to their separate jurisdictions, and when state regulators reviewed intrastate telephone tariffs from 1917 to 1971. He said (p. 42):

> It will be seen that telephone service is classified into exchange service and into toll service on the basis of the fact that **exchange service as a whole has greater value to the public as a whole and is more universally in demand than toll service and because a comparatively small number of the public require and secure value from toll service** [emphasis mine].

As if Pratt understood that the following concepts would become the foundation for political and economic negotiations which would take place between state and federal regulators and the telephone companies in the future, he added (pp. 43, 44):

> ...It would seem to me that, in the discussion of **cost as a basis**, for rates on one side, **and** of **value as a basis for rates** on the other side, it has frequently been forgotten that the telephone company and the commissions, and the public itself, are absolutely controlled in their action by the economic necessity of adjusting rates to both factors jointly and that because this has been forgotten **there has been a tendency to emphasize one factor to the exclusion of the other**....Admittedly, **the necessity for treating both factors jointly in the rate making makes the task an enormously complex and difficult one,** requiring careful scientific analysis of **underlying conditions and the difficult task of estimating what use would be made of a telephone system when the individual users themselves can not know how much use they will make of it** [emphasis mine].

For the 1917 meeting, the report submitted by the Committee on Public Utility Rates said telephone utilities must stand ready to render any service that may be demanded through their installation. Like railway service, very different values could be attached to different classes of service. The report discussed volume of use and time of day as essential engineering considerations, because "peak loads" determine investments in physical facilities. It addressed the issue of economic efficiency (p. 463):

> **In telephone service as in railroad service the general public is best served by means of companies operating over large areas, portions of which could only have inferior service or none at all if restricted to their own limited resources.** This is a fair proposition on the principle that the receiver and the sender are both benefitted and may properly share in the expense [emphasis mine].

This idea of efficiency contributed to the principle of statewide rate averaging and pooling of revenues to cross-subsidize services extended to rural areas. Those were not public policy decisions simply predicated on charitable motives or to satisfy the demands of a rural politician. Rural areas supplied vital agricultural commodities, raw materials and minerals used to fuel national economic progress, providing the means for a national defense.

The report continued (pp. 463, 465):

> **In the rendering of no class of public service does there appear to be less information as to the rate necessary for the proper conduct of the business than in the management and operation of the average telephone company.** The large telephone companies, which are comparatively few, are as a rule providing reasonable service at presumably reasonable rates. Overwhelming numbers, classed as small or medium, range from farmers' lines serving a dozen subscribers and originally constructed for neighborhood convenience and gradually extended to adjoining territory...to regularly incorporated companies...serving a few hundred subscribers.
>
> ....
>
> **...In no public service is there greater inequality of use than in the telephone service...**[emphasis mine].
>
> ...[Because] it is regarded as necessary in order that a community be properly served that every telephone line have physical connection with every other telephone line serving the same or adjoining territory, the problem of estblishing fair rates of exchange between companies of different grade is a very difficult one. It adds one more complication to a rather troublesome rate problem....**In general the consolidation of telephone companies results in improvement in service and greater uniformity in rates, but local conditions are liable to justify rate differences** [emphasis mine].

There was growing concern for the disparity of living standards between the rural and urban regions of the United States. In the future, disparities would become the focal point of conflict as FCC and state regulators developed separate jurisdictional policies for the nationwide telephone grid. Among many state government officials, access to and the quality of service would be expressed in terms of disparate prices charged for similar intrastate and interstate message toll services. Recalling the tenets of the Shreveport decision, the states would exercise pressure to equalize the prices for toll service based on the length of haul: air distance miles. Furthermore, state officials would press for equalization of prices and service quality between rural and non-rural local exchange customers. It would become public policy to provide subsidies develop rural exchanges because diffusion of affordable telephone service would be viewed as beneficial to the nation's general welfare.

NARUC's Committee on Service of Public Utilites reported that there is a continual demand for better telephone service. What passed for good service five years earlier would be intolerable in 1917. People in different localities held different views as to what was meant by "good service." The report added that it was fortunate, from and engineering cost point of view, that subscribers in the smaller communities were more easily satisfied and were not so exacting as those subscribers in larger cities. The report added this caveat about service quality (p. 517).

> **It should not be expected that telephone service will ever be ideal or perfect. Such service will be impossible so long as the frailities of the human being exist, or mechanical devices wear out or become defective, or improvements in the art are being made.** [emphasis mine].

Some messages traveled along circuits energized by magnetoelectric current generated by hand cranks. Large central offices used step-by-step electical-mechanical switches connected to trunks of twisted pairs of wires insulated against environmental interferences. All messages traveled on anolog frequencies. From time to time, segments of the network failed because of equipment incompatibilities or electrical surges. Technological complexities therefore contributed to the challenges associated with arriving at exchange and toll service rates. The committee investigating services made this recommendation among six others (pp. 520, 521):

> 3. **That inasmuch as some kinds of public utilities, for example, telephone systems, are not confined to state boundaries, some uniformity of standards is desirable, to the end that a single enterprise, doing business in several contiguous states, may not be required to observe a different standard in each state** [emphasis mine].

ICC Chairman, Balthasar H. Meyer and NARUC:

Restoring Federal-State Cooperation

Under the leadership of its chairman, Balthasar H. Meyer of Wisconsin, the ICC took an initiative in support of dual regulation of common carriers when it addressed

Congress with its 30th Annual Report, in 1916. Among its recommendations for amendments to the Commerce Act was this one (p. 92):

> **6. That, without abdication of any federal authority to finally control questions affecting interstate and foreign commerce, the Commission be authorized to cooperate with state commissions in efforts to reconcile upon a single record the conflicts between the state and interstate rates** [emphasis mine].

The report summarized the federal commissions actions in the original Shreveport Case (p. 80), and some of the 50 additional cases presented to the ICC after Justice Hughes' opinion was made public (pp. 83-89). The federal commissioners said they submitted the recommendation as a response to "practical administrative problems which the principles of the Shreveport Case" presented. The ICC was authorized to require carriers engaged in interstate commerce to remove prejudice which the Commission found to exist. The act to regulate commerce said any undue or unreasonable preference or advantage or undue or unreasonable prejudice or disadvantage rendered in the trasportation of passengers or property engaged in interstate commerce constituted a violation of federal law (Interstate Commerce Act of 1887, sec. 2, sec. 3).

The 1916 report to Congress said the federal commission anticipated many more such cases (30 ICC Ann. Rep 89, 90):

> **...Were we to look about for opportunities to apply the principles of the Shreveport Case, we could find them in every part of the United States,** and we have been requested in several instances to institute investigations upon our own

initiative with a view to removing unjust discriminations in such cases just as we have proceeded in scores of other instances on our own initiative to apply remedies with law provides [emphasis mine].

Generally speaking, such situations represent rate questions and economic problems rather thn legal controversies and constitutional issues. **While we are fully sensible of the vital principles of constitutional and statutory law which are inherent in certain aspects of such situations, we believe that every case can, as a practical matter, be disposed of without challenge of these principles of government. In fact, controversies over constitutional limitations of powers and statutory grounds of authority tend to obscure the real elements of the rate problems presented and in which the public is primarily interested in these cases. The vital question is, What is the nature of the problem, and through what agencies and by what methods can that problem best be solved in the interest of the whole public?** [Emphasis mine.]

...In the Shreveport Case proper,...we had the assistance of the authorities of only one of the states concerned in addition to counsel for interested parties. **In other cases, involving the same principles, we have had the active cooperation of the respective state commissions.** This cooperation was entirely voluntary and **without status under the act to regulate commerce,** except in so far as the respective state commissions acted in the capacity of interested parties of record [emphasis mine].

Viewing the entire situation as it has been depicted in proceedings before us, affecting widely scattered localities and territories throughout the United States, **we believe that without abdicating any of the federal authority to finally control questions affecting interstate and foreign commerce we should be authorized to cooperate with state commissions in efforts to reconcile upon a single record the conflict between the state and the interstate rates. We believe that procedure like this,...will go far to meet the requirements of the rate situation as it is presented in this country to-day** [emphasis mine].

His presentation seems to be a familiar reflection of one similarly made in 1910, by NARUC's Committee on Legislation (above, p. 151). Then, Meyer was chairman of the Wisconsin Commission, and a member of the that committee.

The Annual Report indicated that ICC had experimentally invited state commissioners to cooperate with ICC in joint hearings when Shreveport-like complaints were brought to the federal commission. The outcomes tended to be mutually beneficial to interjurisdictional harmony and the practical reconciliation of rates. However, "cooperation was entirely voluntary and without status under the act to regulate commerce, except in so far as the respective state commissions acted in the capacity of interested parties of record" (p. 90).

Meyer gave the welcoming address to the 1916 NARUC, as was the tradition of the ICC's chairmen since 1889. He noted the convention grew from its original number of twenty-eight state commissions at the fist meting to forty-seven state commissions that year (1916 Proceedings, p. 3). Meyer said the great emphasis on rate problems was obscuring the vision of "symmetry in legislation" but was a practical reflection on the proposition that "rates have a connection with pocketbooks" of users and owners of the railways (pp. 3, 4).

Meyer came to deliver the same proposition to NARUC that the ICC intended to deliver to Congress. There is little doubt that his earlier affiliation as a state commissioner and president of the association colored his attitudes about the concepts of dual regulation and the principles of just rate making while it sustained his appreciation of state regulatory autonomy. Furthermore, Meyer earned a doctoral degree in political economy from the University of Wisconsin during the period when the State of Wisconsin led the nation in the development of progressive public utility rate-making principles (McCarthy, C., 1912, The Wisconsin Idea).

The challenge, of course, was how to establish rates which were just for each and among the two spheres of federal and state governmental jurisdiction? He was compelled to address the rate-making relationship that existed between the state and interstate commissions, saying (p. 6):

> **I believe, with you, that our common work requires the fullest co-operation between us. Our work, our aims and our pruposes are one. At this moment, and in this presence, it is probably impossible to say a word on the subject of co-operation between the state and interstate commissions without suggesting the name "Shreveport."** Before 1906, when the Interstate Commerce Commission was without authority to prescribe rates for the future, it was practically impossible for conflicts to arise out of Shreveport situations, and the situations themselves were perhaps relatively rare. Since that time **both state commissions and the interstate commission have become active in rate matters, and Shreveport situations could not possibly have been avoided under existing methods of procedure and in the present state of the law** [emphasis mine].

As you know, there are some rates and interstate rates that have little or no relation to one another. There are also state and interstate rates, like those in the original Shreveport case, which are so closely related that they must be one if unjust discriminations shall be avoided [emphasis mine].

Using "Shreveport" in a generic sense to mean those instances when the ICC was required to judge whether or not state-made rates created an undue burden to interstate commerce, Meyer said he believed that it was possible for state and ICC commissioners to sit down and work out Shreveport rate problems if they would simply set aside the controversies about sovereignty, constitutional and legislative power. He suggested that a promising step in the direction of progress in railway regulation, "namely in Shreveport cases" was "to give our joint and co-operative efforts a definite legal status." The purpose of the cooperative proceedings would be to find one rate "within the zone of reasonableness" which would forestall the congressional involvement in issues where there were complaints that the states were engaging in capricious rate-making practices with unlawful consequences. He concluded his comments saying (pp. 7, 8):

...I shall not attempt at this time to discuss the details, but leave you with this general suggestion of providing a legal basis for co-operation between the state commissions and the Interstate Commerce Commission in all proceedings involving the principle of the Shreveport case.

...With respect to this suggestion...of providing a status by law for co-opertion between the state commissions and the Interstate Commerce

> **Commission, I am hapy to be able to say that I speak not only for myself, but in an official capacity for the Interstate Commerce Commission** [emphasis mine].

At the 1917 convention, Charles E. Elmquist, Chairman of the Executive Committee took up the proposition recommended by Meyer and the ICC. He said (<u>1917 Proceedings</u>, p. 13):

> Most of the people who have made a study of regulation realize that it is not as efficient as it should be. There must be some way to effect real co-operation between State and Federal governments particularly in the construction of rates....If that is going to be the sense of this Association, there must be some effort made to have the State commissioners work in conjuction with the commissioners...so that you can complete a harmonious and uniform schedule of rates through a certain geographical section of the State. If the members would give thought to the suggestion of co-operation, and submit their opinions to that committee, I believe the committee can work out a really helpful program to present to the Newlands Committee. **We cannot reach the problem by saying that the Constitution will not permit Congress to deprive the States of the power they now have. We should be big enough to view the transportation problem as it really is, and try to work out something that is useful and helpful** [emphasis mine].

NARUC's Executive Committee introduced a formal resolution for approval of a formal resolution to that effect the following year. Apologetically, Elmquist said it was necessary to do so because in the ensuing year "no action was taken; at least, no results were obtained" from the committees who were thought to be following through with the 1917 recommendation. But, a review of the <u>1917 Proceedings</u> shows that there was no formal resolution proposed then which would require action (see actual text, pp. 124-125). The association incidentally delayed giving its formal support for a statutory amendment granting legal status to formal cooperative proceedings until 1918 (1918 Proceedings, p. 183):

If Elmquist was embarrassed by the failure of the 1917 convention to take a formal stand, he made certain that a definite resolution was adopted in 1918 (p. 183):

> Wheareas, it appears desirable in the public interest that authorization should exist for effective co-operation between the Interstate Commerce Commission and the Commissions of the several States having jurisdiction over intrastate railroad rates in cases where discrimination beteen interstate and intrastate rates might otherwise exist; and
>
> Whereas, such co-operation can now be secured only to a limited extent, and then only by voluntary action, for which no provisions exist in the statutes; and
>
> Whereas, the Interstate Commerce Commission, in its annual report for the year 1916, among its recommendations to Congress recommended as follows:
>
> "That without abdication of any Federal authority to finally control questions affecting interstate and foreign commere, the commission be authorized to co-operate with said commission in efforts to reconcile upon a single record the conflicts between state and interstate rates;" and
>
> Whereas, it is believed that legislation along these lines will go far to meet the requirements of any such rate situations;
>
> Be it resolved, that [NARUC's] Special War Committee be, and is hereby directed to confer and co-operate with members of the Interstate Commerce Commission in bringing said matters before the Federal Congress and the Director General of Railroads, with the view of securing the necessary statutory authority for effective co-operation

> between the Interstate Commerce Commission and the regulatory commissions of the several states.
>
> Be it further resolved, that it shall be the duty of said committee to inform the members of this Association, from time to time, of any such legislation proposed for enactment by the Federal Congress, and that such notification shall be full and timely and that all members of the Association shall have full opportunity to appear and be heard on all such proposed legislation, and to take such action in regard thereto as they may deem best for the public interest.

Meyer's 1916 recommendation on behalf of the ICC had been introduced to Congress at a time when the railroads were calling for an investigation of state rate-making practices, using Shreveport and publicity from similar rate-related cases to make a case that state commissioners were generally committed to the selfish interests of intrastate constituents at the expense of the requirements of interstate business. Many of the appointments to the ICC in those years were of men who came from NARUC's leadership: state commissioners. The prolific self-serving motives of the railroad industry and other enemies of state regulation seemed to be politically persuasive in the congressional offices and meeting rooms.

In 1917, the states thought the Newlands Committee report would lead to proposed legislation recommending the effective elimination of the states' jurisdiction over intrastate rates of the railroads. Nevertheless they would put up a fight against the erosion of their traditional role in railroad rate regulation.

Anticipating Amendments to the Commerce Act

In the the first year after the war, there were calls for extensive revision of federal codes, including major amendments to the Interstate Commerce Act. The most significant change, for purposes of this study, was the result of hearings before the Senate and House during a special session of Congress in 1919, with the subsequent passage of the Transportation Act of 1920 (cited below, p. 202). Activity before Congress was bent toward restructuring legislation to facilitate consolidations and mergers in the rail and telephone industries, vesting greater central authority in the ICC.

Charles E. Elmquist, president of and counsel for the association, acted as principal spokesperson for state interests in matters before the ICC, Congress, and other significant groups affecting federal policies. He testified at hearings set to deliberate the character of post-war legislative reform (Return of the Railroads to Private Ownership, p. 1589 [H.R. 4378 and S. 2906, 66 Cong. Sess. 1; known as "Esch-Pomerene" and "Esch-Cummins" legislation]) which preceeded adoption of the Transportation Act of 1920 In his report at NARUC's Thirty-first Annual Convention in Indianapolis, Elmquist iterated the lengthy set of proposals he had presented to key members of Congress (1919 Proceedings, pp. 197, 198). One among them was the following:

> Fourth, that the Commerce Act be amended so as to provide for co-operation between the Interstate Commerce Commission and the state commissioners affected in the establishment of non-discriminatory state and interstate rates. "In such cases," the report [before Congress] reads, **"the state commission must be permitted to regulate purely intrastate rates and the Interstate Commerce [sic] must regulate the interstate rates; each must exercise exclusive jurisdiction. If the adjustment of rates made after a hearing results in an unjust discrimination between state and interstate commerce, the remedy is for a complaint to be filed with the Interstate Commerce Commission praying for the elimination of the unjust discrimination. If, upon the other hand, the carrier believes that the intrastate schedule is confiscatory it will be able to protect itself in the courts"** [emphasis mine].

In 1919, Elmquist opened the convention with these remarks (p. 9):

> Just now **Congress is a storm center. Every crank is on the scene with his particular pet scheme.** They are as multifarious as an armful of toy balloons...[emphasis mine].
>
> **Congress is about to kick the anti-trust law into the middle of the ocean...**[emphasis mine].

Elmquist explained how actions prematurely taken by the states, acting in anticipation of the return of intrastate rate-making authority, were twisted by the advocates who wanted either central authority of rate-regulation vested in the ICC, or wanted outright government ownership of the railroads. To illustrate, he said (p. 10):

> **...The last session of the North Dakota legislature passed a maximum rate law which prescribed rates much lower than those intitiated by the Director General [of the Federal Railroad Board]. Comparisons between the North Dakota schedule and the present [Railroad Board] rates have been made by the railroads and are freely circulated in congress for the purpose of showing**

> **that the North Dakota rates impose an undue burden on interstate commerce.** At present we hear more about the North Dakota rate law than any other action taken by a state within the last two years [emphasis mine].
>
> **The experience is used to demonstrate the necessity of giving to the Interstate Commerce commission full and exclusive power over all rates.** Of course, these [North Dakota] rates cannot go into effect during the period of federal control. The question of their legality remains to be settled when the roads are returned.... **However well disposed the North Dakota legislature might be, the fact remains that its action has embarrassed the friends of state legislation** [emphasis mine].

Elmquist said too many members of Congress were unaware of the specific responsibilities of public service regulation in the states. He urged them to make personal contact with their respective congressional delegations if they hoped to match the extensive efforts of the groups who were lobbying Congress for the diminuation of state rate-making power. The legislative reform was not limited to railroad issues. But, in many instances, proposed legislation gave the ICC expanded authority to regulate aspects of the telephone industry. For example, one proposal called for the ICC to establish accounting practices which would require telegraph and telephone companies to use accounting practices developed by the federal agency which would prescribe the manner in which depreciation would be calculated. (The provision became Subsection 20[5] of the Transportation Act.)

In his explanation of the pending transportation regulation reform law, Carl D. Jackson, Chairman of the

Wisconsin Commission and of the NARUC Committee on State and Federal Legislation, said this of the Esch-Pomerene bill (p. 199):

> **The consensus of opinion...was that, assuming the constitutionality of the bill, it would deprive the states of practically all their powers over the railroads and wires, including the smaller telephone systems even. The bill retains the general exception now in the act respecting intrastate commerce, but a number of the provisions are inconsistent with the exception, and according to the interpretation of similar provisions...by the Supreme Court, the [preemptive] provisions will govern** [emphasis mine].

Moved by Jackson's analysis, an ad hoc committee, formed after a round-table discussion of telephone rates, proposed the following resolution. It won unanimous support from the members present and voting (pp. 227, 228, 235):

> WHEREAS, There is now pending before the Congress of the Untied States legislation for the regulation of the telephone companies of the country, and
>
> WHEREAS, There are more than 43,000 operating companies in this country and approximately 85 per cent of the telephone revenues of said companies are derived from strictly intrastate business, and there are now well established and efficiently managed regulatory bodies in almost every state in the Union through whom the people and companies can receive prompt attention and redress upon all complaints, and changing conditions as they may arise, and
>
> WHEREAS, The telephone regulatory problems of the country are very different from the railroad problem and the imposition of an extension of thepowers of the Interstate Commerce Commission to all telephone companies would necessitate a greatly increased organization of the Interstate Commerce Commission and would tend to supplant the present efficient regulation by state authority.

THEREFORE, Be it resolved by this Association in convention assembled that it is the opinion of this convention that the interest of all persons concerned will be best preserved by the enactment of laws embodying the following principles:

First--That the regulatory powers of thestates as now existing be diligantly safe-guarded:

Second--That the powers of the Interstate Commerce Commission should not be burdened with security issues and consolidations affecting the great mass of companies in this country who are carrying on primarily a local business.

Third--That the laws governing the regulation of the telephone companies should be considered separate and apart from the laws governing the regulation of railroad companies [emphasis mine].

As Fred J. MacLeod pointed out, there was a drastic contrast in jurisdictional performance of the two industries: (a) The amount of interstate traffic contracted by the railroads amounted to more than eighty per cent of the nationwide business, and (b) interstate telephone traffic accounted for only two percent of the nationwide traffic (p. 229).

Fred W. Putnam of Minnesota ventured that it was possible that extension of the ICC's power could place control of the telephone facilities in private exchanges, business concerns and homes in the various states and cities. Therefore, said Putnam (p. 230): "We believe for that reason that there should be an entire separation of the laws.

Clyde B. Aitchison, Chairman of the ICC, stood prepared to stand with the state members on their resolution, saying (p. 231):

> **I simply want to call the attention of the convention to the fact,...that the Interstate Commerce Commission now stands charged with certain duties under the Act to Regulate Commerce with respect to both telegraph and telephone, duties which it cannot perform** [emphasis mine].
>
> **These companies are charged with obligations under the Act to Regulate Commerce to make returns, but by some singular chance they are not required to file tariffs with the Commission**, and consequently every provision of the Interstate Commerce Act which has to do with the observance of fixed rates does not apply to them, and we do not know what their rates are. **We do not know and cannot tell whether they are discriminating or not, or what their charges are. Manifestly there is a gap that ought to be filled** [emphasis mine].
>
> The Interstate Commerce Commission in suggesting to Congress the desirability of filling this gap, certainly has not the slightest intention of undertaking the impossible problem,--impossible because certain of its members have had knowledge at first hand of the administration of the problem, which shows it is impossible to attempt the policing of the local telephone exchanges throughout the country. But before this thing is disposed of in a cavalier fashion and tossed off with the assurance that the states might handle the whole telephone situation, **I want to suggest one thing for consideration, and that is that the great company which controls it all, under the toll system, the American Telephone and Telegraph Company, is not under the jurisdiction of any State Commission, and if the Federal government is unable to take over that organization, which is the controlling agency of all, why that company is going to go without any regulation whatever** [emphasis mine].

MacLeod pointed out that the resolution intended to provide for necessary extension of the federal control over interstate rates and practices so as to give the ICC the needed additional authority which was presently absent to exercise control over interstate business conducted by AT&T Long Lines or AT&T's larger subsidiary operating companies which extended interstate operations to as many as six different contiguous states. The NARUC committee simply did not want the states to be stipped of rate regulation for intrastate toll or the 43,000 local exchange companies (pp. 232, 233).

Toward a Theory of Cooperation:

Subection 13(3) of the Transportation Act of 1920

(The Act to Regulate Commerce, as Amended February 28, 1920, by Section 13[3]; 41 U.S. Stat. 474 at 484 Sec. 416[3]; 66 th Cong., 2d Sess. Ch. 91.)

From the analysis of the effectiveness of Subsection 13(3) of the Transportation Act of 1920 given by Martin L. Lindahl when he wrote his doctoral dissertation, in 1933, one can infer that the law was bittersweet for state members of NARUC. It codified the Shreveport doctrine, effectively ending the states' autonomous authority to set interstate freight and passenger rates (subsec. 13[4]; see above, p. 160). Lindahl looked at the effects of Subsection 13(3) on the performance of the railroad industry rather than on its political or philosophical design.

Subsection 13(3) required the ICC to notify state authorities when rates made by them were in issue. In consideration of the federal-state intergovernmental relationship, the ICC was authorized to engage in joint hearings whenever a state's rate-making authority could be affected by a decision made by the ICC. Said Lindahl (p. 346):

> ...**[The ICC] was given authority to prescribe intrastate rates in order to remove undue prejudice against persons and localities in interstate commerce or 'any undue, unreasonable, or unjust discrimination against interstate or foreign commerce'** [subsec. 13(4)]. **The ICC was authorized to supervise the aggregate revenue requirement of any railroad company that provided any interstate service by assuring the company a reasonable overall rate of return** [subsec. 20(5)].

Presumably, the provisions of the Transportation Act which gave the ICC preemptive power over railroad rates could be applied also to telephone rates. One of the principal purposes of the legislation gave the ICC power to supervise the aggregate revenue requirement of any railroad company engaged in any way in providing interstate service by assuring the company an overall rate of return on its interstate and intrastate operations. It was for this reason that Subsection 13(3) became a pivotal provision as far as a more formal restructuring of federal-state cooperation as an integral part of the intergovernmental relationship between federal and state public service regulation took place.

Subsection 13(3) was prescriptive. If cooperative mechanisms were to be engaged, it would be the ICC's discretion. The subsection read:

> ...The Commission **may confer** with the authorities of any State having regulatory jurisdiction over the class of persons and corporations subject to the Act with respect to

> the relationship between rate structures and practices of carriers subject to the jurisdiction of such State bodies and of the Commission; and to that end is authorized and empowered, under rules to be prescribed by it, and which may be modified from time to time, to hold joint hearings with any such State regulating bodies on any matters wherein the commission is empowered to act and where the rate-making authority of a State is or may be affected by the action taken by the Commission....[emphasis added].

Lindahl said Congress provided the legal basis for cooperation between the state and federal agencies "to safeguard the interests of the states and to utilize the services of the state commissions in the administration of this more comprehensive regulatory statute [the Transportation Act], whose provisions vacated some powers formerly exercised by the states" (p. 345). He added (p. 346):

> **It was contemplated that the method of harmonizing conflicting views through deliberations upon a joint record,** already successfully tried in rate cases prior to 1920, would be employed as the regular procedure. **Utilization of the facilities and services of the state commissions, while not mandatory upon the Commission, is designed to enhance the efficiency of administration and to promote cooperation in general** [emphasis added].

Although the opportunity to test the new provision authorizing cooperation came sooner than expected, it was apparently not fully taken advantage of. After hearings where state commissioners were invited to comment, the ICC granted approval for a general rate increase to all railroads engaged whatsoever in interstate commerce

(Increased Rates, 58 ICC 220 [1920]; commonly known as Ex Parte 74).

Most states attempted to accommodate the rate increase orders to their intrastate tariffs, but some state commissions could not immediately follow suit because of statutory limitations enacted by their legislatures prior to 1920. Therefore, the railroad companies who were denied immediate intrastate increases to complement the interstate orders sought injunctive relief in the regional federal courts against the states that did not authorize the increases. Furthermore, during the periods of the federal injunctions, some states simply "froze" rates, refusing to attempt to regulate matters which were traditionally intrastate rate issues.

The "frozen rate cases" engendered bitter resentment against the Transportation Act and the ICC by state officials. The states had assumed that the ICC would use Subsection 13(3) to spread the period of adjustment to the new rate-making law so that states with maximum and minimum rates set by their legislatures would have time to modify the intrastate schedules. Such was the case, for example, of Wisconsin, whose legislature was not in session at the time of the ICC's orders.

Letters which traveled back and forth in 1921 between NARUC's general solicitor, John E. Benton, and the ICC's chairman, Edgar E. Clark, convey muted antipathy. (Railroad leaders had lobbied hard for Clark's appointment. They did not want the new chairman of the federal agency to be from the ranks of the progressive state railroad and public utility commissioners [Traffic World, January 23, 1920, pp. 191-194]). The letters contain their comments about how and when officials of the federal and state agencies would practically negotiate even the working rules necessary to make the cooperative provisions of Subsection 13(3) apply to matters such as Ex Parte 74 (see 1922 Proceedings, pp. 304-313).

Harry G. Taylor, NARUC's president, recalled in his opening address three years later (1924 Proceedings, p. 13):

> **Overtures for a closer understanding between the state and Federal tribunals were so formal and restrained as to excite distrust rather than allay it....Indignant and somewhat strident declarations of rights by state commissioners were met with what appeared at least to be rather prideful gestures of complete sovereignty by the Federal body. It was not a happy situation** [emphasis mine].

Benton repeatedly offered the cooperation of the states, but summed up the ICC's responses by saying "The Interstate Commerce Commission proceeded to order investigations in the same manner as previously, without inviting conferences with or suggestions in writing from state commissions involved." Benton drew the following conclusions for the Special Committee on cooperation of State and Federal Commissions (1922 Proceedings, pp. 311, 312):

> ...[**The ICC**] is...by action of the majority of its members taken in the several cases [and subsequently brought before the federal courts]

involving alleged discriminatory state rates, **committed to the proposition that it has full power to review such rates, not only as to their discriminatory character as affecting persons or localities, but also as to their reasonbleness from a revenue point of view.** This claim of power has been sustained by subordinate federal courts, **and the [ICC] expects it will be sustained by the United States Supreme Court** [emphasis mine].

If that commission does in fact have power to deal with intrastate rates without restraint, it may well take the view that it is unnecssary and perhaps unwise to invite to sit with it, upon hearings involving such rates, those who can exercise no power to determine what the rtes invoved shall be in the future. Whatever may be the reason for its position, **that commission is not now disposed to enter upon cooperative hearings in proceedings before it involving state rates** [emphasis mine].

....

The desirability of...cooperation, however, **rests upon the assumption that there is a field within which the federal commission can not act. In order thant joint hearings may work out satisfactorily, both state and federal commissions must have well recognized powers and responsibilities.** If they have such powers and responsibilities, then, without a surrender of the same on either side, **they may conduct** joint **investigations for the purpose of devloping the facts, and of reaching agreement as to how their respective powers shall be exercised** [emphasis mine].

On the other hand, however, if the power of the federal commission is dominant as to all state rates, the desirability of joint hearings is open to serious question. In that case state commissioners sitting with the federal commission would be under the restraints imposed by considerations of courtesy which would unavoidably arise from the fact of their participation upon invitation in procedings with respect to which they could exercise no power, and hence could have no final repsonsibility. In the opinion of this [special **NARUC**] **committee cooperative hearings are not desirable under such circumstances** [emphasis mine].

The Wisconsin legislature froze intrastate rates in anticipation that the ICC would negotiate a mutual adjustment of overlapping interstate-intrastate rates. But the ICC chose not to cooperate. The carriers proceeded to adjust the intrastate schedule upward. Wisconsin sought to enforce its state rate requirements. The carriers sought injunctive relief. The situation burgeoned into the most best remembered of the frozen rate cases (Railroad Commission of Wisconsin v. C. B. & Q. R. Co., 257 U. S. 563 [1922]). Its most immediate effect was the "spirit of antagonism" state commissioners held for the failure of the ICC to procede with cooperation immediately after Ex Parte 74, for Wisconsin was noted for its progressive application of rate-making theory. Furthermore, its commissioners were consistent supporters of intergovernmental harmony (1929 Proceedings, pp. 47-48).

In the Wisconsin opinion, Chief Justice Taft said railroad companies were entitled, according to the Transportation Act, to seek a fair rate of return from the aggregate income of intrastate and interstate activies (at 586). Referring specifically to Shreveport, Taft said the ICC was within its power to alter intrastate rates when it was necessary to exercise "complete effective control over interstate commerce" (at 588). However, Taft chided the ICC because it failed to make proper use of the cooperative mechanisms provided for in Subsection 13(3) (at 563):

> ...[A] conference between the Interstate Commerce Commission and the state commissions may dispense with the necessity for any rigid federal order as to the intrastate rates, and leave to the state commissions power to deal with them and increase them or reduce them in their discretion.

Although the Supreme Court upheld the preemptive effects of the ICC's Ex Parte 74 order, it also said that the ICC's congressionally conferred power should not be construed to involve general regulation of intrastate rates (at 590, 591):

> ...Action of the Interstate Commerce Commission [in matters involving intrastate rates] should be directed to substantial disparity which operates as to real discrimination against, and obstruction to, interstate commerce, and must leave appropriate discretion to the state authorities to deal with intrastate rates as between themselves on the general level which the Interstate Commerce Commission has found to be fair to interstate commerce.

The ICC took quick notice of the Court's emphasis on federal-state cooperation. The Courts' decision was handed down on the 27th of February, 1922. On the 7th of March, Chairman C. C. McChord of the ICC (and NARUC's president who, in 1908, forecast the necessity for legislation such as Subsection 13(3) addressed a letter to NARUC's president, Carl D. Jackson, who was also the Wisconsin Commission's chairman, saying (1922 Proceedings, p. 427):

> **In view of these declarations by the court and of the provisions of paragraph (3) of section 13 of the Interstate Commerce Act, we should be glad if a conference could be arranged in the near future between a committee representing your Association and committee representing this Commission....**

> **We wish in particular to consider what can appropriately be done in furtherance of the view expressed by the Supreme Court** [emphasis mine].

NARUC's President Jackson consequently appointed a special committee of NARUC to confer with a special committee of the ICC. A preliminary cooperative plan was announced on May 3, 1922 (see 1922 Proceedings, pp. 428-431). The plan stated the following (pp. 43, 44):

> **Co-operation is but the working together for a common object or to a common end or result, which end or result is the best possible regulation of the railroads and utilities mutually under the jurisdiction of the respective federal and state commissions** [emphasis mine].
>
> Public regulation of our railroads is performed in part by a commission representing the federal government and in part by commissions representing the various states. **Conflicts of jurisdiction between the two systems of public regulation have arisen from time to time, resulting in litigation and action by the courts; but the federal and state commissions were alike created in the public interest and have a common purpose namely, the maintenance of a transportation system which will in all respects best meet the public needs. In view of this common purpose they should, and we believe they can, work together for its attainment without conflict or resort to litigation. Such co-operation is contemplated by the Interstate Commerce Act as interpreted by the Supreme court, and is highly desirable in the public interest** [emphasis mine].
>
> **The prime essential to such co-operation is realization of the nature and difficulties of the common problem. The state commissions realize that the railroads form a national transportation system which is not split into parts by state lines and that the public interest demands a rate structure, state and interstate, as simple and harmonious as practicable. The Interstate Commerce Commission realizes that there is danger in over-centralization of authority, that the field of regulation is vast, and that the state commissions are often better informed than itself in regard to local conditions and local needs.**

> **In one of its most important aspects, co-operation must look forward to and have in view the voidance, so far as the public interest will permit, of orders under Section 13 of the Interstate Commerce Act, affecting _intrastate rates_** [emphasis mine].
>
> Paragraph 3 of section 13 of the Interstate Commerce Act authorizes the Interstate Commerce Commission to avail itself of the cooperation, services, records, and facilities of state commissions, to confer with them with respect to the relationship between rates structures and practices of carriers, and to hold joint hearings with them "where the rate-making authority of a State is or may be affected by the action taken by the Commission." **Our common purpose is to give the utmost force and effect to this provision of the law** [emphasis mine].
>
> ...[C]**o-operation between the Interstate Commerce Commission and the state commissions must in the nature of things be of the spirit and not a matter of rules and regulations,**...[emphasis mine].
>
> Public regulation of our railroads is performed in part by a commission representing the various states. **Conflicts of jurisdiction between the two systems of public regulation have arisen from time to time, resulting in litigation and action by the courts; but the federal and state commissions were alike created in the public interest and have a common purpose, namely, the maintenance of a transportation system which will in all respects best meet the public needs. In view of this common purpose they should, and we believe they can, work together for its attainment without conflict or resort to litigation. Such cooperation** is contemplated by the Interstate Commerce Act as interpreted by the Supreme Court, **and is highly desirable in the public interest** [emphasis mine].

The plan embraced what was later to become a "Theory of Co-operation" (_1927 Proceedings_, p. 68). It set in place procedures which would be employed at joint federal-state conferences and hearings that brought five members of the

ICC together with eight representatives of state commissions in Washington as Subsection 13(3)'s first "joint committee." The "agreement to cooperate" was signed on May 3, 1922. The ICC's entire membership voted with NARUC's joint committee to adopt the statement. (The ICC's report notes that three of the federal agency's representatives to the joint committee first opposed the proposal. However, it gives no explanation of why they were finally persuaded to vote favorably for the statement [36 ICC Ann. Rep. 80 (1922); the full text appears in Appendix H., p. 233].)

By 1922, the ICC had further reason to turn to the states for assistance: The federal commission's dockets were jammed because Clark had pushed for the broadest interpretation of Subsection 13(4) of the Transportation Act (against "undue, unreasonable, or unjust discrimination against interstate or foreign commerce).

Under Clark's leadership, the federal commission followed the lead of federal court actions which tended interpret "interstate commerce" in a way which covered everything imaginable. For example, there were cases filed in one year against intrastate passenger fares (including interurban lines), pullman accomodations, baggage fees ore, milk and cream, sand, gravel, crushed rock and livestock, petroleum, cotton, wheat, and brick (1922 Proceeding, pp. 209, 210). It became the ICC's practice to permit the railroad officers to file a schedule of proposed rate changes at the commission, which published notice of them.

Protests to the proposed changes had to be filed within thirty days. If not, changes were permitted to go into effect.

The ICC's staff was hard pressed to sort among the filings to send proper notice to the localities. Unless shippers hired rate experts to watch the daily publishings and to file protests on their behalf, they faced rate increases with insufficient opportunity to prepare an adequate response.

The ICC began to eliminate independent rate investigations. It was common for a hearings examiner to award increases based on the affidavits of companies declaring economic hardship due to low revenues, whether in fact the company was "rich, poor, bankrupt, short and long" (1921 Proceedings, pp. 8, 9). Railroad companies receiving the highest rate increases in thirty-five years, from twenty-five to one-hundred per cent under Ex Parte 74, continued claim insufficient revenues to stay solvent on the intrastate short-haul routes.

NARUC's president, James A. Perry, of Georgia, described the situation to the 1921 convention (p. 9):

> ...[T]he movement of various commodities... stopped. Millions of dollars' worth of perishable farm products, vegetables and fruits rotted in the field with staggering losses to producers and carriers alike, no account being taken of the consumer who was forced to buy at greatly increased prices because of the scarcity in the markets.
>
> **Rates that are higher than the traffic will bear stop the movement.** All over the country, for

> comparatively short hauls, essential commodities are costing less that the freight to move them to market, with the result in many intra-state movements, motor power is hauling a good per cent of short-haul freight [emphasis mine].
>
> ...We've had a trial of nearly four years of directing the affairs of this country from centralized powers at Washington and the result has been a staggering loss to the nation's commerce and the carriers as well....**The machinery of the law, as at present construed and enforced by the Federal Commission defeats the very purpose for which it was created to correct** [emphasis mine].
>
> ....
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> ...**Members of Congress have seen the folly of parts of the Transportation Act, as construed by the Federal Commission. So much so that I haven't a doubt that it will be so amended as to speak the truth as intended by some of those who gave it birth** [emphasis mine].

Bills were introduced in the House and Senate from midwestern legislators which where designed to restore to the states full plenary power over state rates and state service, sweeping aside in their entirety Supreme Court decisions in the Minnesota and Shreveport cases (p. 248). NARUC's Committee on State and Federal Legislation submitted a resolutions asking Congress to make clear the states role in intrastate rate-making and service matters.

General Solicitor, John Benton, reminded NARUC that the carriers would continue to attack the states' rate-making authority unless Congress amended the legislation "to make clear beyond denial or misconstruction, the intent...that nothing in that act should apply to transportation of persons and property wholly within one state" (p. 253). At the very least, said Benton, the states would be wise to ask Congress to make clear to the courts that it was not its intent to prevent the states from making their own rates applicable to their own commerce.

The people of Wisconsin did not return John J. Esch (of Esch-Cummins fame) to Congress. Instead, he was appointed to the Interstate Commerce Commission. There he would be forced to see the residual effects of the re-regulation of the railroad industry under the Transportation Act. The most immediate effect was that motor carriers entered the short-haul intrastate markets where railroad freight rates began to quickly rise. As railroads began to abandon service to remote communities, they lost the passenger car service which had been supplied as a tandem low-cost benefit. In many instances, it was unprofitable to replace passenger rail service with passenger motor carrier service. In many instances, rural dwellers became geographically isolated, making low cost message toll telephone service more important than ever to state public officials.

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POLITICAL-ECONOMIC ORIGINS OF SECTION 410 OF THE COMMUNICATIONS ACT: FEDERAL-STATE JOINT BOARDS, COOPERATIVE FEDERALISM AND REGULATION OF THE DOMESTIC TELEPHONE INDUSTRY (1913--1971)

Volume II

By

Joan V. Miller

A THESIS

Submitted to
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In partial fulfillment of the requirements
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Department of Telecommunications

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CHAPTER VII

TELEPHONE JURISDICTIONAL RATE-MAKING ISSUES: THE ICC AND BEYOND (1923-1934)

Introduction and Summary

Introduction

The years from 1923 to 1934 were turbulent and transitory years for federal and state regulatory officials. Each commission represented by NARUC now had broader and more varied jurisdiction than it possessed before "the great war" (1928 Proceedings, p. 28). Amid criticism of regulatory bureaucracy, little was done to reduce the responsibilities assigned to public utility regulators. The ICC faltered under its burden until, at last, Congress saw the need to transfer federal interest in telephone regulation to a new federal agency. By delegating authority to determine telephone rates to those states choosing to exercise do so, Congress limited the extent of commerce power otherwise assigned to the FCC. As the third of four chapters which reconstruct a description of the ideas, issues, people and events contributing to the statutory provisions of Section 410, this one identifies some which are more specifically associated with the passage of the Communications Act of 1934, and the scheme of dual regula

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regulation drawn by the terms of that federal legislation which describe the development of the intergovernmental relationship associated with dual regulation of the telephone industry. The Annual Proceedings of NARUC continue to supply primary proofs, supplemented by other contemporaneous sources when appropriate.

Summary

Because railroad problems seemed more pressing, very few of the federal agency's resources were assigned to telephone work. The federal agency, by default, relied on state commission personnel to sort among the varied accounting procedures and valuation methods necessary to responsible rate-making. Important federal court cases caused members of Congress to ask whether or not independent state regulatory commissions were sufficiently able to regulate local public utility companies whose management decisions were controlled by parent holding companies beyond the lawful reach of a separate state's examiners.

State officials tended to hold these three common positions: (a) They wanted an accounting convention which would permit them to collect and compare financial information submitted by companies operating in similar market environments (b) They were willing to accommodate state-by-state procedures to a set of commonly held rate-making principles. (c) Each state wished to retain the autonomy to apply the information and the principles to their specific geopolitical environment.

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In matters associated with development of methods and the means of reporting depreciation expenses and reserves, the ICC considered instituting joint proceedings under the aegis of Subsection 13(3). However, the ICC's Annual Reports and NARUC's Proceedings suggest that alternatives to Subsection 13(3) mechanisms were adopted. Telephone depreciation issues became the purview of panels of state officials, appointed by NARUC, who represented regional subdivisions of the United States, or "districts." Those informal district committees evaluated the reporting methods utilized by telephone companies operating in those regions who provided both local exchange services and intrastate and interstate message toll services. The express purpose of the panels was to assist the ICC with revisions of the USOA with regard to methods and forms used by companies to report expenses and costs.

NARUC also established a standing committee to facilitate federal and state cooperation for a range of interjurisdictional regulatory matters. Paul A. Walker, of the Oklahoma Commerce Commsission, was its chairman. Walker advocated a "theory of cooperation" he believed would accommodate reconciliation of interjurisdictional rate-making conflicts.

In 1929, Senator James Couzens, Chairman of the Interstate Commerce Committee, introduced legislation to transfer telephone regulation from the ICC to a new federal agency. The "Couzens bill" was pieced together from exist

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existing legislation covering old provisions from the Transportation Act, federal administration of broadcast radio services, and legislation designed to address matters of interstate transmission of hydroelectrical power. NARUC set out to block the bill because (among several reasons) adoption of it meant destruction of the states' telephone rate-making autonomy.

NARUC's executive committee understood that a "communictions commission" of some design would replace the ICC. Therefore, the association intended to have new statutory provisions meet two of its primary goals: (a) to limit the extent of federal preemption of state rate-making prerogatives, and (b) to provide a mechanism whereby interjurisdictional solutions could be sought without the intervention of the courts where the lawful rate-making authority exercised by commissions in either sphere of federal or state governments impinged on the lawful rate-making authority of the other.

Interjurisdictional rate-making issues were once again highlighted in decisions written by Hughes, who returned to the Supreme Court bench in 1923 as Chief Justice. After the passage of the Communications Act in 1934, the opinion he wrote for Smith v. Illinois Bell had substantial influence on the application of jurisdictional allocation of interstate and intrastate revenues and costs (below, p. 254). Therefore it was a major factor contributing to the deve

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development of the intergovernmental relationship addressed by Section 410 until 1971.

State commissioners believed their rate-making autonomy was protected by the Communications Act when Congress effected a transfer of power from the ICC to the FCC in 1934. They were further encouraged when one of their foremost proponents of federal-state cooperation, Paul A. Walker, was appointed as a charter member of the FCC. His immediate assignment was to head the federal agency's division on telephone matters.

The following subsections have been organized to present evidence to address the research question and test the thesis statement:

1. A "Theory of Cooperation" and Paul A. Walker
2. Perceived Threats to the States' Telephone Rate-making Authority
3. NARUC Opposes "The Couzens Communications Bill"
4. The Chicago Rate Cases: Charles Evans Hughes and Interjurisdictional Rate-making Methods
5. NARUC Supports a New Communications Commission

A "Theory of Cooperation" and Paul A. Walker

Perhaps no other member of the NARUC had stronger convictions about, or commitment to, the importance of cooperation between state and federal regulatory agencies in the period from 1914 ot 1934 than did Paul A. Walker. He adopted a theme which he called a "theory of cooperation" to rec

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reconcile interjurisdictional regulatory problems (1927 Proceedings, p. 68). It was drawn from the preamble of the joint agreement adopted by the ICC and NARUC in 1922 (above, pp. 207-209).

A Theory of Cooperation

Walker was NARUC's chairman for the Committee for Cooperation Between Federal and State Commissions from 1925 to 1934. As soon as Walker assumed the job, it became his task to introduce proposed revisions to the ICC-NARUC joint procedural agreement first negotiated in 1922. When Walker introduced the drafted revisions, he spoke fervently about his conviction that it would take "the spirit of cooperation" rather than formal rules to make the cooperative mechanisms work successfully. The state commissioners who had worked on the joint ICC-NARUC committee to redraft the statement of cooperative principles and procedures were as eager to trust in mutual good will as Walker was.

Subsection 13(3) had been written with railroad issues in mind, the joint cooperative agreement was intended to apply to them rather than to telephone questions. The post-war experiences of some state officials caused them to scrutinize the agreement carefully. Perhaps Walker and his committee did not anticipate the spirited response the report would arouse from delegtates once they evaluated the implications of the agreement's language. Walker and his committee were distressed as they listened to some state comm

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commissioners who were unable to support the draft proposal.

Lewis Gettle most articulately expressed skepticism about a number of the agreement's provisions. The Wisconsin commissioner, an attorney, would not rely solely on good intentions or the "spirit of cooperation" (1925 Proceedings, p. 69). His challenges were made as if he were a student of Aristotelian logic. Gettle paid careful attention to phraseology. Whatever good will accompanied the "theory of cooperation," Gettle did not like the implication of the following sentence: "The State commissions realize that the railroads form a national transportation system which is not split into parts by State lines and that the public interest demands a rate structure, State and interstate, as simple and harmonious as practicable." Speaking about preemption, Gettle reasoned with Walker's committee. He said (p. 69):

> It has been the subject of discussion of every session of this National Association which I have attended for the last four or five years, and **here we seem to be tumbling over ourselves to declare that the national transportation system is a unit. That sounds very well, it sounds so plausible, it is such a sweet phrase to roll out from under the tongue--"the national transportation system is a unit." Now, when you examine into the rate questions which come before you, you know it is not a unit and you have never treated it as a unit. The Interstate Commerce Commission has never treated it as a unit, has it? And yet we come here and solemnly declare--we surrender the last vestige of State control and State authority by declaring that the system is a national unit and that we have nothing, by reason of that largely, to do with it any more, and then right after that this inconsistent declaration is made: "The Interstate Commerce Commission realizes that there is danger in over-centralization of authority."...I say that that language ought to be stricken out** [emphasis mine].

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If NARUC were a partner to the agreement, and the states were to be later engaged in litigation challenging their rate-making authority, Gettle thought the statement could be introduced as evidence working against state-made rules for two reasons. The statement said the transportation system was (a) national in character, and (b) as a national system, it was perceived to be an unseparable unit for any reason. Under those circumstances, one could conclude that the federal commission was dominant in every transportation matter. The experiences of the Ex Parte 74 proceedings and the Wisconsin case left the states with only a residual claim that they shared any authority to regulate the intratate busines of the railroad companies. Since "transportation" now embraced motor carriers too, the sentence had sweeping implications.

Walker and the members of the cooperative committee tried to dismiss Gettle's apprehensions about the way the joint agreement read. Exasperated, Gettle turned to the general membership and said (p. 72):

> ...I **am a little surprised that these old, seasoned warriers of this Committee**, whom I respect personally exceedingly, having been associated with them for a great many years, **should get up here and plead in the manner that they have done that the report ought to be accepted, notwithstanding anything that may be in it, by reason of the very high character of the men who produced it.** I concede that, but I think that to open this discussion... without saying anything except what is laudatory of the committee, would be senseless and useless....
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> **We believe as heartily in co-operation as any of the, but neither do we propose to stultify**

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> **ourselves by voting for provisions in that report which are wholly inconsistent with our laws and our duties as commissioners. That is my position** [emphasis mine].

The appeal was convincing. It was obvious that the state members of NARUC were prepared to reject the proposed joint agreement. Fortunately, the annual convention was being held in Washington. It was possible to avoid an embarrassing deadlock if the ICC-NARUC joint committee conferred once again, this time to consider Gettle's reservations about the proposed language of the agreement.

Accordingly, the "theory of cooperation," or preamble of the agreement, was altered to read:

> **"The prime essential to such co-operation is realization of the nature and difficulties of the common problem. The state commissions realize that the railroads form a national transportation system and that the public interest demands a rate structure, state and interstate, as simple and harmonious as practicable. The Interstate Commerce Commission realizes that there is danger in over-centralization of authority, that the field of regulation is vast, and that the state commissions are often better informed than itself in regard to local conditions and local needs."**

It was a compromise. It acknowledged a "national" transportation system, but did not claim it should be treated in a unitary fashion. Instead, it offers a reason why rate structure which should be both "state and interstate" in character.

The language of a procedural rule Gettle thought to be fundamental in protecting each state's right to submit evidence in a joint federal-state cooperative proceeding was also altered. A commissioner could not be both an examiner and

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and an advocate for the state the commissioner represented, but the state would not be denied from submitting evidence to a joint board because one of its local commissioners sat on the panel in a joint hearing. It was one which Gettle insisted upon. It read (p. 242):

> It is our judgment that state commissioners or their representatives would not expect or desire to sit with members of the Interstate Commerce Commission or its examiners in joint hearings in any case in which they appear as advocates. This is not to be understood as precluding a state commission from causing pertinent evidence to be presented in any such case with respect to the matters in issue.

With those adjustments, and other corrections, the somewhat revised plan was adopted by the ICC and NARUC in 1925 (39th ICC Ann. Rep., p. 273; 1925 Proceedings, p. 253). Walker's "theory of cooperation" would become increasingly important as the federal-state intergovernmental relationship moved from the field of transportation to the field of telecommunications.

From 1922 to 1929, commissioners from several states took extensive leave from normal duties to participate in formal ICC-state cooperative railroad rate proceedings. State officials also rendered substantial aid to the federal agency in development of accounting and valuation matters involving the telephone industry. Gettle, as NARUC's president in 1929, had this to say about the way the states provided services to the ICC to make the concept of dual regulation work, and to overcome the negative Shreveport legac

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legacy which still worked against state rate-making credibility (1929 Proceedings, p. 31):

> ...**Never before has there been such a close sympathetic study and comprehension of the economic and rate problems of large groups of sister States. Co-operating commissioners have devoted weeks and months away from their homes and State duties, largely at the expense of their own States** [emphasis mine].

Paul A. Walker

Paul A. Walker, a western Pennsylvanian by birth, attended law school in his adopted state of Oklahoma, where he began a career with Oklahoma Corporation Commission as a staff attorney. He left the state commission having served as its chairman. Walker was an outspoken man who began an official inquiry of rates and practices of telephone companies operating in his beloved Oklahoma. He became convinced, like many other state utility commissioners, that the only way to achieve effective regulation of the communications companies operating across state lines was to support formation of a separate federal communications which would work closely and cooperatively with the state commissions (Emery, 1961, p. 382).

Walker began attending NARUC conventions in 1918. He was chairman of NARUC's standing committee on matters involving formal federal-state cooperation (the Committee on Co-operation Between the Federal and State Commissions) from 1925 until 1934. Walker's reports to the annual conventions were perhaps tedious, but they supply a year-by-year

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year overview of the Subsection 13(3) cooperative proceedings. Walker's summaries were throrough. It is possible to cross reference the ICC's Annual Reports with them to follow the record of cooperative proceedings held from 1920 to 1933. The task of enumerating the occasions when Subsections 410(a) and 410(b) between 1934 and 1971 would require a careful assessment of NARUC's Annual Proceedings, the FCC's Annual Reports to Congress, and a case-by-case review of dockets from FCC Reports.

It became Walker's custom to speak about cooperative railroad rate proceedings with pride as he enumerated them and described their "harmonious" results. Walker put the best light he could on the federal-state relationship and the outcomes of the cooperative hearings. For example, Walker said (1925 Proceedings, p. 42):

> ...[W]e have not attempted to catalog or refer even to the many cases which have been handled cooperatively. We have merely called attention to such cases as we think will convince any disinterested party that co-operation is practicable and successful, and to give suggestions to others who ought to be in the business of co-operating [emphasis mine].

When his reports are read carefully, or in the context of the commentary of other state commissioners' comments, one realizes that there were impediments to the success of the cooperative agreement. Access to pleadings filed before the ICC for cooperative proceedings in interjurisdic-tional railroad rate cases became increasingly difficult for state commissioners to come by. Many railroad companies refused to s

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to serve state commissioners with documents they were required to file with the federal commission, claiming that the states were not entitled to service because they served only in an advisory capacity. The ICC was without sufficient financial resources to reproduce and distribute them to the cooperating state officials. It appeared as if only an amendment to the Transportation Act could require the railroads to do so. Furthermore, the ICC was without sufficient financial resources to duplicate and distribute documents to the cooperating state officials. Therefore, the cooperating commissioners found themselves inadequately prepared to participate as contributing members of the cooperative panels. It appeared as if an amendment to the Transportation Act would be necessary to require the railroads to extend service to the states (1927 Proceedings, pp. 71-74).

Walker occasionally spoke of these practical problems. In one of his written reports, he included the following topic: "How the Working of the Co-operative Plan May Be Strengthened" (1929 Proceedings, pp. 45-47). The report spoke about the time and money, saying (p. 47):

> **A practical difficulty, which has been repeatedly mentioned, under which co-operation labors, is the lack of time of State commissioners to attend the co-operative proceedings, and of funds incident to such attendance. This has been a very real problem with a number of the State commissions. It has made it impossible for a number of the State commission repesentatives to participate to anything like full extent in a number of the co-operative proceedings** [emphasis mine].

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Travel time as well as time to prepare for and participate in cooperative proceedings factored into a financial problem for many state commissions. The federal agency did not receive general appropriations to support cooperative proceedings, but from time to time turned to an uncertain remedy: special congressional appropriations to offset some expenses of joint proceedings.

Walker usually followed a basic theme when he discussed what it would take to strengthen the effectiveness of the joint agreement to cooperate. For example, he said (1929 Proceedings, p. 45):

> **The chief weaknesses of the co-operative plan, as it has been thus far effected, grow out, in our opinion, of a lack of proper understanding of the spirit, plan and purpose of co-operation.** It is not unfair to say that neither all of the representatives of the State commissions nor of the Interstate Commerce commission fully understand and appreciate the spirit of co-operation. **Unless the co-operative matter concerned be approached in the proper spirit, misunderstandings are bound to arise, and little good can be accomplished through co-operative efforts** [emphasis mine].

Walker, as did many public policymakers of the period, thought the management of the public utility holding companies obstructed the execution of the public service contract in matters of rate regulation. As if he were echoing Clyde B. Aitchison's comments about AT&T in 1919 (above, pp. 197, 198), Walker summarized what he believed to be the major regulatory concern of the day when he addressed the 45th meeting in Cincinnati (1933 Proceedings, pp. 224-225):

> **The question of holding companies...is one of the most important questions with which public utility commissioners are called upon to deal. I know that it is a thing which gives our Commission as much trouble as any other one thing, except possibly the question of valuation, and the elements that enter into the proper basis for rate making. And even those things are largely influenced and determined by the holding companies** [emphasis mine].

Walker shared the problems faced by all state officials who attempted to investigate the values and costs associated with telephone plant, facilities and operations. In a typically direct manner, he addressed his NARUC colleagues further (p. 226):

> **...When you have one company holding some half dozen, or perhaps as many as fifty other companies, and you have to search through the ramifications of this long line of companies to get down to your local utility, it is a practical impossibility to regulate the local utility.**
>
> Now I belong, I presume, to the school of those who feel that public utility regulation has not been all that it ought to have been. I do not mean to charge that State commissioners have not been conscientious, or that they have not attempted to do their duty under the law. But I do say that the system, whether it be the law, whether it be the method of approach, or whether it be the method of operation, has not brought the results that the public feels should have been accomplished. **And I belong to that school of thought which believes that the public utility commissions were created for the protection of the public , and by "the public" I mean primarily the consuming public, although with justice always to both sides, the consumer and the utility** [emphasis mine].
>
> **But my observation has been that the utilities have been amply able to take care of themselves, and that the public is seldom**

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> **represented, unless it is represented by some member of the staff of a particular utility regulating commission itself** [emphasis mine].

Walker thought that the states should regulate the utilities without abdicating to federal authority, but supported a "proper place of Federal regulation in these problems [holding company financial management] which cannot be adequately handled by the States" even if it meant the inviolability of states' rights were sacrificed (pp. 227, 231). He recommended, in 1932, that NARUC "go on record as sponsoring regulation of holding companies, both as to the states and as to the Federal government; keeping in mind, of course, the protection of the rights of the states, so far as possible to protect their rights" (1932 Proceedings, p. 127).

Walker's firmly held personal convictions remained consistent throughout the time he served as chairman of NARUC's Committee on Cooperation. It was common for Walker to say that his fellow commissioners ought to look upon the conduct of federal-state interactions as he did (1931 Proceedings, p. 45):

> **[C]o-operation as a practical matter is not accomplished so much by formal agreement as by the spirit in which the respective Commissions work together.** Both Federal and State Commissions recognize that, **to accomplish anything worthwhile, a thorough spirit of mutual understanding and helpfulness must be manifested by each of the respective Commissions charged with the handling of mutual problems** [emphasis mine].
>
> **Effective co-operation can be brought about only when the respective Commissioners have sufficient time to devote to the problmes at hand**

> **an are able to approach them in the proper spirit and attitude of mind** [emphasis mine].

The verbatim transcripts recommend that Walker was more accomplished at probity than polity. Upon reading the biographical descriptions of Walker's life, written by his FCC counsel Walter Emery, one senses that Walker was not as comfortable in Washington's social circles as he may have in Oklahoma. Emery says Walker was respected for his unswerving probity but suggests that his self-righteousness may have been fatiguing (1945; 1961).

Walker spoke sometimes stiffly to his colleagues, lecturing them about procedural rules. For example, he told them to attend to "the integrity of the manner of conducting [an] investigation" when arriving at a decision. Walker said these rules ought to be applied at joint hearings if a plan of cooperation was to be workable (<u>1929 Proceedings</u>, p. 45):

> **...No litigant, for example, has a right to receive or to expect confidences from those participating as commission representatives in the investigation. Hence, conferences and suggested reports must be mutually confidential. Each commission has a right to expect that the representative of the other will not discuss with the litigants or other parties the results of conferences or the contents of tentative proposals for reports.**
>
> **This question commends itself so strongly to the fairness of everyone that it seems only necessary to offer a word of caution against violating confidences to insure that all parties participant will keep in maind the necessity for integrity in the manner of conducting mutual proceedings. Otherwise there can be no co-operation in fact** [emphasis mine].

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Walker left the Oklahoma Commission in 1934. In his final year as a state commissioner, he served concurrently on four of NARUC's committees (1933 Proceedings, pp. iii-viii). With a recommendation by Speaker of the House, Sam Rayburn of Texas, President Franklin D. Roosevelt nominated Walker to be one of the charter members of the FCC. One of Walker's first tasks was to launch the first comprehensive investigation of AT&T. After lengthy proceedings, Walker submitted a controversial preliminary report which did not receive the support of his fellow federal commissioners.

Walker advised greater control of the parent operating company and its subsidiaries to eliminate managerial decisions which were contrary to the public interest according to the monopoly power awarded to them under the public utility paradigm. (Proposed Report--Telephone Investigation, pursuant to Pub. Res. No. 8, 74th Cong.; Special Investigation, FCC Docket No. 1, submitted by Commissioner Paul A. Walker [April 1, 1938]). Segments of the communications branded him a "big corporation foe" (Emery, 1961, p. 384). Walker's effectiveness was weakened when his fellow federal commissioners refused to adopt his report. They instead submitted a revised version which was more conciliatory to the AT&T's opposition to the Walker report (Investigation of the Telephone Industry in the United States, H.R. Doc. No. 340, 76th Cong. 1st Sess. [1939]).

If Walker's leadership was diminished by the behavior of his commissioner-colleagues, his character was not. Unlike other early appointees to the FCC whose reputations were damaged by allegations of conflicting interests, Walker's integrity was never impuned. He continued to be the FCC commissioner who was the principal common carrier expert when the nation's attention was riveted on the questionable behavior of the commercial radio broadcasting industry, and problems of the emerging television industry.

Finally, President Harry Truman, a New Deal-style Democrat named Walker as his choice as the FCC chairman in 1952. In 1953 Walker retired quietly after nineteen years of federal service. Republican President Dwight Eisenhower named Rosel Hyde to succeed Walker as chairman. He had worked with Walker, as a staff member and then as a commissioner, since the federal agency was created in 1934. Walker's belief that the "spirit of cooperation" rather than rules of cooperation would have a substantial influence on the way the FCC accommodated Subsections 410(a) and 410(b) in the subsequent decades after their adoption and before the adoption of Subsection 410(c).

Perceived Threats to the States' Telephone Rate-making Authority

From 1914 to 1934, state commissioners (rather than the ICC) held the telephone common carrier companies to a public service contract. The telephone industry was divided into two organizational camps. One camp dominated message toll facilities and exchanges serving nearly eighty-five per cent of the subscribers in fifteen per cent of the land area. It was owned or controlled by the parent AT&T supervising the behavior of its Bell operating companies. The second camp belonged to a variety of "independents" who were further subdivided into two groups by their spokesperson, Frank B. MacKinnon, President of the United States Telephone Association. He called one group "independent" and the other "independent as hell" (1921 Proceeding, p. 137).

By 1922, some form of regulation applied to telephone lines in all states except Iowa, Texas, and South Carolina (1923 Proceedings, p. 423). Practical regulation of the telephone industry was a state-by-state proposition, only episodically winning the attention of federal commissioners, until the ICC's authority was transferred to the FCC in 1934. By 1930, "all but three states (Delaware, Texas and Iowa) provided themselves with regulatory commissions "clothed with comprehensive intra-state telephone rate jurisdiction" (Wheat, 1938, p. 847). The ICC's marginal commitment to regulation of the telephone industry may be one explanation why it seemed to treat issues associated with the calculation of depreciation expenses and reserves as haltingly as it did. Nevertheless, the states have never treated the telephone depreciation methodology as a minor jurisdictional issue.

Depreciation reserve contributes to the overall value of the rate base under the public utility paradigm. Therefore, some of the early court challenges to state rate-making authority came from companies claiming that state officials were outside their field of competency to determine which methods ought to be applied to the determination of the rate base.

Depreciation Methodology

When the Transportation Act was officially approved, Congress expanded the authority of the ICC with regard to determining the standards for reporting depreciation, but the statute did not enable the ICC regulated interstate telephone rates. While Subsection 20(5) authorized the federal agency to prescribe depreciation charges "as soon as practicable," it did not delineate between depreciation applied to interstate or intrastate rates (41 Stat. 456, 493 [1920]). The ICC sent a circular to the state commissions saying the requirements of railroad regulation forestalled any federal action on telephone depreciation charges. Several states with experienced commission rate staffs were engaged in ongoing depreciation investigations. Since depreciation is an essential element in determining rates, the states said nothing ought to interfere with their prerogatives to approve or disapprove the way depreciation was calculated and reported for intrastate telephone business. Because the Transportation Act introduced uncertainties in the way depreciation methods contributed to matters of rate base valuation, some of the larger Bell operating companies seized the opportunity to challenge the states' power to approve or disapprove of their depreciation calculations or any of the methods they employed to arrive at a valuation for rate base purposes.

Depreciation appears in the valuation equation. (Valuation is a process of appraising a base value of the investment in plant and equipment used to provide intrastate services.) The methods used to calculate and report depreciation will, in part, determine an amount of money a company earns. Depreciation enters the revenue requirement in two ways. First, it is treated as if it behaved as an annual annual expense. Second, it appears as accrued monies held in reserve deducted from the value of the assets establishing the rate base upon which an operating company was permitted to earn a reasonable rate of return in a given year.

From 1922 to 1937, telephone companies applied one set of methods which produced large annual depreciation charges to be included in operating expenses and simultaneously applied another set of methods which reported relatively low ammounts of accrued depreciation to be deducted for valuation purposes. Those inconsistencies gave rise to some bitterly fought rate cases between state regulators and telephone companies (Proposed Report--Telephone Investigation, p. 387). By manipulating depreciation methodologies, it was possible to skew the outcome of the rate base in such a way as to inflate telephone prices, to obtain profits in the terms of an unnecessarily high rate of return, and to finance expansion of the telephone network without borrowing capital to do so. The amount of compounded excess depreciation meant additional justification to raise subscriber rates (pp. 410, 411).

Frank S. Fowler, Chief of the ICC's Bureau of Accounts, addressed the NARUCs thirty-fourth meeting in Detroit. Fowler admitted he preferred to keep out of the "State and Federal tangle," but that among the many problems with which regulating bodies dealt with, none quite as complicated or quite so susceptible to arguments and contrary conclusions as the subject of telephone depreciation. Said Fowler (1922 Proceedings, p 238):

> **The methods...are by no means uniform but the fundamental principles underlying the requirements are, for the purposes of accounting, more nearly in accord** [emphasis mine].

Fowler, the federal agency's staff member, thought Congress required the agency to look more closely at the methods telephone companies used to calculate depreciation when it amended Section 20 of the Interstate Commerce Act. Fowler thought it was the first piece of legislative action by either state or federal governments requiring a regulating body to prescribe percentages of depreciation (p. 239). He said he thought it was "inevitable that differences of opinion" would develop if companies were required to conform to ICC depreciation regulations. His answer to the resolution of the differences was this: State and federal regulators ought to meet to discuss the reasonableness of depreciation provisions, "in the hope that by a frank exchange of views and close cooperation" with the aim of minimizing differences in the methods of accounting they chose to prescribe for reporting depreciation charges (p. 240). Although NARUC and the ICC met in a joint conference to discuss the process of reconciling procedures, the ICC took no further action on the tentative reports submitted by the informal cooperative committee. Although the ICC mentions telephone companies when it reports on the Bureau of Accounts, the real attention is directed to steam railroads (37 ICC Ann. Rep., p. 26).

At the following convention, a special report of NARUC's Committee on Statistics and Accounts of Public Utility Companies--On Accounting for Telephone Companies said (1923 Proceedings, pp. 299-301):

> **During the past year, the several state commissions have been confronted by an effort on the part of the larger telephone companies to free themselves from the regulation of state commissions with respect to accounting methods and also from practically all control of rates for telephone service.** The companies have taken the position that certain rules and regulations prescribed by the Interstate Commerce Commission in 1913 require them to keep their accounts in a specific manner and that the companies' officers and employees are the sole judges of whether the accounting rules are correctly applied. Although these rules have been in effect for ten years, it **was not until during the last year or two [since the passage of the Transportation Act] that the companies denied the authority of the state commissions, notwithstanding the fact that state laws specifically authorize the state commissions**

> **to prescribe the manner in which accounts of telephone companies shall be kept** [emphasis mine].
>
> ....
>
> Another means by which companies have sought to escape regulation of rates is to set up the claim that the states have no authority to consider and fix depreciation charges of telephone companies. This claim is based on the contention that sole jurisdiction rests with the Interstate Commerce Commission. **It has been nearly three years since Congress authorized the Interstate Commerce Commission to fix the rates of depreciation for telephone companies. Said commission has held hearings on the subject, but it is not yet known when, if ever, it will establish rates for depreciation. The companies claim that, before the Interstate Commerce Commission takes action, their own representatives are the sole judges of the depreciation charge. If this contention be sustained, there can be no effective regulation of telephone rates** [emphasis mine].

Prior to 1920 there was no question about who approved of the depreciation charges claimed by telephone companies. Authority rested with the various state commissions for very practical reasons. Commissioner Ratts of Indiana pointed those reasons out as he expressed his dismay at the telephone rate-making challenges the state commissions were experiencing because of the confused messages sent out by the ICC under the terms of the Transportation Act (p. 301):

> **Now, the trouble is that 95 to 97 per cent of the revenue of the telephone companies of the country comes from the intrastate business, leaving only 3 to 5 per cent coming from the interstate business....In other words, what the [telephone companies] are trying to do here is to have the tail swing the dog, and the Interstate Commerce Commission is undertaing to regulate the whole proposition of depreciation on 100 per cent, when only 3 per cent or 5 per cent is really used in interstate commerce. You know that the telephone lines of the country are practically all**

> **within the jurisdiction of the state commissions, and yet the state commissions can't regulate unless they can fix the depreciation charge...**[emphasis mine].

To contribute support for the Indiana man's view, Harry G. Taylor of Nebraska added comments which sounded very much like the states' claims in the more contemporary Louisiana case (above, pp. 10; also see Appendix B). Said Taylor (pp. 305, 306):

> If the Interstate Commerce Commission can reach out and determine the rate of depreciation for the Bell Telephone Company in Nebraska, which is essentially an operating expense, it can as readily and with the same propriety, reach out and determine the rate of pay to the operators, which is likewise an operating expense....**I know of no reason why the Interstate Commerce Commission should be granted authority to pick out one of the operating expense of a local utility, and determine that, and thus remove it from within the province of the local authority which has charge of all the other operations of the company, including its rates and its service** [emphasis mine].

At NARUC's Phoenix meeting, the Committee on State and Federal Legislation recommended to and received approval from the membership of the following resolution (1924 Proceedings, p. 151):

> Resolved: That we urge upon Congress amendment to Paragraph 5, Section 20, of the Transportation Act of 1920, specifically to provide that the provisions therof relating to **depreciation accounting, and the rate of depreciation to be set up, shall not apply to telephone properties within states**, the major part of the revenues derived from which is from intra-state transactions [emphasis mine].

In 1926, the ICC stressed the importance of and a strong desire for full cooperation of state commissions in

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the determination of depreciation rates, saying (118 ICC 295, 233 [Nov. 2, 1926]; Docket 14700):

> **...[Subsection 13(3) authorizes] us to avail ourselves of the 'co-operation, services, records, and facilities of such State authorities in the enforcement of any provision of this Act!' This, we believe, is a provision of the law of which we may well take full advantage in the instant proceedings. The plan or method by which this may be done will be considered later in connection with the details of our regulations relative to the depreciation requirements for telephone companies** [emphasis mine].

The ICC report continued (at 374):

> **...The great bulk of telephone business is of strictly local concern, and the State commissions are much better informed and equipped than we are to pass upon the conditions surrounding this local service. Moreover the interstate commerce act now specifically authorizes us to avail ourselves of the co-operation, services, records, and facilities of such state authorities in the enforcement of any provisions of the act....In the present instance, aid from the state commissions is not only desirable because of the essentially local character of most of the telephone service, but also because of the substantial relief which it will afford us in the burden of determining prospective service lives and depreciation percentages for the large number of telephone companies operating in this country** [emphasis mine].
>
> **We are, therefore, of the opinion that in all cases where state commissions have authority intrastate over telephone companies, the prospective service lives and depreciation percentages estimated in the first instance by such companies, with the accompanying expositions of the reasons therefor, should be transmitted to the appropriate state commission or commissions instead of to this Commission, and that our temporary order prescribing depreciation percentages should be based upon the recommendations of such commissions. Further proceedings, with a view to modiciations of the temporary orders, should be conducted for us by the state commissions. Where more than one state commission has jurisdiction over a particular**

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> **telephone company, co-operation between such commissions can no doubt be arranged. In the event, also, that no state commission has jurisdiction or in the event that such state commission has jurisdiction or in the event that such state commission or commissions as have jurisdiction are unwilling to assist us in the manner indicated, it will be necessary to follow the same procedure as in the case of steam railroad companies** [emphasis mine].
>
> **In the present instance, aid from the State commissions is not only desirable because of the essentially local character of most of the telephone service, but also because of the substantial relief which it will afford us in the burden of determining propsective service lives and depreciation percentages for the large number of telephone companies operating in this country** [emphasis mine].
>
> **And in the case of telephone companies this Commission shall by temporary order prescribe similar depreciation percentages following the recommendations of the State commissions to the extent that such advice can be procured....** [emphasis mine].

Although the statement suggested that Subsection 13(3) might be engaged to open formal federal-state hearings on the matter of depreciation, three years later, no formal joint board was appointed.

NARUC appointed a special committee on depreciation. The Association wished to avoid Shreveport-like experiences, saying "co-operation between the Commissions of the States transversed by the lines of a single company is quite essential..." (1929 Proceedings, p. 574). The committee was organized to provide assistance the ICC required from the states. The state commissions supplied a field organization to develop as fully as possible uniform procedures and forms which would permit the telephone companies to present present comparable data.

Walker was a participant in a joint conference between ICC officials and NARUC's Special Committee on Depreciation, organized to devise a plan of practical cooperation (in May, 1931). Then, the Association's president, Harvey H. Hannah of Tennessee, appointed ten "Regional Committees on Depreciation." The regional committees represented geographical subdivisions of the United States. Their purpose was, in part, to examine the considerations which entered into the effective service life of plant and equipment in an era of rapidly changing technology. According to the 1931 Proceedings, the activities of the regional committees and joint conferences were among the most important cooperative activities engaged in by federal and state officials (pp. 136-147).

A. M. Bunten, the ICC's Chief of the Depreciation Section, delivered an historical perspective of the original development and contemporanteous status of the depreciation inquiry and orders (Docket 14700) at NARUC's annual meeting in Cincinnati (1933 Proceedings, pp. 151-164). As he closed his comments, he said (p. 163):

> ...[T]he time is fast approaching when the telephone companies must submit their estimates [of depreciation] to the State commissions or to the Interstate Commerce Commission [emphasis mine].

Because the ICC made reference to Subsection 13(3) in its report in 1926, it is possible to consider the cooperative conferences and process of investigation as if they represented application of Subsection 13(3). But the assistance rendered by the special depreciation committee and the regional district cooperators does not appear in the lists of Subsection 13(3) activities in NARUC's Proceedings, or in the ICC's Annual Reports.

Court Intervention

William E. Mosher and Finla Crawford conducted an extensive study of public utility regulation in the United States. They concluded that the effectiveness of public service commissions depended largely upon the timeliness and finality with which state commission orders would be executed (Public Utility Regulation, 1933, p. 43). They said the threat of federal judicial review of each state commission order began to be "shadow that always hovers over the offices of the public service commissions" (p. 53). The peril began in earnest after the passage of the 1920 Transportation Act. As an illustration of a chilling example where the courts permitted excessive private mangerial discretion to override responsible state regulation, they turned what was known as the Missouri Case (Missouri ex rel. Southwestern Bell Tel. Co. v. P.S.C. of Missouri, 262 U.S. 289 [1922]).

AT&T entered into a determined legal contest challenging the Missouri Public Service Commission's methods used to arrive at an overall estimate of value, including a reserve for depreciation. The Court accepted AT&T's

contention that its investors were entitled to a rate of return based on an estimate of the cost to duplicate the cost of the network at present day costs (reproduction cost, or "present value" of the investments; at 287) than the recorded original costs ("historical" or "original" costs) actually spent on building the facilities. Use of the reproduction cost method of valuation meant that the revenue requirement could fluctuate in the economic cycles of inflation and depression, with the dollar amount being contributed to a reserve for maintenance and expansion becoming equally uncertain. In fact, investors could not be certain what they might earn and the public could not be sure how the rates would vary from year to year (see the dissenting opinion of Justice Louis Brandeis, at 292).

Furthermore, the Court said the Missouri P.S.C. could not disallow half of an expense category reported by Southwestern Bell which it attributed to a proprietary contractural agreement negotiated by the subsidiary and its parent, AT&T. AT&T refused to cooperate with the Missouri Commission. Indeed, the Court itself chastised the state agency for superimposing its professional judgment ay the discretion of the parent corporations's board of directors (at 289).

Missouri made it obvious to the states that the valuation they made of the Bell operating companies could mean costly, protracted legal battles. If a state invalidated the reports submitted by the company with respect to costs and/or expenses, the courts would very likely undermine the state's evidence. The decision substantially limited the number of future challenges state public utility commissions were willing to lodge against the operating companies' proposed upward rate revisions (Mosher and Crawford, p. 85). NARUC's reaction to Missouri is reasonably well characterized by the report made to the 1923 convention (by the Committee on Statistics and Accounts of Public Utility Companies--On Accounting for Telephone Companies, above, pp. 235, 236).

In addition to prohibitive expenses attendant to cases which reached the federal courts, there were serious delays and the possibility that the courts would issue injunctions against state rate orders until, at a subsequent trial, the case would be heard de novo before a court-appointed official who was often without technical familiarity with matters associated with regulatory standards of practices associated with the industry. Frequently, court examiners ingnored the original testimony presented at state commission hearings, and/or new issues were permitted to be introduced. The impression left by the federal courts was that they behaved as regulatory surrogates, in a legislative fashion, superseding the authority of the state commissions. One of the Chicago Telephone Cases, begun in 1923 and decided in 1934, was among the lengthiest cases (discussed and cited below, p. 259).

NARUC Opposes the "The Couzens Communications Bill"

When Lewis Gettle delivered his presidental address to NARUC's New Orleans convention in 1929, he talked about what he thought was a pervasive encroachment of federal power upon "the rights and prerogatives of the several States and their sovereignty. Gettle had been a witness representing the states at Congressional hearings in which the credibility of public utility regulation by the states was impuned. Therefore, Gettle anticipated a flood of proposals to centralize greater control over public utility holding companies following the outcome of the investigations. Said Gettle (1929 Proceedings, p. 34):

> **This Association has taken a firm and uncompromising attitude towards a stand in opposition to any of these centralizing proposals.** I have been, for the past eight years, in very close touch with the forces in this Association which have outstandingly and vigorously oppósed additional, unnecessary centralization. **My own profound conviction is that this opposition does not spring, as has been charged, from a jealous desire to protect the powers of State commissions or the jobs of State Commissioners, but has its roots in the deeper conviction that the interests of the public, and especially of those of the millions of small users of public utility services, cannot be adequately protected by other great and expensive bureaus at Washington. It is a well known fact that the Interstate Commerce Commission never has been and is not now provided with even approximatey adequate funds to perform its wide and difficult services with reasonable dispatch. It is an old axiom of law that unreasonable postponement of justice is in fact and effect a denial of justice** [emphasis mine].

An article written for an industry periodical focusing on rule-making standards described a demand for new legislation which was building in Congress (Lambert, J.T., Public Utilities Fortnightly, 4 [1], pp. 38, 39 [1929]):

> ...**The basic theme is that authority over an industry which is basically electrical should be centralized instead of being scattered among numerous Washington bureaus and departments. More intelligent as well as more effective regulation would be a logical result if the overlapping functions of the industry were supervised by one body supposedly familiar with the industry as a whole, according to the argument.**
>
> Regulation of the telephone and telegraph companies by **the Interstate Commerce Commission** is said to be as much of a myth as Coolidge's reticence on occasions....The Commission **is loaded to the guards with railroad work anyway. One Commissioner is said to have been suprised when recently informed that the Interstate Commerce Commission Act equipped the commission with jurisdiction over telephone rates and service** [emphasis mine].

Amid calls for more direct anti-trust litigation or outright government ownership of utilities, the chairman of the Senate Committee for Interstate Commerce, James Couzens, progressive Republican senator from Michigan, introduced a legislation contemporaneously known as the "Couzens Communications Commission Bill" (S. 6, 71st Cong., 1st and 2d Sess. [1929]). Couzens proposed a "Commission on Communications and Power" would do three things: (a) It would accept and expand upon the ICC's preexisting authority to regulate interstate telegraph and telephone services; (b) regulate "all intelligence by wire and wireles" including the broadcast radio industry and the allocation of radio spectrum frequencies, and (c) regulate interstate transmission of water-generated electrical power.

John E. Benton, NARUC'S general solicitor, said the idea of a Communications Commission originated with Couzens' predecessor, but it was Couzens who enlivened interest in the proposal (<u>1929 Proceedings</u>, p. 137). Benton said the bill, if enacted, would give the new federal agency powers at least as sweeping as those which effectively destroyed the states' railroad rate-making authority when the Transportation Act was passed.

Furthermore, Benton said he thought the proposed legislation would give the proposed commission the same power to set maximum and minimum rates after hearing on complaint or on its own motion, thereby setting aside intrastate telephone rate schedules just as the ICC was able to set aside intrastate railroad rates (p. 141). He said the Couzens bill had not taken into account the resolution made by NARUC which specifically asked Congress to award authority to set depreciation charges for intrastate operating companies to the separate jurisdiction of the states (p. 143).

If Benton's view was accurate, state authority to regulate the telephone industry would be become as obsolete as state regulation of the railroad industry had become. Benton was sure that once the federal courts began to review the new commission's prerogatives, all alleged protection of the states' reserved sphere of authority would be erased (p. 142). Benton said "inadvertent" oversights caused members of Congress to think it was appropriate to regulate telephone lines with the same methods the ICC applied to railroad lines (pp. 141, 143). It was similar simplistic understanding of technology and finance which permitted Couzens to say it was appropriate to combine the issues associated with the transmission of hydroelectric power with the transmission of telephone messages (p. 144).

If Couzens hoped the exclusive statement he gave to a widely published periodical garnered support for his bill from state officials, he was wrong. Rather than clarifying his position, it tended to obscure his objectives. As Couzens explained why he thought it was appropriate to place wire and wireless communications services under the umbrella of once federal commission which would also represent the federal government's interest in the allocation of scarce broadcast frequencies and the interstate transfer of electrical power, he said (Public Utilities Fortnightly, 4 (4), pp. 217-218 [1929]):

> ...**[The corporations] are in fact doing a work which the public permits them to assume and which the public itself could have done through a system of public ownership and public operation had it so desired** [emphasis mine].
>
> ....
>
> ...**It is but the essence of democracy that the people of today, through their Government, should regulate any corporation or group, which possibly could acquire dominion over the transmission of intelligence** [emphasis mine].
>
> The plain fact is that the system of regulation which I propose is already established. Radio is regulated by a Radio Commission. **The telephone and telegraph companies presumably are regulated by the Interstate Commerce Commission.**

> I propose that these shall be assembled in a single body, instead of being alloted as they are now, piecemeal, to a group of widely diffused and scattered public agencies, some of which have other arduous and unrelated duties to transact.... **I am quite confident that an exhaustive search of the records would fail to disclose any important act of telephone or telegraph regulation ever exercised by that body** [meaning the ICC; emphasis mine].

It was an admission of federal regulatory failure in the field of telecommunications thus far. Couzens said the problems attendant to electrical power were "identical" to those of wire or wireless communications because power generated at sites such as the Boulder Dam project would "cross the lines of half-dozen commonwealths" just as wire or wireless communications did. Couzens saw no reason why electrical transmission should be outside the proposed list of responsibilities for one federal agency.

He thought that the development of the "complicated business relationships under the modern system of holding companies' rendered "null and void all efforts at regulation of rates and service" by the states. He said Court interpretations made it clear that the states could not go beyond state lines in their efforts "to ascertain the costs of distribution and production." Hence, it was impossible for the states "to fix a fair rate" (p. 219). Presumably the same federal agency could remedy the securities problem as well.

On the other hand, Couzens declared himself to be a fervant advocate of home rule. The former mayor of Detroit said (pp. 219, 220):

> ...I believe that authority should be **exercised nearest its source. Accordingly, it is provided in the bill that in the determination of interstate rates and related matters....The authority shall be vested in commissions composed of representatives of the Public Utility Commissions from the affected states.** It is also provided, however, that **should they fail to act, the national government shall act.** This provision was necessary in order than any national right should be conserved and in order that **the public should not be deprived of their right of regulation by any reluctant or recalcitrant state Commission** [emphasis mine].
>
> **While maintaining the doctrine of state's rights, I have had experiences with the methods whereby a matter, which seems to be purely intrastate on its face, is in fact a matter of interstate importance and effect** [emphasis mine].

Couzens' statement was published five days before NARUC's annual meeting convened at Glacier National Park, August 27th to August 30th. Couzens' self-proclaimed commitment to "states' rights" did not seem to mollify resistence to the legislation by state commissioners gathered in the Montana mountain resort.

Benton finished his analysis of the Couzens bill with this statement (1929 Proceedings, p. 150):

> **The point I make is that there is no claimed necessity for giving the new Commission this power to paralyze State authorities, and that the facts which were by some thought to justify the granting of that power as to rail rates are wholly nonexistent in the case of the companies to be subject to the new Commission. The inclusion of the provisions in question would seem to be hostile to State regulation** [emphasis mine].

Couzens' bill included joint board provisions directed more clearly to issues associated with the transmission of electricity. However proposed Subsection 47(d) did not directly address issues associated with telephone regulation. Once again, the formal mechansisms which would facilitate intergovernmental cooperation in the dual regultion of the telephone were interpolative. It described the function of joint boards as a type of customer complaint bureau about electric rates. Presumably joint boards dealing with telephone issues were to operate in the same fashion if at all (pp. 151, 152).

Furthermore, the joint boards were mentioned as the last among 47 sections of the proposed legislation. It did not reflect an appreciation of how well Subsection 13(3) functioned reduce the number of cases which otherwise might have occupied the calendar of the federal courts for years in the matter of freight rates.

Perhaps most offensive of all was the recognition that Subsection 47(d) permitted the new agency to accept or reject the common record of evidence compiled by the joint board if, at its own discretion, it chose to accept wholly new evidence for review and consideration after the joint board produced and submitted a common record on an issue. In other words, there would be an incentive for petitioners or respondents to an rate question brought before a joint board to withhold evidence until they made a second appeal to the federal commission. In the second proceeding, state commissioners would not be in a position to issue a direct, immediate challenge to the facts presented. The proposal meant joint board hearings would be rendered meaningless.

Among a spate of bills introduced by Couzens in this session of Congress, S. 6 seemed to be a patchwork of unrelated provisions which angered the state members of NARUC. They mobilized against the Couzens Bill at Benton's urging, passing a resolution proposed by the Committee on Legislation (p. 369):

> **Resolved, That this Association is unalterably opposed to U.S. Senate Bill No. 6 and its amendments, or to any enlargement of Federal authority by the creation of new agencies or the enlargement of the authority of present agencies whereby the regulatory authority of the State Commissions where they are now adequately functioning** [emphasis mine].

In response to Couzens' article, Benton used the Public Utilities Fortnightly forum to publicize the position of state commissions. Benton wrote: "No bill ever before introduced into Congress caused so much apprehension, and such earnest opposition, on the part of state regulatory officials (5 (1), 3 [1930]). He continued (p. 4):

> If **reason is sought for the degree of unanimity which exists among state regulatory officials in their opposition to the Couzens bill** and its amendments, it **may be found in the fact that many of such officials were in service when Transportation Act, 1920, was passed.** They know from from their own experience the effect of that legislation upon state regulation of railroad rates and service, and **they fear a like experience in the public utility field would result from the enactment of the legislation proposed by Senator Couzens** [emphasis mine].

Benton's candid representation of the demise of state railroad rate-making, beginning with the Shreveport Rate Case continued. He said the Transportation Act of 1920 made it impossible to maintain or extend freight and passenger service along routes which could not guarantee revenues to cover costs and contribute to the rate of return guaranteed by the ICC to the companies (p. 5). He gave examples to support his contentions. He added (p. 6):

> **...[I]t is difficult, if not impossible, to use words which will insure state power in any field from invasion and destruction once a Federal agency is empowered to act within that field** [emphasis mine].

In an assessment of Couzens' bill, Benton continued (p. 10):

> **It seems federalism run mad to propose to bring every telephone company in the United States to Washington for approval of its securities issues, and for determination of the amount it shall set aside for depreciation, and for its general supervision and to bring the telephone users, even local exchange subscribes, of these same companies also to Washington for the ultimate decision as to what their rates shall be. Yet this is what the Couzens Bill will do if it is enacted. It is because the State Commissioners know this that they so unanimously protest its passage** [emphasis mine].

Thirty-seven states joined in an NARUC-sponsored campaign to stop Couzens' proposal to create a new communications commission designed along the lines of S. 6. They made their opposition clear when they appeared before the Commerce Committee (Hearings on S. 6, vol. 2, pp. 2167-2336 [February 1930], cited by A. H. Ulm in Public Utilities Fortnightly, 5 (7), p. 411 [1930]).

Benton was able to report the demise of the Couzens' Communications Commission. S. 6 was not reported out from the Senate committee (1930 Proceedings, p. 281). Benton attributed the bill's failure, in part, to the Association's strategies. The separate commissions directly appealed to their Congressional delegations, Benton and NARUC's elected leadership were present at formal hearings and informal staff meetings, and Benton managed a public affairs campaign which took NARUC's position to the press where it would receive the attention of national public opinion leaders.

Benton reported that Couzens would redraft the legislation differently. Benton said (p. 282):

> ...[T]**he purpose of the bill, apparently, is to subject to Federal regulation toll service of telephone companies, and to retain to the states the regulation of exchange service, wherever the states are regulating that service** [emphasis mine].

Although Couzens' S. 6 failed to reach the floor of the Senate, it stirred fervent discussion of whether or not the states ought to continue regulate the rates for local services. It also raised important questions about how joint boards fit into a scheme of dual regulation for the telephone industry. Many of the issues posed by Couzens in 1929 and 1930 would resurface in the 72d Congress--the New Deal Congress of Franklin D. Roosevelt's first administration. NARUC had taken its case to influential members of the Senate and House Commerce Committees.

The issue of dual regulation vs. federal preemption of commerce power was not lost on Senator Clarence C. Dill, from the State of Washington, who would introduce the Communictions act of 1934. The editors of Public Utilities Fortnightly asked his opinion about centralizing telephone rate-making authority in a federal communications commission such as the one proposed by Senator Couzens. Dill gave his handwritten signature to this response (5 [8], pp. 468, 469 [1930]):

> I believe the power of State Commissions should be retained so far as possible and that the sweeping power given the Interstate Commerce Commission should not be granted to a communications commission or a power commission that is to control interstate rates of public utilities [emphasis in the original text].

The Chicago Rate Cases: Charles Evans Hughes and Interjurisdictional Rate-making Methods

While the Senate pondered the Couzens Communications Commission and Power Bill, Chief Justice Charles Evans Hughes, who returned to the Court in 1923, wrote the first of two decisions, taken together as the Chicago Rate Cases, which would influence the direction of the intergovernmental relationship which developed once the Communications Act was adopted in 1934. In the first decision, the Court supported a claim by the State of Illinois that it was within its field of competence to devise methods to arrive at a schedule of telephone rates prescribed for the City of Chicago: Smith v. Illinois Bell Telephone Company (282 U.S. 133, 51 S. Ct. 65, 75 L. Ed. 355 [1930]); Frank L. Smith was chairman of the Illinois Commission when the case was first heard in the United States District Court).

Illinois Bell gained an injunction from a federal district court, saying the methods employed by the Illinois Commission assigned a rate schedule which were confiscatory under the Fourteenth Amendment (U.S. Const. amend XIV, sec. 1). The commission appealed to the Supreme Court to dissolve the injunction, claiming among other things, that Illinois Bell's method of assigning costs placed an unfair burden on local exchange customers. The state commission's premise was that charges for interstate message toll service ought to reflect a proportion of the costs for using the local exchange facilities to begin and terminate messages.

The opinion, written by Chief Justice Hughes, sustained the state's argument that allocation to the state of all costs associated with jointly used equipment was erroneous methodology. Doing so, the Court remanded the dispute to District Court for reconsideration of its decision. Although the case addressed several issues, it was this particular opinion which is germane to the subsequent development of the intergovernmental relationship which emerged between the FCC and state commissioners after the passage of the Communications Act with its adoption of original joint board language. It would have a subsequent impact on the development of Section 410.

Chief Justice Hughes wrote (282 U.S. 133, 146):

> **...[W]e are met with the fact that, in these findings, the Commission and the court made no distinction between the intrastate and the interstate property and business of the company** [emphasis mine].

The Court was disturbed that the rate structure was based on the total Chicago property of the company rather than "recasting the figures in order to make allowance for interstate or intrastate toll property and earnings" (at 147). Hughes continued (at 148, 149):

> **The separation of the intrastate and interstate property, revenues and expenses of the company is important not simply as a theoretical allocation to two branches of the business. It is essential to the appropriate recognition of the competent governmental authority in each field of regulation** [emphasis mine].
>
> ...The proper regulation of rates can be had only by maintaining the limits of state and federal jurisdiction, and this cannot be accomplished unless there are findings of fact underlying the conclusions reached with respect to the exercise of each authority. In view of the questions presented in this case, the validity of the order of the state commission can be suitably tested only by an appropriate determination of the value of the property employed in the intrastate business and of the compensation receivable for the intrastate service under the rates prescribed. **...As to the value of that property, and as to the revenue and expenses incident to that business, separately considered, there should be specific findings** [emphasis mine].

The Court said the traditional method employed by Illinois Bell had been "adopted as a matter of convenience, in view of the practical difficulty of dividing the property between the interstate and intrastate services" (at 150).

The method assigned to toll only the value and expenses associated with the actual toll trunk lines interconnecting separate local exchange switchboards. It was called the "board-to-board" theory for allocating costs and assigning value to determine the rate base for a revenue requirement for each category of service, local exchange, intrastate toll, and interstate toll. The cost of providing a port of entry or exit for toll service messages was not reflected in toll service rates. Therefore, it is possible to infer that local exchange service rates included a subsidy for services provided to toll customers by reducing the a portion of toll costs which were not accounted for in the board-to-board method of determining the basis for rates.

The Illinois Commission claimed there ought to be costs assigned to toll services in consideration for a percentage of the subscriber's station, and other facilities associated with local exchange services because they contributed to the completion of toll message interconnections. The Court agreed, saying (at 150, 151):

> **...While the difficulty in making an exact apportionment of the property is apparent, and extreme nicety is not required, only reasonable measures being essential...it is quite another matter to ignore altogether the actual uses to which the property is put. It is obvious that, unless an apportionment is made, the intrastate service to which the exchange property is allocated will bear an undue burden--to what extent is a matter of controversy. We think that this subject requires further consideration, to the end that by some practical method the different uses of the property may be recognized and the return property attributable to the intrastate service may be ascertained accordingly** [emphasis mine].

Hughes recommended a concept of "reasonable measures" which has been a term commonly applied to appraisal techniques. The valuation process is not exact. it combines both "art" and "science." Hughes knew apportionment of costs between exchange and toll services was too "difficult" to be "exact." He asked regulators to apply "some practical method" which recognized the "different uses" of applied to the investment and expenses associated with providing local exchange services. Given the methods used during this period, it is possible to infer that local exchange services subsidized the development of interstate services.

The Court said local exchange rates should not be expected to reflect the costs of providing message toll service for the fraction of the customers who used long distance services. But, Hughes did not say how the regulators should apportion the integrated costs between toll and exchange facilities, or between state and federal jurisdictions. The Court left the methodology to the agencies authorized to supervize rates in the separate jurisdictions. It would be up to them to devise some practical and/or some reasonable methods to accommodate the separations.

The task of devising practical and/or reasonable methods would be difficult. Customers using the different classifications and categories of services would be required to satisfy the costs of providing all of those services, at the same time the companies who provided the services for a nationwide network were assured of an opportunity to earn a reasonable rate of return on the money invested in making the services available to anyone willing and able to use them. As an alternative to the board-to-board theory, state and federal regulators adopted a "station-to-station" theory of allocation of costs and revenues among the service categories, and hence the federal and state jurisdictions. Smith v. Illinois is typically cited as the case which justified the apportionment of costs associated with building and maintaining local exchange facilities and equipment to intrastate and interstate message toll services using methodological variations of the station-to-station theory.

The issue resurfaced in Lindheimer v. Illinois Bell Telephone Company (292 U.S. 151 [1934]). In this case, the Court accepted the modification of rates put forth by the state as a compromise in the proceedings of Illinois Bell Telephone Company v. Gilbert (3 F. Supp 595 [N.D. Ill. 1933]. The Court dissolved the injunction against enforcement of the Illinois rate orders. In doing so, it tacitly "approved" the allocation of intrastate costs and revenues to interstate message toll service. After the Lindheimer decision was published, some states began allocating costs to interstate jurisdiction. The memory of Shreveport caused some states to resist the station-to-station theory because it meant that the FCC would necessarily become more greatly involved in matters which the ICC had traditionally left to the states (Maher, W. F., Jr., 1985, p. v.13). Taken together, and sometimes referred to as the Chicago Rate Cases, the two decisions written by Chief Justice Hughes set the stage for at least four more decades when the matter of separating the costs for intrastate service from interstate service would become a source of controversy as well as cooperation among the federal and state commissions.

NARUC Supports A New Communications Commission

The conjunction of events associated with the Couzens bill and Chicago Rate Cases bore a direct relationship to passage of the communications Act of 1934, and the development of the intergovernmental relationship addressed with the adoption of Subsections 410(a) and 410(b). Felix Frankfurter (a professor of law at Harvard in 1930) wrote that there was a growing public feeling there must be a transition involving greater federal government involvement in the regulation of public utility holding companies if the interests of the consumers were to be served (p. 93). The Couzens Bill made it apparent that the traditional autonomy of the states could only be protected by more carefully executed language than the Interstate Commerce Act provided. The Chicago Rate Cases recommended the necessity for statutory provisions, not entirely unlike Subsection 13(3) of the Transportation Act which would permit the FCC commissioners to meet in cooperative proceedings with state commissioners to reconcile rate-making issues in circumstances where the individual practices of the lawful agencies within each jurisdictional sphere would necessarily influence the performance of a nationwide system of common carrier telecommunications services.

From 1929 to 1933, it became evident that a bill creating a federal communications commission which would consolidate federal interests in the broadcasting and telephone industries would be approved. Members of NARUC recognized a very real danger to the authority of state rate-making prerogatives if the law simply adapted provisions of the Transportation Act without clearer confirmation of the role of the states in the scheme of dual regulation of telephone service.

The chairman of NARUC's Special Committee on Depreciation, Milo R. Maltbie (first appointed to the New York Commission by Governor Charles Evans Hughes) reminded his colleages that "nine tenths" of the telephone service in the United States was interstate service "over which the Interstate Commerce Commission can have no jurisdiction." Maltbie estimated interstate revenues to have reached twenty per cent of the aggregate nationwide revenue (1933 Proceedings, p. 167).

In spite of the work of the regional committees on telephone depreciation, AT&T and its subsidiary operating companies resisted each proposal submitted by the states, extending the hearings necessary to achieve cooperative and permanent adoption of depreciation standards by both the ICC and state commissions. The ICC issued supplemental orders delaying the dates for Class A exchange companies to conform to its forms and schedules until August 1, 1934, and for Class B exchange companies to report until August 1, 1935 (1933 Proceedings, p. 147; companies were ranked from larger to smaller, A to B, etc. by the number of subscriber lines they served).

Although the "great depression" visited the nationwide economy in the years from 1930 to 1934, state commissioners became increasingly optimistic about the progress of interjurisdictional harmony. NARUC's President Hannah noted a perceptible tendency of Justices Stone and Hughes to defer to an appropriate role for the states in matters of public service regulation (1931 Proceedings, p. 25). The ICC's Walter M. W. Splawn addressed its importance (p. 436). Alabama Public Service Commission's Frank P. Morgan declared if Rip Van Winkle awakened in 1931, he would find the promise of security for a new form of federal-state partnership. Feigning a southern Democrat's astonishment at the comments came from "a Massachusetts Republican," Morgan noted quoted the former President Calvin Coolidge who said the states should keep jurisdiction over the service and rates of public utilities (p. 149).

By 1934, Paul Walker, as well as John Benton, were prepared to speak favorably of the formation of the new federal agency. The atmosphere of dual federalism which sometimes immobilized the execution of dual regulation prior to the New Deal seemed to fade as new members of congress and the state commissions entered office in 1932. They appeared to acknowledge, as Frankfurter had, the necessity for greater national control of the security issues associated with public utility parent holding companies (Public Utility Holding Company Act, 49 Stat. 838, 15 U.S.C. [1935]) and the importance of relieving the states of the constant threat that their rate orders faced years of litigation before the state and federal courts (to Johnson Act in 1934, S. 752, 73d Cong.; PL 222; Judicial Code). The Johnson Act put an end to federal court injunctions against state commission rate orders of the character of those brought in the Missouri case or the Chicago Rate Cases. Now judicial review would begin in the state where the order was made, upon the record of evidence originally compiled in hearings before the state commission.

Benton said there had been no question that a bill creating a communications commission would be enacted. Instead, the question was, what kind of a bill it should be (1934 Proceedings, p. 31):

> **[Shreveport] powers in their relation to telephone companies had been harmless in the hands of a Federal commission inactive in the telephone field, but they would be destructive in the hands of a new commission, created to become active in that field** [emphasis mine].
>
> **The task which faced the Association representatives accordingly was the somewhat difficult one of convincing Congress that in setting up a new commission to do a more thorough**

> **job of regulating telephone companies than the Interstate Commerce Commission had done, it should give the new commission less power over those companies than the Interstate Commerce Commission had possessed** [emphasis mine].

Benton said the draft of Communications Act originally contained the same destructive "Shreveport" provisions which had been in the original Couzens bill. But, in the end, NARUC's old committee redraft of the Couzens bill were largely adopted and improved so that the Shreveport power which had enabled the Interstate Commerce Commission to destroy state railroad rate-making power, "to enter the state field, and set aside rates prescribed for intrastate application by state commissions," had been struck out of the Communications Act. Benton was emphatic (p. 32):

> **Nothing of that sort can happen under the Communications Act in the telephone field. In that field State control of intrastate rates has been restored and made absolute** [emphasis mine].

Benton described the legislative strategy employed by NARUC in the year following the 1933 convention. He called it a year of unusual legislative activity requiring almost constant attention by the associations' representatives, not only during sessions of Congress, but in preparation for the sessions. Benton credited Commissioner Kit F. Clardy of Michigan, NARUC's chairman of the Committee on Legislation, for the efforts he made to include NARUC-supported amendments to the Judicial Code and to the new Communications Act. Clardy piloted his plane between Lansing and Washington to lobby Congress with Benton.

Clardy said the influence exerted by the commissioners on each of the state's respective congressional delegations led to protection of the states' jurisdictional authority in telephone rate-making issues. Clardy said: "I think we were extremely fortunate in having kept the Federal Government from stepping on our toes in a jurisdictional way..." (1934 Proceedings, p. 92)

NARUC's legislative strategy was designed to preserve state rate-making autonomy in matters affecting local exchange services. Benton said (1935 Proceedings, p. 360):

> [We recognized] **danger would exist if the Federal commission and the State commissions were engaged in making rates for the local service of the same utilities. Nothing is more certain that that [a] claim of discrimination would at once result if rates prescribed by State authority, applicable to intrastate exchange service, should chance to be lower than those allowed by the Federal commission for exchange service through the same exchange** [emphasis mine]

Said Benton, the Couzens' bill "crystallized the sentiment of State Commissioners, and marked the beginning of the fight to eliminate the Shreveport provisions from Federal telephone law" (p. 360). Benton said Subsection 221(b) excluded exchange rates altogether from the application of the Act and from the juridiction of the federal commission. Benton added (with what seemed within the context of his commentary to be satisfaction; p. 361):

> **[I]t is not possible for any Shreveport case to arise, or the [Federal] Commission to make any order affecting telephone exchange rates** [emphasis mine].

The Act, said Benton, was designed to accomodate cooperation even if there would be no Shreveport-like cases. He commented on Subsections 410(a) and 410(b) as similar to the provisions which appeared originally in Section 13(3) of the Interstate Commerce Act, although he said these provisions permitted "any matter arising under the act" to be considered by a joint board composed of State nominees. Benton said the federal agency was expected to make every effort to engage in a joint conference whenever it was necessary to negotiate agreed-upon accounting conventions. Said Benton (p. 361):

> **This provision** [220(i)] **and the co-operative and joint board provisions of Section 410 open the way for the most complete co-operation between the State commissions and the Federal Commission** [emphasis mine].

Benton expressed the Association's pride in the appointment of its colleague to the newly established Federal Communications Commission. He said (p. 361):

> **The State commissions are fortunate in the fact that the Chairman of the Telephone Division of the Federal Communications Commission is Hon. Paul A. Walker....Mr. Walker and his fellow Commissioners and associates have shown every disposition to co-operate to the fullest extent with the State commissions upon all matters subject to the jurisdiction of the Communications Commission in which that Commission and the State commissions have a common interest** [emphasis mine].
>
> **...[Mr. Walker] made it very plain that his belief in the value of co-operation had in no respect diminished, and that the Communications Commission would welcome the closest association with the State commissions in the regulation of telephone companies** [emphasis mine].

CHAPTER VIII

COOPERATION AND CONFLICT: FEDERAL-STATE TELEPHONE RATE MAKING (1935-1971)

Introduction and Summary

Introduction

The is the fourth and final chapter drawing examples from NARUC's Annual Proceedings to illustrate how people, issues and ideas combined to influence the federal-state intergovernmental relationship predating the adoption of Subsection 410(c). When the FCC began to be actively involved in making interstate message toll service rate adjustments, state regulators realized the importance of coordinating those adjustments with intrastate rate-making practices. Between 1935 and 1971, federal and state officials who attended NARUC conventions had different ideas about how cooperative mechanisms ought to be employed to facilitate the scheme of dual regulation of the telephone industry according to the terms of the Communications Act and within the framework of a public utility paradigm. The review of the Proceedings after 1934 began with the logical question: Why was the Communications Act amended to add Subsection 410(c)?

Summary

Congress established several new federal regulatory agencies as companions to the FCC for the purpose of exercising greater control of the commercial affairs of the United States in the 1930s. There were partisan changes in the population of federal and state executive and legislative branches of government. Therefore, there were major changes among state commission officials who attended NARUC's annual meetings.

For more than a decade, whenever state officials sought the views of the FCC on telephone matters they turned to Paul Walker who was presumably the federal agency's expert in this field of regulation. As a new FCC commissioner, Walker usually turned to the themes of mutual federal and state interdependence and cooperation when he spoke at NARUC meetings. Walker and John Benton, NARUC's general counsel, developed a close alliance because each promoted the theme of dual regulation of the telephone industry, facilitated by federal-state cooperation. It was Benton who devised the strategy designed to preserve the states' rate-making autonomy when New Deal legislation was formulated.

State officials expected to participate actively in the FCC's formal deliberations when adjustments made in the schedule of interstate rates influenced similar tariffs for intrastate services. They were encouraged to hold the view by Walker whose early addresses at NARUC conventions stressed the theme that the states and the FCC were partners in the regulation of the telephone industry's rate structure. Presumably, Subsections 410(a) and 410(b) were written to accomplish that end. However, authority to determine which, if any, of the cooperative mechanisms of Section 410 would be employed rested with the FCC.

On one occasion the FCC impaneled a joint board under the terms of Subsection 410(a) in a matter involving the petition for an increase in interstate telegraph rates. State officials actively participated as deliberators in the disposition of the case on the premise that price adjustments for interstate services would be mirrored by adjustments for intrastate services. It was reasonable for state officials to assume that similar procedures would follow when adjustments would be made to AT&T's interstate rate schedule. Ideally, Section 410 would be employed whenever the FCC and/or the states wished to reconcile overlapping effects of telephone rate-making decisions.

That was not to be the case. On the single occasion before 1970 when the states were encouraged to participate in a telephone rate investigation by the FCC, the formal proceeding was cancelled. The FCC and AT&T-Bell officials used private, informal negotiations to adjust the interstate rate schedule.

The FCC claimed that an informal process was better suited to federal-state cooperation. Employing the mechanisms of Subsection 410(b), FCC and NARUC officials formed panels of cooperative committees whose purposes were to gather and share data, to study the data and formulate recommedations about how the nationwide aggregate revenue requirement for the AT&T-Bell system would be divided between the federal and state jurisdictions. The ultimate determination of which standards were acceptable rested with the FCC. Gabel claims de facto authority was AT&T's. The states were left to administer the remaining revenue requirement according to their interpretations of the public utility paradigm. In each jurisdiction, federal and state regulators used two interrelated measures for rate-making effectiveness: the prices charged for services and the residual rate-of-return for the companies providing the services.

The tangible product of the federal-state study committees was a "separations manual" which was revised from time to time. The revisions usually meant that some dollar amount representing a portion of the total revenue requirement was moved from the intrastate jurisdiction to the interstate jurisdiction. The ostensible reason for this to happen was to slow down the inflation of the rate of return earned on interstate services and to slow down the inflation of prices of intrastate services. Theoretically, the separations process was the ideal means of achieving an equitable relationship which considered actual costs, actual use, and actual prices for the services rendered in each jurisidiction. The process of separations was inherently

complicated by the financial and technological integration of AT&T and its associated and affiliated subsidiaries. Futhermore, the income of the non-Bell companies (independents) was tied to the outcome of jurisdictional separations. Contracts negotiated between AT&T-Bell and the independent companies were based, in part, on the revenues earned by AT&T-Bell for controlled nationwide MTS.

The FCC often went outside the FCC-NARUC separations adjustment formulas to adjust interstate MTS prices. It was within its jurisidictional authority to supervise the rate-of-return earned by AT&T by simply lowering interstate prices. By inference, the FCC appeared to effectively engage in rate-making when prices were coming down and use was going up. By contrast, the states did not seem to be as effective, because they had to make a further segregation of the revenue requirement within their jurisdictions between intrastate MTS and local exchange service. Each time the federal agency lowered prices, price disparities between interstate message toll service (MTS) and intrastate MTS became more apparent to customers, creating a practical and political problem for state officials.

The problem of message toll rate disparities could not be solved without cooperation from the FCC. But the federal agency avoided the issue unless pressed politically to do otherwise. As an agency of Congress, the FCC responded to the pressure placed upon it from that source rather than from a "spirit of cooperation." Because the FCC controlled the mechanisms of Section 410, NARUC first used the strategy of appealing to Congress by letter and formal resolutions.

Furthermore, NARUC accepted an FCC-recommended amendment to the original language of Subsection 410(a) in 1956 which substantially reduced the authority joint boards would exercise if the FCC formally impaneled them. The action of the federal commission was to ostensibly enhance the possibility of using joint boards in the future.

It would be another ten years before the FCC invited state commissioners to serve as "cooperators" in a passive capacity when the federal agency was engaged in a formal investigation of AT&T's rate structure. The states were not co-deliberators, but they could, individually or through NARUC, intervene to present and support their point of view on issues.

Finally, in 1969, NARUC engaged in a well designed legislative campaign. One of its goals was to require mandatory appointments of joint boards in matters where the outcomes of federal rate-making orders had direct effects for the states rate-making practices. After the first set of congressional hearings, the FCC and NARUC agreed to experimental modification of the provisions of Subsection 410(a). In 1970, formal joint board was organized to amend separations procedures for the first time since 1934. NARUC General Counsel Paul Rodgers and FCC Chief of the Common Carrier Bureau Bernard Strassburg worked out the procedural details. Subsection 410(c) reflects the compromise arrived at by Rodgers and Strassburg and the mechanisms used for the 1970 proceedings.

Subsection 410(c), addressed by the 1986 Louisiana opinion is a product of a period when the FCC exercised full control of the mechanisms which had been designed to permit more formal coordination of dual regulation, adapt rate-making procedures to the the principles of the public utility paradigm, and produce greater uniformity between procedures and prices for telephone services in the United States.

Chapter VIII continues with the following subsections:

1. Paul Walker's View of Section 410
2. FCC-NARUC Agreement to Cooperate and Problems With Section 410
3. Discussion of the Separations Manual, Toll Rate Disparities, and an Amendment of Subsection 410(a)
4. John Benton and Paul Walker; Paul Walker and Walter McDonald
5. Subsection 410(b) and the Toll Rate Disparities Problem
6. Requiring Federal-State Cooperation: Section 410(c)

Paul Walker's View of Section 410

NARUC's Fiftieth Convention in New Orleans was attended by more people than any other prior to 1938. As FCC Commissioner Paul Walker stepped forward to address the audience, there were two reasons why he rightly assumed many of those congregated there were attending their first convention. (a) New Deal politics had caused a rotation of

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personnel in state government, and (b) New Deal laws created several new federal regulatory commissions. Walker used the opportunity to speak about what he said was one of the most vital of all subjects to be considered by the association: cooperation between the state Commissions and the Federal Communications Commission (1938 Proceedings, pp. 141-154).

Walker said it was unnecessary to continue the long controversy about where a bright line should be drawn between states' rights and federal sovereignty if officials from the state and federal agencies cooperated in dual regulation of public utility companies engaged in both intrastate and interstate commerce (p. 142). According to Walker, Congress first recognized necessity for federal-state cooperation by statutory enactment of Subsection 13(3) as a provision of the Transportation Act of 1920. Federal-state cooperative proceedings reduced the occasions when the states and the ICC were embroiled in federal court cases involving conflicting railroad policies. Therefore, Congress was persuaded by NARUC to incorporate language similar to Subsection 13(3) into the Communications Act of 1934, and into the Federal Power Commission Act (49 Stat. 847, c. 687 [August 26, 1935]).

Walker was pleased by the cooperative opportunities available to the FCC and the states to solve common problems arising from dual regulation of the telecommunications

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industry when he narrowed the discussion to Subsections 410(a) and 410(b) of the Communications Act (p. 143):

> In 1934, when Congress created a new Commission to regulate communications...it was only logical that there should be embodied in the Communications Act specific and definite provisions for co-operation between the New Federal Commission and the several State Commissions. **Sections 410(a) and (b)...give the broadest authorization for co-operation between Federal and State Commissions found in any regulatory Act of Congress to that date,** concluding with this proviso: "The Commission is authorized in the administration of this Act to avail itself of such co-operation, services, records, and facilities as may be afforded by any State commission" [emphasis mine].

Walker understood that the authors of the Communications Act appreciated governmental <u>interdependence</u> as well as rate-making <u>independence</u>. The Act called for something other than multi-state compacts to manage questions of overlapping jurisdiction. Walker explained (p. 144):

> **...The interrelationship between State and interstate communications is so vital that complete regulation cannot be had by either the State Commissions or the Federal Commission acting independently each of the other. Together, there exists complete jurisdiction over regulation of communications. The Act recognizes that no system of interstate regulation can cover the whole field, and that certain vital matters of regulation necessarily are left under the control of the states. The Act likewise recognizes that no state, or even group of states working together, can regulate successfully all matters incident to complete control of wire communications of telephone and telegraph companies** [emphasis mine].

Here, Walker was admitting that the resources of the federal commission itself were insufficient to regulate the

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telephone industry. Commerce power had been distributed between state and federal authorities in a way demanding a working arrangement to accommodate a federal-state working relationship.

Walker spoke about the advances in communications technologies. He discussed the importance of the rapid dissemination of information and its impact on the nation and the world. Walker described the recent great hurricane which devastated New England coastal communities, and how panic about another "great European was" was averted by broadcast news of the Four-power Munich Agreement. He used them as illustrations to make the following point (pp. 144, 145):

> **...Recent days have brought before us with a force most startling the possible truth that communication now is a greater and more potent factor than transportation, in both national and international affairs** [emphasis mine].

Walker thought that federal and state officials would be called upon to work together as the multiple communications technologies became increasingly integrated (p. 145):

> The close relationship of wire communication to broadcasting, through the transmission of broadcast programs from one end of the country to the other, the possible transmission of television programs from city to city through the development of coaxial cable, and the other interrelated services of wire and radio communications, bring definitely to the fore the keen interest of all regulatory authorities in all communications. **The tremendous development and improvement in wire communications further indicate the necessity of active interest of state and federal authorities**

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> **in a co-operative handling of the regulatory problems arising therewith** [emphasis mine].

Walker said the FCC's immediate past chairman, Frank R. McNinch, shared the "spirit of co-operation" (p. 145). Walker spoke as if the audience of commissioners should be confident that the FCC would apply the measures provided by Section 410 (p. 146):

> **I am most happy to give definite assurance that the Communications Commission is today adhering to the principles of co-operation so well enunciated by earlier leaders of the co-operative movement** [emphasis mine].

Speaking again of the cooperative provisions under Subsection 410(b), Walker said the most important practical instance of cooperation between state and federal authorities came very soon after the organization of the FCC in the matter of proposed telephone accounting rules and regulations which had not been satisfactorily concluded in the several years of hearings before the ICC.

Those rules, jointly adopted by the FCC and NARUC, had been vigorously resisted by AT&T's associated Bell System operating companies who sought an injunction against the application of them. When the rules were challenged first in the federal district court, and then before the Supreme Court, the same spirit of active cooperation prevailed. NARUC's general solicitor John Benton presented the oral arguments, prepared with the assistance of legal counsel from the FCC and New York's PSC, to support the FCC's accounting orders. Unanimous opinions in both instances

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upheld the cooperatively written accounting rules (AT&T v. United States, 299 U. S. 232 [1936]; on appeal of AT&T v. United States, 14 F. Supp. 121).

Walker summarized the importance of the federal decisions (p. 148):

> ...[T]hrough unanimously co-operative efforts of every state having a regulatory commission and the Federal Communications Commission, unity in accounting rules and requirements was effected, and the basis laid for an actual, rather than a fictitious, valuation of telephone properties for rate-making and taxation purposes. The principles concerned were far more important than any mere accounting rules. They involved the rights of the several commissions to require data from the utilities fundamental and vital to regulation. This decision of the Supreme court of the United States, sustaining the Federal Communications Commission in its accounting rules and regulations, provided a precedent for other commissions, state and federal, to prescribe similar regulations for other utilities, including transportation, power, and natural gas. **This victory was so vital to the cause of regulation that we can all take pride in crediting co-operation with one of the great accomplishments in its history** [emphasis mine].

Walker spoke positively about how the FCC applied the provisions of Subsection 410(a) to a matter involving a petition to raise interstate rates and charges for telegraph messages. FCC Chairman Frank McNinch called upon representatives of NARUC's Executive Committee. They agreed that the rate case should be conducted as a joint proceedure, because the federal agency's disposition in that case would have an impact on state rate-making practices too.

Speaking about the overlapping character of federal and state rate schedules, Walker said: Any change in the level

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of interstate rates must obviously be met by a corresponding change of intrastate rates, to prevent unjust discrimination (1938 Proceedings, pp. 148, 149; emphasis mine). NARUC appointed a committee of five state cooperators to sit with the FCC. The state and federal commissioners who weighed the common record of testimony jointly conferred and agreed that the rate increases requested by the telegraph companies should be denied (Petitions of Domestic Telegraph Carriers for Authority to Increase Rates and Charges, 5 FCC 524, 526; summarized in 1938 Proceedings, p. 229).

Walker described the support several state commissions had given the FCC when it engaged in its major investigation of AT&T, its subsidiaries, and other telephone companies. The states loaned accounting, engineering, and legal staffs to the federal investigation. Walker said he regretted that time and financial limitations made it infeasible to have state commissioners sit in jointly conducted hearings and conferences on matters engaged in by the federal investigators. Nevertheless, Walker said (p. 150): "The co-operation given by the state commissions was deeply appreciated by our Commission." As an alternative to jointly held hearings, the states and the FCC, therefore, relied on the exchange of documents and personnel to conduct separate federal and state investigations and rate cases (p. 150).

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vital to the successful regulation of the industry that they necessitated cooperation (p. 151):

> ...One is the question of what constitutes exchange rates....The other problem is designated as one of separation, that is, the determination of where the division between state and interstate jurisdiction on toll calls begins. Such a separation is essential before any final solution of exchange and toll rates can be brought about [emphasis mine].

As he discussed the character of the proposed FCC-NARUC Agreement for Cooperation to be voted upon by the members attending the 1938 convention, Walker seemed reflective. He reiterated his long held view that it took will more than machinery to make cooperation workable. To drive the point home to the NARUC conferees, Walker restated the theory of cooperation (p. 151): "Co-operation is of the spirit, and not of the letter."

Walker continued (pp. 151, 152):

> I believe that both the state commissions and the Federal Communications Commission are sufficiently imbued with the spirit of co-operation to make it a successfully working factor in bringing about effective regulation on communications matters within the jurisdiction of the respective Commissions. Speaking further of the machinery of co-operation, I trust that the day is not far distant when sufficient funds can be available to carry on co-operation as intended by Congress and as hoped for by the commissions concerned.

As Walker concluded his comments, he ventured a guess about how the value of Section 410 would be measured at a somewhat distant time in the future. He said (p. 153):

> To be worth while, co-operation must reflect itself in something tangible. The spirit must be translated into deeds. A mere willingness to co-

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> **operate or work together, though a necessary predicate to co-operation is not enough....It is my hope that our Federal Commission shall be able to function in the practical manner intended; not that we should take over functions of the state authorities, but rather that we should, by our assistance, make the state commissions able to function as it was intended that they should, as completely effective regulatory agencies. This must necessarily imply a mutual concept of the theory of regulation. If we are agreed that the primary function of a utility or public service commission is the protection of the public, that is, to see that every right of utility patrons is fully sought out and protected, as to both services and charges, while at the same time doing justice to the utilities themselves, then we have a basis which both justifies regulation by commissions and guarantees the success of co-operation** [emphasis mine].

Although state and federal officials could agree that their primary function was to protect the public, they were less sure how they would coordinate separate jurisdictional measures to do it. Ideally, cooperation would be based on a "mutual concept of the theory of regulation" and reflect "something tangible." A series of interstate telephone rate reductions begun by the FCC would set into motion events which would make Walker's concluding comments before this convention almost prophetic.

FCC-NARUC Agreement to Cooperate

and Problems With Section 410

Paul Walker said (1935 Proceedings, pp. 407, 408):

> **It must be kept in mind that the Communications Act of 1934 provides for a dual system of regulaton, with responsibility divided and subdivided among the Federal and the several State governments. It is said that a chain is no stronger than its weakest link. To make regulation effective, there must be unanimity of purpose and action....**

> ...**The whole field of telephone regulation, under the Communications Act, is built around effective co-operation between Federal and State commissions** [emphasis mine].

At its 1938 convention, NARUC adopted a resolution approving a plan of cooperation between the state commissions and the FCC (<u>1938 Proceedings</u>, p. 211; see pp. 228-234 for the full text of the plan). In its explanation of the cooperative agreement, NARUC's executive committee acknowledged that it was not a telephone question which prompted the draft of the agreement with the FCC. Instead, it was a telegraph rate case (above p. 280).

The text of "A Plan of Co-operative Procedure in Matters and Cases Under the Provisions of Section 410 of the Communications Act of 1934" was quite different from the ICC-NARUC cooperative agreement adopted in 1925. For example, the FCC-NARUC plan made no reference to a "nationwide system of communications" as compared to the ICC-NARUC acknowledgement of "a nationwide system of transportation," and there was nothing suggesting Walker's "theory of cooperation." With no recorded floor discussion, the FCC-NARUC was adopted (<u>1938 Proceedings</u>, p. 210, 226-234).

The FCC-NARUC plan was a set of <u>recommended rules</u> for how and why either Subsection 410(a) or Subsection 410(b) would be employed. It described how cooperators <u>might</u> be selected by NARUC. For reasons which are not altogether made clear in the <u>Proceedings</u>, everything about the plan was optional. Indeed, it included this caveat (p. 229):

> It is understood that **each commission**, whether or not represented in the National Association of Railroad and Utilities commissioners, **must determine its own course of action with respect to any proceeding in the light of the law under which, at any given time, it is called upon to act, and must be guided by its own views of public policy; and that no action taken by such Association can in any respect prejudice such freedom of action.** The approval by the Association of **this plan of co-operative procedure**, which was jointly prepared by the Association's standing Committee on Co-operation between Federal and State Commissions and said Federal Commission, is accordingly recommendatory only; but such plan **is designed to be**, and it is believed that it will be, **a helpful step in the promotion of co-operative relations between the State commissions and said Federal Commission** [emphasis mine].

Were those who drafted this "plan" attempting to avoid the floor debate which followed Walker's introduction of the proposed NARUC-ICC agreement to cooperate in 1925? At that time, Lewis Gettle said he would not vote for an agreement which seemed contrary to the purposes of Wisconsin's public utility laws (above, p. 223).

NARUC's New Deal leaders thought the Communications Act with its cooperative provisions made jurisdictional rate-making conflicts unlikely. NARUC's legislative committee, in 1933 and 1934, dealt with several statutory proposals constituting creation of New Deal federal agencies. Therefore, several problems associated with the overall language of Section 410 were undetected when NARUC originally reviewed the draft language of Section 410.

First, nothing in either subsection addressed the occasions when <u>all states</u> would be affected by a decision rendered by the FCC. Second, nothing in the statute authorized NARUC to be an intermediary in the selection of the state officials who would meet with the FCC as cooperators. Third, the FCC held all power to decide which cooperative mechanism would be engaged, and under which situations.

Gabel seemed also to take note of discrepencies in the language of Section 410. He wrote little about them except the following (p. 29):

> **...NARUC was in an anomalous position in separations matters. It was a federated body without authority over its constituent state regulatory members. Acting through its Commissioner Committees, together with a small staff drawn from the Commissions, it found itself in the position of recommending and adopting positions without authority to implement them, other than through personal persuasion** [emphasis mine].

How would cooperation be financed? Although Subection 410(a) authorized the FCC to award "allowances" to support cooperative activities, there was nothing which said how the monies would be funded. NARUC's President Alexander M. Mahood recommended two funding alternatives: (a) Each of the federal agencies should request appropriations to cover the traveling and subsistence expenses of cooperators in cooperative proceedings from Congress when they submitted budget proposals with their annual reports, or (2) federal statutes enabling cooperative proceedings should be amended to designate federal funding to support them (1938 Proceedings, pp. 16, 17). But federal and state legislators who freely encouraged intergovernmental cooperation were not as easily persuaded to appropriate funds needed to support the logistics of cooperative ventures. Therefore, regulators from each jurisdiction either subdivided their annual operating funds to meet ad hoc expenses of a cooperative proceeding, or refrained from active participation in cooperative activities.

The originally adopted language of Subsection 410(a) became a justification for why the FCC was reluctant to engage the states in formal rate proceedings in matters associated with the effects of interstate rate-making procedures. If the problem was recognized by federal and state officials, it was not directly addressed until the 1956 NARUC convention, and only then because the association by default or determination, yielded to an amendment alleged to correct its functional flaw. Since the next subtopical heading addresses issues for which Subsection 410(a) was presumably written to address, further discussion follows there.

Discussion of the Separations Manual, Toll Rate Disparities, and an Amendment of Subsection 410(a)

AT&T and the associated Bell companies providing interstate and intrastate toll services maintained similar price schedules before the formation of the FCC. Between 1936 and 1940, the FCC informally negotiated four reductions in interstate toll prices (Gabel, p. 36). From that time forward, prices for intrastate MTS were generally higher than interstate MTS; sometimes they were as much as 100 percent higher.

State officials were faced with political problems as soon as the public began to be aware of the interstate and intrastate MTS price differences. After all, railroad interests manipulated public perceptions in the aftermath of Shreveport in such a way as to engineer the practical political destruction of the states' railroad rate-making autonomy. Perhaps memories of those earlier years crossed Walker's thoughts when he spoke to the NARUC convention in 1938 (1935 Proceedings, p. 393):

> **...The most important reservations to the States, in the Communications Act of 1934, were made at the instance of the State commissions. They asked that their jurisdiction be preserved. They have kept to themselves the responsibility for intrastate telephone rates and services, and particularly for all local exchange rates and practices, where the Federal Commission is wholly without jurisdiction....The public will not draw fine lines of jurisdictional distinction. It will look only to the results. Either telephone regulation must be effective in giving the public satisfactory service at reasonable rates, or radical changes will be demanded in our telephone utility laws** [emphasis mine].

When the FCC announced its intention to investigate the Bell System's interstate toll rates (Docket No. 6053, April 1, 1941), NARUC asked to have the investigation made a formal cooperative rate case according to the terms of Subsection 410(a) making state commissioners voting partners with federal commissioners determining the outcome of the

<u>interstate</u> rate proceeding. The FCC responded by inviting NARUC to appoint five cooperators to sit with the federal commissioners at the first oral arguments to be presented on June 9th with a series of joint conferences scheduled to follow afterward. Attempting to follow the FCC-NARUC plan of cooperation, NARUC's President James W. Wolfe planned to select and announce a panel of cooperators to be drawn from NARUC's regional panels of available cooperators when the association's executive committee held a scheduled meeting on June 6th. But there would be no joint FCC-NARUC interstate rate case. Instead of impaneling a joint board, the federal agency announced another interstate telephone MTS price reduction on June 4. The FCC achieved a settlement with AT&T representatives by meeting with them privately (<u>1941 Proceedings</u>, pp. 142-146).

The FCC's exercise of interstate rate-making autonomy may have been a tactical blunder, injuring the effectiveness of dual regulation. Influential state commissioners interpreted the FCC's private negotiations with AT&T as an indication that the FCC was committed to rhetorical rather than functional interjurisdictional rate-making cooperation. As a compensatory gesture, the FCC asked Wolfe to appoint a "Special Committee of Conferees" to discuss "proper methods for the determination and separation of rate base value, and of operating expenses and of operating revenue as between business subject to state regulation and business subject to regulation by the Federal Communications Commission" (1941 Proceedings, p. 145).

Chairman James L. Fly of the FCC expressed his approval of the newly established FCC-NARUC cooperating committee, saying he thought the new venture would be an increasingly important joint regulatory activity. Fly said that it was impossible to apply simple models of regulation for the telephone industry because it was not readily subdivided into distinct and separate lines of business. Said Fly (p. 105):

> **The laws of physics, the plant and equipment of the companies which render telephone service, and the corporate structure of the industry were not designed with the interstate-intrastate distinction in mind. When you pick up the telephone, you are picking up an instrument which is by its very nature both interstate and intrastate. When you signal the operator, you are opening part of a circuit which may end up across the river in Minneapolis, across the state line in Wisconsin, or across the ocean in London or Tokio** [sic; emphasis mine].

Fly understood the implication of lower interstate rates, because he added (p. 105):

> And when you pay your telephone bill at the end of the month...you are paying with one check to one company for both interstate and intrastate services. **The cold hard fact which every one of us is in duty bound to recognize is that our telephone system is both interstate and intrastate--and the vision of each regulatory body must be as broad as the problem which confronts it** [emphasis mine].
>
> **A state regulatory body may think that it is concerned merely with local exchange rates, plus an occasional nod to intrastate toll connections. ...[T]he Federal Communications Commission can't knock a nickel off interstate rates without affecting directly or indirectly the regulatory**

> **problems in Albuquerque and Kalamazoo** [emphasis mine].

Fly gave these opinions of AT&T's behavior prior to the formation of the FCC (p. 106):

> Because interstate matters were in those days essentially unregulated, **there was a natural tendency for all the expenses of the telephone industry to gravitate over the intrastate side,** right under the noses of the state commissions, **while the revenues tended to gravitate over to the interstate side, beyond the reach of state regulation** [emphasis mine].

Before the FCC was created, no one could say whether or not the interstate equation yielded unwarranted profits. Fly said he thought it was possible to imagine that AT&T and its Bell System operating subsidiaries might make an opposite case if they dealt only with federal regulators, and there was no state rate regulation. In that case the telephone companies would want expenses for operating the nationwide network to be assigned to the interstate jurisdiction and revenues allocated to the intrastate jurisdictions (p. 106).

Fly described the federal agency's strategy adopted to deal with AT&T. He said (p. 107):

> **...The task of regulation should be as continuous a process as the operation of the companies regulated; particular rate proceedings are thus properly mile-posts in that continuous process** [emphasis mine].

The process became known as "continuous surveillance" of the industry. Advocates of the process said it permitted greater flexibility and would be less costly to administer. Because it depended on private, informal meetings with industry officials, the process itself would become a focus for interjurisdictional rate-making conflicts. Even at his early date, Fly seemed to understand that FCC was impolitic when it decided to set aside a jointly heard FCC-state rate case for private negotiations with AT&T, for he said somewhat apologetically (p. 107):

> **I hope that none of you will think the new program of cooperation is any less important because it is not attached to a particular rate case. Properly pursued, the cooperative studies can be more important than any single rate case, for they can be applicable to any situation which may hereafter arise.** By exploring the basic principles underlying regulatory problems, by devising practicable techniques and economical shortcuts, the cooperative venture now under way can measurably lighten our tasks in the preparation of rate orders hereafter. By sharing our burdens, we lighten them [emphasis mine].

Of seven topics assigned to the cooperative committee, Fly approved of "tackling...the separation problem as the first item on which we are to cooperate" (p. 108).

<u>The Separations Manual</u>

<u>Smith v. Illinois</u> established the principle that some investment and expenses associated with providing local exchange services should be allocated to message toll services. According to the board-to-board theory of telephone rate making, local exchange companies received monies in the form of contractual compensation for maintaining the end-point connections necessary for beginning and completing message toll service, but the parent operating company dictated how much compensation was justified on the basis of billing and operator expenses for

facilitating toll traffic rather than for the investment in central office equipment. AT&T controlled the message toll market through "the physical plant" (the tangible equipment such as poles, lines, circuit switchers) provided by either its Long Lines Department (primarily interstate message toll services) or through the interconnecting routes and plant of its affiliated Bell System operating companies.

The first "Report of the Committee of Five, Cooperating with the Federal Communications Commission in Special Telephone Studies" was an interim progress report designed to describe details of the long and complicated work undertaken by a "staff committee" (made up of state and federal commission staff members) who set about the task of examining a variety of cost allocation methods which might appropriately apply to the treatment of jurisdictional separations. The staff recommendations were presented at hearings held in October and November 1942, in Chicago.
Although some states experimented with station-to-station segregation of exchange service costs and revenues from those of message toll service, officials from other states were less confident that the Act would protect their jurisdictional rate-making autonomy if board-to-board methods were replaced by station-to-station procedures.

At NARUC's 1942 convention, the states and the FCC agreed that it would be wise to discontinue the study of separations procedures until the end of World War II. In 1943, the FCC negotiated another reduction in message toll rates. Each of the successive reductions in interstate toll rates was followed by requests for increases in the intrastate rate structure. In 1946, NARUC unanimously passed one of many subsequent resolutions addressing the FCC's reduction of interstate rates before the FCC and the states jointly adopted uniform separations procedures. The resolution "respectfully asked" the FCC to resume the proceeding slated to begin in 1942 as an investigation of separations methodologies (Docket No. 6328). The resolution was a direct result of the FCC reductions of interstate rates without federal-state jointly agreed upon standards for separations.

The first "Separations Manual" printed and distributed by NARUC in September, 1947 was predicated on the station-to-station approach (1948 Proceedings, p. 90). The station-to-station approach was inherently more complex in terms of how accounting and engineering elements would be measured, then applied. Each amendment to the manual tended to be known by a place name representing the localtion where the FCC and NARUC study groups reached an accord about the methods to be used by the companies to report the composite figures which would contribute to the aggregated revenue requirement of each jurisdiction.

Richard Gabel's 1967 text continues to be accepted as a definitive assessment of the amendments made to the separations procedures for the next nineteen years. The investigation of separations methods continued as FCC Docket

No. 6328 until January 20, 1966 when it was supplanted by another rate investigation (In The Matter of Methods for Separating Telephone Property, Revenue and Expense, cited by Gabel, p. 44, n. 30). Gabel makes a substantial case supporting a thesis that AT&T was able to seize upon the competitive regulatory interests of state vs. federal interests in order to maneuver price and revenue requirements (p. 31). Although Gabel indicated that the discrepancies between interstate and intrastate message toll prices became a significant political conflict between the state agencies and the FCC, he was silent about how the FCC may have applied Subsections 410(a) and 410(b) in alternative ways to overcome either the separations or the political problems more effectively.

Toll Rate Disparities

Toll rate disparities occurred when the prices for interstate and intrastate MTS for similar distances and time of day were different. Disparities were related to the way the FCC arbitrarily lowered prices for interstate services, and to the methods the FCC adopted which approved of the division of the aggregated revenue requirement for the AT&T-Bell System between the interstate and intrastate jurisdictions. When the FCC cancelled the 1941 rate hearing, it chose to do two things: (a) arbitrarily lower interstate prices, and (b) turn to the joint board provisions of Subsection 410(b) to establish an FCC-NARUC joint study committee. With input from the telephone industry, the committee engaged in informal data gathering and evalution of proposed methods to determine which of them had sufficient merit to be recommended as reasonable modifications to jurisdictional separations procedures.

An argument might be made that the federal commission failed to perceive that the most important manifestation of its commitment to cooperative dual regulation of the industry was to engage the states as partners in a formal rate proceeding. AT&T's Long Lines interstate toll facilities were engineered for higher capacity than the interconnecting equipment providing intrastate toll services. If engineering considerations dominated pricing considerations, then lower average unit costs to provide interstate message toll service tended to support lower prices for those services. But AT&T's economic structure was both vertically and horizontally integrated, making the financial as well as the technological integration of the interstate and intrastate MTS service categories a maze for regulators.

Most of the subscribers to the nationwide system were connected to local exchanges controlled by AT&T. At one time or another, all of the nation's long distance callers used interstate or intrastate message toll services relying on circuits controlled by AT&T. Except for the investment in approximately fifteen percent of the intrastate exchange facilities owned by the independent companies, AT&T and the Bell System accounted for all telephone revenues collected throughout the United States. A transfer of allocated costs from its Long Lines subsidiary meant that those costs would be assigned to the aggregated revenue requirements of AT&T's associated Bell System subsidiaries. In that case, they were further allocated to interstate or intrastate operations. If costs were assigned to intrastate operations, the states had the option of separating allocations between the revenue requirement of either local exchange or intrastate MTS. It was a "no win" situation for state regulators. Because they chose to keep local residential rates as low as possible, state officials risked taking the political backlash for the public's perception of the "toll rate disparity:" The Associated Bell Operating Companies priced intrastate message toll services at rates substantially higer than the prices charged by AT&T Long Lines for message toll services covering the same airline distances (<u>1942 Proceedings</u>, p. 171).

As state commissioners engaged in a discussion with Paul Walker about the importance of separations, Walter R. McDonald, chairman of Georgia's Public Utility commission, wanted "to pause long enough to whisper something in the horse's ear" (p. 379). McDonald said it was "with a great deal of chagrin" that he remembered how "the Communications Commission refused to permit [the states] to participate or cooperate in the hearing out of which this very investigation [of telephone problems] grew" in 1941. McDonald said the Georgia commission was "in the midst of bringing about reductions in exchange rates and bringing...intrastate toll rates on a level with the long line rates" when the FCC bypassed an opportunity to include the states in the FCC's Long Lines rate case.

McDonald looked upon the FCC's reduction in interstate rates as an "undue" allocation of AT&T's network costs to state jurisdictions without proper consultation with the states. This was, after all, what the states had objected to when the Transportation Act of 1920 permitted the ICC to reallocate costs for railroad freight rates to intrastate ratepayers. McDonald, who had been with the Georgia Commission since 1923 expressed a view which seemed to be held by commissioners from other states when he admitted: "...I am somewhat suspicious of the Federal Communications Commission" (p. 180).

Although Paul Walker and other FCC commissioners had spoken at length about a "spirit of cooperation" they did not seem to understand why the federal agency's insular agreement with AT&T to lower interstate rates breached cooperative intergovernmental poltical protocol. Many state officials believed they ought to jointly adjudicate cases in a manner similar to the Shreveport-inspired ICC-NARUC railroad freight rate cases heard under Subsection 13(3).

An Amendment of Subsection 410(a)

NARUC's Annual Proceedings reveal no certain evidence which explains why the FCC did not engage the states in formal telephone rate cases as it had done in the telegraph case. The federal commission's failure to do so in this first instance, and its reluctance to do so in the future, was translated by some state commissioners as a betrayal of the presumed design of interjurisdictional cooperation which would make the provisions for dual regulation of the telephone industry successful.

The record suggests but does not prove a reason why the FCC withdrew its invitation to the states. The text suggests that the FCC did not want to set a precedent which might be interpreted as state preemption of federal rate-making authority as a consequence of joint board cooperative participation. The idea is admittedly creatively assembled from a review of the legislative history of amendments to Section 410, and comments in the 1956 Annual Proceedings. The reconstruction follows:

The report of NARUC's Committee on Legislation (1956) said federal-state cooperation had been impeded by existing language of Subsection 410(a) which made the decision of a federal-state joint board equivalent to a decision of an FCC commissioner. Describing an amendment which would alter the provisions of 410(a), the report said (p. 53):

> **The broad scope of authority conferred by this language has resulted in nullifying the employment of the joint board procedure** under the Communications Act [emphasis mine].

The intent of the amendment was to make certain that any decision arrived at by a joint board would be subject to review by the entire federal commission.

The troublesome second sentence of Subsection 410(a) originally read:

> **For purposes of acting upon such matter any <u>such board shall have all the jurisdiction and powers conferred by law upon the Commission</u>, and shall be subject to the same duties and obligations** [emphasis mine].

It was followed by the next sentence which was not to be amended, but read:

> The action of a joint board shall have such force and effect and its proceedings shall be conducted in such manner as the Commission shall by regulations prescribe.

The amendment to Section 410 inserted the words "an examiner [provided for in section 1010 of Title 5,] designated by" before the words "the Commission" as Subsection 410(a) originally read. (Section 1010 referred to a general provision of the Administrative Procedures Act of 1950.). The legislative history of the amendment indicates that the FCC requested the change, with no known opposition to the FCC's proposal

The House Report to the Committee on Interstate and Foreign Commerce made the following assessment of the amendment (re: S. 1456, 84th Cong., 2d Sess.; <u>1956 U.S. Code Cong. and Adm. News</u> 4134, 4136 [Aug. 2, 1956]; c. 874 sec. 4, 70 Stat. 931).

> Section 410(a) of the act provides for the referral of matters arising under the Communications Act to joint boards composed of members from the FCC and the various States affected by a particular communications problem at issue. **Originally, the section provided that such boards should have the same power and authority as a single Commissioner designated to hold a**

> **hearing.** However, **the Communications Act Amendment** of 1952 (act of July 16, 1952, 66 Stat. 711) **abolished the former procedure under which single commissioners could hear cases, and section 410(a) was amended at the same time so as to confer on joint boards the same authority as it conferred on the commission itself** [emphasis mine].
>
> The Commission believes that such a delegation of power is too broad. It also felt that, in view of such a broad delegation, it is unlikely that it would ever find it desirable to refer matters to such boards. **The proposed amendment**...would authorize the commission to confer on joint boards the same power and authority as is now conferred on the Commission's hearing examiners in adjudicatory cases and thereby **gives the full Commission an opportunity to act before a final determination is made** [emphasis mine].

The 1956 Annual Proceedings reveal that Lester Hooker, Chairman of the Committee on Legislation was supportive of the amendment (p. 53):

> **The amendment** contained in S. 1456...**is much more conducive to the employment of the joint board procedure** than the provisions contained in the present Act [emphasis mine].

Lester Hooker was chairman of NARUC's Committee on Federal-State Cooperation in 1941. In 1945, he was chairman of its Special Telephone Problems Committee. Presumably Hooker had first hand knowledge of the 1941 occasion when the informal FCC-NARUC committee structure was substituted for the formal rate case investigation.

John Benton and Paul Walker;

Paul Walker and Walter McDonald

John Benton retired from NARUC in 1944, having served as general counsel, executive director and legislative strategist for the organization since 1920. Benton was Paul Walker's trusted professional associate and closest personal friend. He died in 1948, ending a critical NARUC-FCC affiliation.

Of Benton, Walker said: "Outside my own family, I never had a better friend" (1948 Proceedings, p. 210). Walker acknowledged (p. 211):

> **John Benton**, in his long years of service as our General Solicitor, **was very largely responsible for the adoption of the constructive policy of cooperation between Federal and State Commissions.** His contribution to the cause of Federal and State cooperation will always be a lasting monument to his memory [emphasis mine].

Walter Emery's brief biographical sketches of Walker give the impression that Walker was skeptical about the motives of people who sought out his assistance. Therefore, he placed personal trust and confidence in few people. John Benton's reputation for integrity matched Walker's. Because Walker thought of Benton as a like-minded colleague, he placed personal trust and confidince in him. ICC Commissioner William E. Lee remembered Benton as the person who had been responsible, to a marked degree, for the establishment, and finally the practical and effective operation of the cooperative arrangements between the ICC and NARUC under the Transportation Act's Subsection 13(3) (p. 209).

It is fair to say that Benton contributed to the positive attitudes about federal-state cooperative efforts in the 1920s, 1930s, and the early 1940s. There are clues which suggests that Benton's loss influenced the short-run behavior of Walker, and of other federal and state officials who negotiated proposals designed to alleviate MTS disparities. For a few years after his resignation, the Proceedings were published with minor transcription errors and were poorly indexed, unlike texts produced during Benton's administration. Formats of the Proceedings indicate that the conduct of the annual meetings changed too.

Benton perfected the art of interjurisdictional statesmanship. Where he was tactically well-practiced in the art of federal-state communication and cooperation, the Annual Proceedings indicate his immediate successors were not. The conferees received superficial briefings of pending legislation and analyses of federal court decisions prepared by Benton's short-term replacements. Interspersed in NARUC's Executive Committee reports, there are indicators of financial and organizational mismanagement in NARUC's Washington office.

NARUC called upon Walter McDonald, who had been NARUC's president in 1948, to supervise the reorganization of the association's Washington office in 1950. McDonald agreed. He took a leave of absence from the Georgia Commission to do so. Because McDonald was sightless, he may have been less aware of the publication deficiencies of the Proceedings. But McDonald was adept at the efficient replacement of staff and finances of NARUC's headquarters. McDonald served as

NARUC's interim general solicitor for several months. Therefore it was McDonald who dealt most directly with the FCC through Walker's office during critical years when the states looked upon contrasting toll rates as inequitable and untenable. As it has already been stated, McDonald doubted the FCC's commitment to federal-state cooperation (above, p. 180).

McDonald tersely challenged Walker on the concept of cooperation more than once (1942 Proceedings, p. 180; 1950 Proceedings, pp. 83-86). Walker was not one to have his integrity impugned, personally or professionally. Therefore, it is possible to infer that the social relationship between the two men was strained. McDonald used coercion as a prod for federal-state interaction. He wanted to use cooperative mechanisms to accomplish those goals he believed to best represent the interests of the public through rate regulation (below, p. 305). Of what we know of Paul Walker's public statements and his attitude that "cooperation was of the spirit" not of rules, McDonald's style was almost antithetical to the federal commissioner's public demeanor.

Subsection 410(b) and the

Toll Rate Disparities Problem

Subsection 410(b) was designed to permit FCC and state officials to confer about rate structures, accounts, charges, practices, classifications, and regulations of telephone companies subject to each jurisdictional sphere of delegated authority. The FCC is permitted to designate joint federal-state hearings, and to accept the cooperation, services, records and facilities provided by the state commissions. The subsection permits federal and state officials to confer for the purpose of exchanging information and data. By employing the mechanisms of Subsection 410(b) it avoided the appearance of establishing a common record prepared by more formal joint boards. It was a strategic move designed to avoid legal entanglements if a jointly prepared record was presented as evidence in a federal court appeal of the federal agency's orders. As long as a decision in Docket 6328 was pending, adjustments to the separations manual could be temporarily accepted by the FCC, leaving the agency free to move outside the informal FCC-NARUC committee structure to its internal decision-making realm without doing legal violence to the "spirit of cooperation." Thus began relentless informal adjustments and readjustments to either the separations methodology or the interstate rate structure, negotiated by the FCC and AT&T-Bell representatives.

At the Sixtieth Annual Convention, NARUC President Walter McDonald addressed the Savannah meeting with these comments (1948 Proceedings, pp. 18, 19):

> **The report of the Special Telephone Committee ably headed by my own colleague, Matt L. McWhorter [also of the Georgia commission] will be received....**[emphasis mine].

.....

> **This convention should give thought to the adoption of a resolution calling upon the Federal Communications Commission to institute a full scale cooperative investigation into the exisitng differentials and apparent unjust discrimination between interstate and intrastate toll rates as well as into the method now employed by the parent company for the division of revenues and expenses between interstate and intrastate operations** [emphasis mine].

Average daily toll calls (interstate and interstate) increased by more than 300 percent 1939 to 1948. The increase justifies the states' concern with message toll rate disparities (<u>1948 Proceedings</u>, p. 173; 6.2 million in 1948 compared to 2 million in 1939). Dissatisfaction with irresoluble nature of toll rate disparities was greater than it had been in 1941.

Matt L. McWhorter, of the Georgia commission, and the chairman of NARUC's Special Committee Cooperating with the Federal Communications Commission in Studies of Telephone Regulatory Problems said (<u>1950 Proceedings</u>, p. 45):

> **As a result of recent state rate increases, due to increased state costs, the disparity between state and interstate toll rates has become very substantial and is increasing.** Present methods employed to separate toll plant and expenses between state and interstate operations produce a higher rate of return on interstate toll than on state toll operations notwithstanding the fact that **state toll rates are now at considerably higher levels than the interstate schedule.** As a matter of fact, the interstate toll rate schedule has not been increased at any time during the past 25 years. **The disparity between state and interstate toll rates is extremely difficult for the public to understand and is a matter of serious concern to all of our state commissions** [emphasis mine].

> **The true test of any separations plan is whether or not it produces reasonable and equitable results.** Your Committee is of the opinion that the application of the procedures contained in the present Separations Manual does not produce reasonable results under present conditions as between state and interstate jurisdictions, and penalizes state regulatory authority. **The seriousness of the problem is emphasized by the recently reported increase in earnings from interstate toll service, and rates for which have been unchanged since they were reduced in 1946, while at the same time all of the states have found it necessary to substantially increase rates subject to their jurisdiction one or more times** [emphasis mine].

McWhorter's committee argued that revenues generated by intrastate operations redirected to the development of the Long Lines subsidiary rather than being reinvested in intrastate network redevelopment according to a management scheme directed by the parent operating company. Therefore, the committee reasoned, it was appropriate to establish a public policy which would equalize the levels of rates and earnings applicable to services under different jurisdictions.

Walker presented the FCC's reply to the Special Committee. He said the federal agency looked upon disparities differently. Although the FCC agreed that a separations procedure should produce equitable results, the agency disagreed that disparities between state and interstate toll rates and earnings were evidence of "inequitableness." The federal agency rejected the premise that uniform state and interstate rates and earnings satisfied the test of "reasonableness" which Chief Justice

Hughes spoke of when he discussed the problem of separations in Smith v. Illinois). Walker was unprepared to accept premises of telephone separations based on what the states considered to be publicly accepted principles of social value (p. 78- 81):

> **We submit that a separations procedure should be judged on its own merits as a method of cost allocation and should not be arbitrarily modified or abandoned for the purpose of equalizing the levels of rates and earnings applicable to services under different jurisdictions** [at 78; emphasis mine].
>
> ....
>
> **At present, the Separations Manual provides, wherever possible, for the direct assignment to a particular service of the toll line plant, including related expenses, that is used exclusively in that service, and allocates that portion of the plant and related expenses used jointly for the state and interstate services on the basis of relative use. This method would appear to be based on sound principles of cost allocation and at the same time recognizes the division of jurisdiction** [at 79; emphasis mine].
>
> ....
>
> **Furthermore, the proposal is objectionable in that, through the contemplated averaging of costs, as described in the Special Telephone Committee Report, the more favorable costs of the Long Lines interstate operations, which are under the exclusive jurisdiction of the FCC, would be used to reduce the allocation of Associated company toll line costs to state operations, which are under the exclusive jurisdiction of the several states** [at 79; emphasis mine].
>
> ....
>
> **Now the Federal Communications Commission is not asking that state telephone lines be placed under the Federal Communications Commission and the states are not asking for the jurisdiction to regulate the interstate toll rates and the toll lines. So I assume the matter of jurisdiction**

> **will stay where it is. We believe that the costs of furnishing both state and interstate telephone services should be determined as accurately and as equitably as it is possible to do, with due regard to existing jurisdictions. If this is accomplished, there can be no question of services under a particular jurisdiction subsidizing services beyond that jurisdiction** [at 80; emphasis mine].
>
> **In conclusion, let me again emphasize that the purpose of separations procedures is to determine, through the application of sound allocation principles and procedures, the costs of the several services under different jurisdictions The purpose is not to equalize the cost levels applicable to those services...nor to establish uniformity among the levels of earnings and rates with respect to those services. Let us not make the mistake of judging the reasonableness of a procedure solely by the results achieved by its application** [emphasis mine].

Following Walker's pronouncements, there was a brief exchange of comments. They were, however, as energized as the discussion of the Shreveport doctrine in 1914. The interim solicitor general, Walter McDonald, suggested that it was AT&T, not the FCC, who changed its method of cost allocation and division of revenues. Analagous to the statement made of Williams of Texas (above, p. 163) AT&T seemed to shape the process to its advantage: If the revenue requirement went either way, through its subsidiaries' earnings, the parent company secured increased profits. McDonald implied that profits should not be made at the expense of cooperation between the FCC and the states (p. 84):

> **So we have got to work closely together, and I don't understand some of the arguments that Mr. Walker has brought forth here** [emphasis mine].

McDonald advocated uniform pricing for interstate and intrastate MTS. McDonald, who began his professional career as a railroad regulator, looked at MTS disparities from the Shreveport interpretation of reasonable prices versus unjust discrimination. McDonald adopted the Courts' criteria determining fairness: similar rates, similar distances, similar conditions whenever a single system served both interstate and intrastate trade. He continued (p. 85):

> **...I will tell Mr. Walker that it is going to be done. If it isn't done through cooperation of the state and Federal Commissions, it will be done through Congress** [emphasis mine].

To allow the convention members to escape the heat of McDonald's assessment of Walker and/or the FCC's attitude about engaging in formal joint meetings, NARUC's president, Harry M. Miller of Ohio, adroitly said (p. 86):

> **Now, because of the lateness of the hour, I think we will pass over the report of the Committee on Cooperation Between State and Federal Commissions** [emphasis mine].

Having examined the data supplied by the FCC-NARUC staff committee, Gabel concluded that major elements which were actually pure toll investments appeared on the accounts of the local opeating company. Toll connection costs were met by prices charged entirely to local ratepayers. Although customer equipment and the local distribution facilities were engineered to meet the standards of toll transmission, rates for interstate message toll services did not reflect those costs. Each measure devised to assign a proportion of those costs to interstate toll required a political as well as an economic decision. Fairness was a judgement call rather than an absolute measurement of what was reasonable.

The procedures for allocating costs and revenues for a complex technologically and financially integrated system are exercises predicated partly on certain quantifiable costs, but partly by qualitative public policy goals, legal precedents and political maneuvers. Chief Justice Hughes knew the process of determining how separations would be achieved was not amenable to "extreme niceties" or simple solutions to separations problems when he rendered the opinions for the Chicago Rate Cases.

Federal and state jurisdictions were understaffed. When they worked together on separations and toll disparity issues, they were without the complement of cost accountants and quantitative economists to match the professional staff of AT&T and its subsidiaries. The states held perceptions of the political goals of universal service which meant they were inclined to distribute the intrastate revenue requirement in such a way as to keep prices charged for connecting and maintaining residential subscribership to local exchange service as low as possible. Gabel said (p. 60):

> **The state commissions, through the rate making process, were aggravating the problem. To meet the increase in statewide revenue requirements found necessary, the state commissions frequently imposed the major portion of increased charges on state toll rates, rather than exchange services. This was done usually**

> without knowledge of where the revenue deficiency lay; only California and Wisconsin Commissions required a breakdown of intrastate toll and exchange costs. Regulatory commissions are political bodies. While increases in exchange rates have widespread impact on all telephone ratepayers, toll rate changes have the largest effect on the business class of users [emphasis mine].

McDonald's view of the MTS pricing policy tended to prevail among state commission members. McDonald thought most toll revenues came from day time business customers who were in a position to pass through costs for telephone service. He was more sympathetic to the impact of costs on local exchange residential customers. Nevertheless, McDonald did not want intrastate MTS users to pay prices higher than interstate MTS users.

How much influence did McDonald exercise on the telephone matters? Perhaps none. But the record shows that for almost each of the years between 1947 and 1971, key chairpersons of NARUC-FCC study committees dealing with telephone issues were, as McDonald was, from the Georgia Commission. The 1966 Proceedings names NARUC-FCC cooperative committee leaders studying telephone problems (p. 529): McDonald, McWorter, Wiggins.

According to the NARUC-FCC Toll Rate Subcommittee, intrastate toll rates were averaging thirty-five percent more than interstate rates. The subcommittee report continued (1951 Proceedings, p. 357):

> **The magnitude of the disparity is such that it cannot be easily corrected. State revenue requirements in most cases would not permit any substantial reductions in intrastate toll rates.**

The FCC rejected a proposed transfer of annual revenue requirements from state toll to interstate toll. Instead, the NARUC-FCC staff committee planned to look for a way to establish a "Uniform Toll Settlement Schedule" which would permit revenues from both state and interstate toll service to be combined, and then divided to each federal and state jurisdiction according to a formula which would permit each jurisdiction to prescribe its own toll rates (p. 358).

Gabel's assessment of the toll rate disparity problem corresponds with the records of NARUC's Annual Proceedings. Gabel describes the plan which emerged as the "Davis Plan" after N. Knowles Davis who chaired the NARUC-FCC Toll Settlement Plan Subcommittee. (Knowles was chief engineer of the Georgia Commission.) It recommended jointly conducted FCC-NARUC rate proceedings which would review a single uniform nationwide schedule of message toll rates covering costs of both state and interstate toll service. Revenues would be divided among the companies to yield a return on the investment of the net book cost of the toll plant furnished by each of them. The accounting principles conformed to acceptable standards and the procedures accommodated the strategic goals of jurisdictional separations. To protect the jurisdictional authority of the states, each state would be permitted to modify the division of revenues allocated to intrastate services as it chose to, and as contrasted to a basic nationwide schedule.

AT&T vigorously opposed the plan. One of the eight reasons the company listed for doing so was tailored to irritate raw political nerves (Gabel, p. 71): "The plan would encroach upon state jurisdiction." Gabel's analysis of the FCC-NARUC telephone committee meetings indicated that from the years 1944-1955, the FCC only adopted separations procedures which met the prior approval of the parent company: AT&T.

Walter McDonald followed through with a threat to turn to Congress with the states' complaints. Consequently, in January, 1951 Senator William McFarland, of Arizona, Chairman of the Senate Interstate Commerce Committee wrote an instructive letter to the FCC's Acting Chairman, Paul Walker (cited by Gabel, p. 69 n. 52 from Telecommunications Reports, February 5, 1951, pp. 22-23). McFarland also spoke of the importance of public perceptions:

> **The trouble is the general public does not realize that every move that is made to reduce long distance toll rates results directly or indirectly in an eventual increase in local telephone rates and in intrastate toll rates. Put very simply and plainly, this merely shifts the cost from the big user to the little user...**[emphasis mine].
>
> ....
>
> **I had hoped that the proposal of NARUC for a tryout of its new separations formula would get a green light from the Commission [FCC]. Now, I understand the Commission is going ahead with a heavy schedule to begin in April for a further**

> **reduction in long distance toll rates...**[emphasis mine].
>
> **I am not in a position to pass upon the question as to whether the remedy suggested by NARUC is the proper one, but I am certain that something should be done--and at once** [emphasis mine].

Walker stepped before the NARUC's 1951 convention in Charleston on October 18th to introduce proposed changes in the methods of separating the costs of telephone exchange plant in connection to the federal agency's interstate rate investigation (Docket No. 9889). Walker had been hesitant to accept an invitation to speak at this meeting because he wondered whether there was anything he could say which would help in the solution of the toll rate problems. But a week before NARUC's convention, representatives from the Bell System presented a plan which the FCC and the Special Committee accepted. Walker said (p. 160):

> **Fortunately, events have been kind. I think we have found an effective solution to these problems** [emphasis mine].

Walker recommended an "interim plan" which, if adopted by the Charleston conferees, would permit certain adjustments to the separations manual which would justify a shift to the interstate revenue requirement of an equivalent amount of aggregated intrastate costs and expenses amounting to 112 million dollars (p. 163). Furthermore, the recalculation of certain other toll factors related to expenses between interstate and intrastate services, meant that the Bell System would transfer another 37 million dollars in corrected expenses. Walker added (p. 163):

> I realize that each State Commission representative is speculating as to the extent to which his individual State will benefit from these proposd revisions in separations procedures....I am confident that every State will look after its interests in this regard, and that the Bell System companies and the State Commissions will see to it that the benefits to the states resulting from these changes in separations, if placed in effect, will be appropriately reflected in each jurisdiction.

A somewhat reticent Walker closed his statement with these words (p. 165):

> **So I say to you, my brother Federal and State commissioners, that I hope this effort in telephone rate making which I have outlined today may be concluded as an example of a constructive effort at cooperation between the States and the Federal Communications Commission.**
>
> ....
>
> **To these staff members,** [speaking of the NARUC-FCC staff committee] **some of whom have worked their hearts out on these problems,...I take off my hat and I pay a heart felt tribute and express for our Commission a deep debt of gratitude and a vote of thanks** [emphasis mine].

The next day, NARUC's delegates voted to support revisions to the Telephone Separations Manual (pp. 211, 212):

> Whereas, The procedures now used for separating telephone property and expenses as outlined in the Separations Manual, which were recommended by the Executive committee of this Association in May 1947, have been under review by this Association and the Federal Communications Commission, and
>
> Whereas, It is essential that a single uniform method of separations be used by the state and federal jurisdictions, and

<u>Whereas</u>, Representatives of the Federal Communications Commission have proposed to this Association revisions of the present separations methods, on an interim basis, which revisions were outlined and recommended to the Convention by FCC Commissioner Paul A. Walker on the 17th day of October, 1951, and

<u>Whereas</u>, These revisions will result in a separation of telephone property and expenses between state and interstate operations which will reduce the burden on intrastate services and will be accompanied by upward adjustments in some interstate rates, to the end that the existing disparity between intrastate and interstate toll rates will be reduced;

<u>Therefore, Be It Resolved</u>, That this Association accept on an interim basis the proposed revision of the present separations methods and recommend their use by all State Commissions and the Federal Communications Commission, and

<u>Be it Further Resolved</u>, That the Association commends its Special Telephone Committee, the Federal Communications Commission and their staff committees for their action in bringing about these changes.

Gabel reported that the net transfer was somewhat less than Walker's optimistic estimates. Furthermore, the FCC permitted a $22 million interstate rate increase to go into effect (p. 159). The "Charleston Plan" as the the 1951 amendments to the separations manual came to be known only "slowed the pace of state rate applications" by the Bell System companies. It did not result in either state toll or exchange rate reductions (Gabel, p. 78). Gabel catalogues several other attempts to modify the separations manual, but he says AT&T held the upper hand. Each plan resulted in a transfer of Bell System earnings from the interstate pocket to the intrastate pocket, or vice versa.

Adjustments to the Separations Manual did not translate to reductions for either intrastate message toll or local exchange rates. Maintenance and expansion of the intrastate network presented a set of economic imperatives which sustained or elevated each state's revenue requirement. The post-war era introduced accelerated demand for expanded local exchange services, which were less sensitive to the economies which were available because of technology used by AT&T's Long Lines division. Instead, the burden of inflated material costs, wages settlements, and taxes added substantially to the intrastate revenue requirement.

The chairman of NARUC's Special Telephone Problems Committee, Matt L. McWhorter, responded to a question he heard: When would the committee's work be completed? (1958 Proceedings, p. 233):

> It is quite a difficult question to answer, but I would say, **the only way you can become stable in separation procedure is for the telephone industry to absolutely cease progressing**. So I think your Special Telephone Committee will be with you a long time [emphasis mine].

The reports of the committee, across time, are assessments of the relationship of various considerations creating impacts on service delivery and telephone rates: overseas services, defense activities, industrial safety, depreciation, wages, taxes, maintenance and expansion of new facilities, and relentless adaptations of technology which were destined to create an entirely new agenda for regulators of the telephone industry in the 1970s.

All separations amendments came about through the work of conferences and committees organized under Subsection 410(b). The message toll rate disparity problem provided the persistent source of interjurisdictional conflict. The MTS disparities were aggravated by the unilateral activities of the FCC. The Annual Proceedings indicate that the state officials were ready and willing to engage AT&T in jointly conducted formal rate case to overcome what appeared to be a political impasse. The FCC staked out insular rate-making autonomy heedless of the effects on the contrast between interstate and intrastate prices.

In 1959 McWhorter, now NARUC's president, sent a letter protesting an FCC rate reduction of $50 million applied to AT&T's interstate telephone prices to John C. Doerfer, the federal agency's chairman. Reprinted in the Annual Proceedings, it said (pp. 409, 410):

> **The suddenness of this action and the secrecy surrounding the negotiations leading up to this decision compel me to express my deep dissatisfaction and disappointment in the procedures adopted by your Commission** [emphasis mine].
>
> Since the formation of the National Association of Railroad & Utilities Commissioners of the Special Telephone Committee, of which I was Chairman for several years, the State Commissions have earnestly striven to obtain the closest possible cooperation with your commission in matters affecting the regulation of the telephone industry, particularly the American Telephone & Telegraph Company and its affiliates....It, **therefore distresses me that your Commission has seen fit to act in such fashion, to the complete exclusion of the opinions and thoughts of the State Commissions, and without due regard to the**

> **effect your actions may have in the various states** [emphasis mine].
>
> ....
>
> We view this break in the excellent cooperative spirit, which has been built up over the years, with grave concern. **It would indeed be regrettable if such actions were to prove a precedent establishing a new direction in your regulatory policies. If such were to prove the case, it would leave the states in the unenviable position of having to seek redress wherever possible, as was the case in 1951** [emphasis mine].

When Doerfer was a Wisconsin commissioner in 1950, he served with McWhorter on the Special Telephone Problems Committee. As the FCC's chairman, Doerfer said the federal agency's rate adjustment policy was consistent with its established attitude toward cooperation with the states. He therefore adopted a position asserting the jurisdictional autonomy of the federal agency for interstate rate-making. He addressed, in part, this reply to NARUC colleague, McWhorter (1959 Proceedings, pp. 411, 412):

> ...[T]**hese rate reductions were announced without prior consultation with the Association** ...[emphasis mine].
>
> **We regret that you view our recent action with respect to interstate rates of the Bell System as a departure from the policy of cooperation that has obtained between the Federal and State jurisdictions. We cannot view it as such** [emphasis mine].
>
> **This Commission, like all other telephone regulatory commissions, has a statutory obligation to maintain rates for services subject to its jurisdiction which are just and reasonable.... [Our] action was warranted by the level of the Bell System interstate earnings and the obvious trends therein, of which the NARUC has also been aware. We believe that a regulatory policy of this kind is in the best interests of the rate**

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paying public and the telephone industry and is consonant with the purpose and provisions of the Communications Act of 1934...[emphasis mine].

As the federal commission applied the public utility paradigm to the question of interstate rates, it focused attention on the rate of return earned on interstate services. Rate of return became a convenient measure of whether or not a company's prices were reasonable. According to the public utility paradigm, the rate of return for a regulated monopoloy enterprise should be comparable to what companies in an openly competitive market could expect to earn when they incurred the normal risks of doing business, operated efficiently, sought to either borrow money or attract new investment capital. If the rate of return exceeded prearranged upward level expected by the regulatory agency, the excessive rate of return was a signal that prices ought to be lowered.

Furthermore, demand elasticity aggravated the toll rate disparity. Each time the FCC lowered prices it was trying to reduce rate of return AT&T companies earned on interstate toll service. As prices were lowered, demand for interstate toll calling increased, reducing losses attributable to underutilization of Long Lines' facilities. Electronic refinements gave the interstate circuits greater capacity to accomodate greater traffic more efficiently than the facilities used to supply intrastate MTS or local services. Thus, in the manner of a landlord with space to rent on its interstate network, AT&T posted fewer vacancies when prices were lower.

The 50-million-dollar downward shift in interstate prices in 1959 simply exacerbated the message toll rate disparity. President Doerfer offered a reply which exacerbated the hostility of NARUC members. NARUC looked upon the price discrepencies in a manner similar to the issue of unjust discrimination addressed by Justice Hughes in the *Shreveport Rate Case*. Excerpts from the NARUC resolution adopted after Doerfer's reply to McWhorter reflect the states' *Shreveport*-like interpretation of the FCC's rate reductions (*1959 Proceedings*, p. 279):

> ...There exists a nation-wide problem with reference to the disparity between charges for interstate telephone tolls and intrastate telephone tolls and this problem seems to become more acute as time passes....
>
> ...It is a matter of common knowledge that in most of the states intrastate calls are more expensive than interstate calls *even though the calls are based on the same mileage and other factors are likewise the same*...[emphasis mine].
>
> ...A typical illustration of the problem can be given as follows: A four minute intrastate person to person call at night and on Sunday between Biloxi, Mississippi, and Corinth, Mississipi, a distance of 315 miles cost $2.60, while a similar interstate toll call betwen Biloxi, Mississippi, and Memphis, Tennessee, a distance of 366 miles cost only $1.55....
>
> ...The telephone subscribers and the general public constantly complain and justifiably so about this differential in intrastate and interstate toll calls and it is a problem which the state regulatory bodies cannot explain in any practical manner to the telephone users to their satisfaction....

> ...The disparity in intrastate and interstate toll calls is so great and the problem has become so acute that...[i]n **many cases the intratate call costs 100 per cent more than the interstate call....**

One way to alter the rate of return is to adjust rates: to raise or lower prices for services. Another way to manipulate the rate of return is to make adjustments in the revenue requirement, or to shift portions of the revenue requirement from one service category to another, or from one jurisdiction to another. Separations procedures provide the justification for the shift in the revenue requirement.

The FCC adopted a persistent rhetorical stance of asking whether or not state commissions applied the "savings" accrued by the transfers of portions of the intrastate revenue requirement to the interstate jurisdiction of the network. The implication was that state regulators were inefficient because intrastate customers did not appear to benefit from commensuarately lower intrastate MTS prices. Long Lines interstate services were streamlined. By contrast, the associated companies providing both intrastate message toll and local exchange services presented a sharply different configuration of costs and expenses when they applied for tariffs and justified their rates of return. They were required to upgrade central offices so that local equipment would adapt to the more sophisticated Long Lines engineering specifications. There is scarce acknowledgement of this reality found in the comments of FCC officials whether one reads the Proceedings or the FCC's annual reports to Congress.

Athough demand for high quality residential service was strong in the 1950s, at the end of the decade approximately 20 percent of the households in the United States were yet not served by local exchange service. Universal service began to be measured quantitatively by the percentage of households in each state where a telephone was operational. Therefore, the common attitude was that universal service would not be achieved unless residential prices were low enough to make connection affordable for every household.

At the same time, associated companies supplied convincing statistics which seemed to "prove" that each central office served an optimal number of subscribers. Beyond the optimal number, the marginal cost of adding each new customer increased. Hence, new residential customers reduced the economic efficiency of the network, driving up the prices for local service, and working against the goal of universal service. Even to those who familiar with the tenets of public utility economics, the accounting, engineering, and political reconciliation of revenues and costs associated with telephone separations seemed unfathomable. To those economists and public utility regulators who developed models requiring precise methods of quantifying cost allocations, justification for separations procedure seemed fictitious.

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To all but a few, however, there remained the indispensable purpose of the revenue requirement under the public utility paradigm: to produce revenues sufficient to cover all costs of operation and make possible a reasonable rate of return on the value of the plant assigned to each of the three service categories: interstate MTS; intrastate MTS, and local exchange service. Rates should provide a steady revenue stream avoiding wild fluctuations so that there would be uninterrupted maintenance and expansion of an acceptable grade of service within each customer classification. Furthermore, the states held a general view that a "good rate structure" meant that prices charged for basic rates to customers in any one of an operating company's exchanges should be the same as customers paid in exchanges of similar size, and that MTS rates should be uniform for length of time and distance.

Requiring Federal-State Cooperation:

Subsection 410(c)

From the 1950s to the mid-1960s, the <u>Annual Proceedings</u> present various discussions of the "climate of cooperation" said to exist between officials of the FCC and state commissions. The extended informal FCC-NARUC study committees were testimonies of endurance as they attempted to achieve what sometimes were competing political and economic goals. The "Special Committee on Telephone Problems" was reorganized and renamed as a pragmatic acknowledgement that the special nature of telephone pr

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problems had become an enduring problem: MTS disparities between the federal and state jurisdictions.

Telephone committee reports were written as if the best hoped for was _detente_ between federal and state authorities. But resolutions adopted at annual NARUC conventions left little doubt that much of the strain on the federal-state intergovernmental relationship centered on MTS toll disparities. Another generation of federal and state regulators tried to come to grips with the challenges of dual regulation of the telephone industry at the same time the FCC began to engage in hearings which had the potential of introducing limited competition into industry submarkets. Nothing appears in the _Proceedings_ to refute Gabel's hypothesis that AT&T was the primary beneficiary of separations procedures. As potential competitors petitioned to enter interstate submarkets, AT&T would surely marshall a bevy of analysts to explain why the federal authorities should resist any further transfers of the aggregate revenue requirement to the interstate jurisdiction.

NARUC's Communications Committee Chairman Ben T. Wiggins of Georgia sent a letter (in February, 1965) to the FCC's Chairman E. William Henry asking him to convene an immediate hearing for the purpose of reconsidering interstate rate reductions scheduled to be effective April first (_1965 Proceeding_, p. 433). Henry wrote back to say it would not be useful or productive to hold further meetings on the toll disparity issue. According to Henry, the FCC sta

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staff used the process of "sound cost allocation" to determine how much prices should be reduced.

Several months later, Henry addressed the New York NARUC Annual Convention to speak on the topic: "Communications Problems--1965." With comments which were now routine when federal commissioners addressed these gatherings, he said FCC-NARUC staff committees had worked together "over the years...harmoniously and successfully." In doing so, he used the tried and true examples of successful federal-state cooperation: accounting regulation and depreciation rates. Then the FCC Chairman moved on to tell state commissioners what to expect if they pressed on with the topic of message toll disparities as the justification for amendments to the separations manual (p. 505, 506):

> In the area of telephone separations procedures...there have been substantial differences among us as to what can and should be done to improve those procedures. The fact that much difference of opinion should exist is entirely understandable, considering the complexity of the problem, and its far-reaching impact on rates and revenue requirements in all jurisdictions [emphasis mine].
>
> Our mutual concern with this area is of course intensified by the so-called disparity problem [emphasis mine].
>
> It is well known that in many instances the charges for interstate toll calls are considerably below those for intrastate calls of approximately the same distances. This has caused much dissatisfaction among users as well as regulators, and has generally sparked continuing efforts on both our parts to mitigate and minimize this problem. Such disparity, and its influence on our separations procedures, has thus created widely

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> **disparate views within our ranks, and at times threatened to "separate" us** [emphasis mine].
>
> **...Under our federal system, each separate state jurisdiction not only has the authority, but the responsibility to fix...charges in accordance with the conditions it finds in the area subject to its jurisdiction....Under these circumstances, we must acknowledge that these different bodies of men--with different philosophies, faced with different physical factors, different usage patterns and different elements of investment and expenses--will come up with differing systems of charges for their own jurisdictions. And thus are disparities born** [emphasis mine].
>
> ....
>
> **...I believe it is clear...that in the very nature of things, disparity rather than uniformity should be expected, and treated as the norm. The only way that disparity could effectively be eliminated would be to transfer responsibility for all toll calls, whether intrastate or interstate, to one jurisdiction...**[emphasis mine].

Henry denied that he was advocating a "super-regulatory agency" to deal with the disparities problem. Although he praised the NARUC-FCC separations committee for devising a plan in 1962 which "killed two birds with one stone by reducing the disparities" at the same time intrastate toll prices were reduced. Henry warned that the FCC would resist further efforts to transfer any more of the aggregate revenue requirement to the interstate jurisdiction (p. 507).

Henry wanted the NARUC convention to realize that a "communication explosion" was already altering the configuration of the "telephone industry." He was speaking about a number of applications reviewed by the FCC, which, if approved, would make it possible for new entrants to scale the protective barriers of the telephone industry which had

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been erected by AT&T and maintained by the application of the public utility paradigm. By adapting existing technologies and creative marketing, entrepreneurs wanted to provide direct and specialized customer-to-customer services which would mean that revenues generated by some customers classified as using subcategories of interstate message toll services would be drawn away from the existing public network (p. 507).

Furthermore, Henry said the public network would experience growth in plant and equipment making the aggregated value of the public network approach $75 billion by the mid-1970s. He predicted that each jurisdiction would be required to cope in its own way with the growth and complexity of the communications revolution of the next decade. Politically speaking, each jurisdiction was going to "go it alone" with its separate constituents. Henry concluded (pp. 508, 509):

> ...**[W]e must, each of us in our respective jurisdictions, devise procedures to provide us with the fullest and most accurate information regarding plant, equipment usage trends, and new service demands** [emphasis mine].
>
> ...**[W]e must each take steps so as to provide ourselves with staffs that will be adequate in size, outstanding in competence, beyond question in integrity, and as fully trained as necessary to meet such expanded and complex tasks** [emphasis mine].
>
> ...**[W]e must, each of us, devote an increasingly large proportion of our available resources to planning for the future, to the development of blue prints, if you will, to develop some regulatory goals, and the procedures needed to reach them.** If we fail, we will

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> inevitably become prisoners of the vast volume of applications, tariff filings and other paper work that are an inevitable part of such regulation. we will lose our initiative, and become increasingly unable to meet our basic responsibilities to regulate for the public good [emphasis mine].
>
> **Of this much we may be certain; the problems of our new age cannot be contained in a box labelled "the good old days." So I call upon you to commit yourselves--as we commit ourselves--to increased effort to meet the challenges that lie ahead. With such effort I am sure that we will achieve our goals, and fulfill our role as meaningful partners in the solution of Communications Problems--1965** [emphasis mine].

The FCC was not going to take on jointly heard formal telephone cases when it was grappling with the introduction of satellite services, the emergence of cable television, minority ownership of broadcast stations, and a host of other issues. President Lyndon B. Johnson had announced that the nation's economy was prepared to deal with both "guns and butter." He announced commitment to a full scale military involvement in Vietnam at a time domestic policy called for a "war on poverty." The economy faced the possibility or rapidly escalating inflation to satisfy the competing demands for a fixed money supply. Therefore, it was in the short term political interest of the FCC to demonstrate that it was performing efficiently by lowering interstate telephone rates.

In what must have seemed a heretical statement to the state commissioners, Henry said they ought to accept MTS disparity as a fact of life. His entire address was the equivalent of saying: You have your problems, we have ours.

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We're going to go it alone on these rate related issues and you should too. Solve your own political problems about telephone rates. It was not a message state officials wanted to accept.

Officials of the FCC's Common Carrier Bureau were by now accustomed to negotiating the terms of rate reductions with AT&T officials in private meetings. This was part and parcel of continuous surveillance regulatory strategy adapted to keep interstate earnings within a permissible range for the company's rate of return designated by the regulatory contract according to the public utility paradigm. Use of unannoucned private meetings rather than public hearings is not a tenet of public utility regulation; it is an administrative mechanism claimed to expedite the regulatory process. The FCC said the in camera meetings reduced regulatory lag, saved public and private resources otherwise spent on drawn-out hearings. The unanswered question, however, was whether or not interests of an anonymous public are served when rates were adjusted upward or downward through private meetings. The states wanted to be active partners in the process rather than passive recipients of the outcomes of FCC-AT&T negotiated rate reductions.

Most state commissions used private meetings at one time or another for what they believed to be the immediate benefit of the utilities and their customers: to negotiate the terms of rate changes (1966 Proceedings, p. 405).

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There was a difference in the outcomes. The states were seldom able to adjust prices downward, and whatever the price adjustments were at the state level seemed to have no relevance to the interstate rate structure. When the separations process was modified, however, it was done more openly, with input from varied sources. Furthermore, the effects of the transfers of revenue requirement to the interstate equation seemed imperceptible to the general public.

NARUC's complaints to Congress about the FCC's in camera meetings with AT&T/Bell officials were welll-suited to a period when there were general questions raised by reformers about federal administrative procedures. They were more specifically expressing dissatisfaction with the results of those meetings. The disparity issue was at the heart of the following resolution which said, in part (1965 Proceedings, p. 590):

> ...**Cooperation between the Federal Communications Commission and the several State regulatory authorities in regulating the rates and services of such companies is definitely in the public interest**...[emphasis mine].
>
> ...**The Congress in enacting the Federal Communications Act recognized the necessity for such cooperation and specifically provided for a joint board procedure to facilitate cooperation between the Federal Communications Commission and State regulatory authorities in matters of mutual concern**...[emphasis mine].
>
> ...**[T]he Federal Communications Commission has engaged and is still engaged in conducting informal and in camera proceedings...which...have in the past produced these irrational and unconscionable disparities between intrastate and**

interstate message toll rates and earnings and have failed to give weight to the contribution of local exchange facilities and service...[emphasis mine].

...[We]...call upon and urge the Federal Communications Commission to immediately reactivate the joint board procedure established by such Cooperative Agreement and, in lieu of the present method of in camera rate negotiations, that proceedings involving rate changes be made the subject of formal investigation and public hearing under the Cooperative Agreement, with full notice to the public and opportunity to all interested parties, including State regulatory authority representatives, to participate in such hearings to the full extent provided for under appropriate procedure, and, on the basis of such hearings, to eliminate the iniquitous disparities between intrastate message toll rates and earnings and to prescribe just and reasonable rates so as to advance the public interest...[emphasis mine].

Copies of the resolution were sent to the FCC, state commissions, House and Senate Committees on Commerce and to all other members of Congress (p. 550).

The <u>1966 Proceedings</u> gives no hint of whether or not the FCC received pressure from Congress because of the resolution. However, NARUC's President James A. Lundy was pleased to announce that three state commissioners would be parties to an investigation into AT&T's interstate and foreign rate structure (p. 14; re: Docket No. 16258):

...The most significant matter which arose to require our serious attention during the past year was the action of the Federal Communications commission in initiating an investigation of rates of American Telephone and Telegraph Company and associated matters. The former Chairman E. William Henry of the FCC very cordially extended an invitation to me to designate cooperating State Commissioners to sit in with the presiding officers of [the] FCC for hearings and considera-tion of the proceedings. It was my happy privilege to comply with that request by

> appointing Commissioner Wallace R. Burke of Connecticut, Chairman Paul A. Rasmussen of Minnesota and Commissioner Jesse W. Dillon of Virginia to serve in that capacity. They have my sincere gratitude for their willingness to undertake the onerous amount of work which these appointments entail [emphasis mine].

The state cooperators sat with the FCC as passive observers rather than co-examiners (comments to me by Bernard Strassburg, November 10, 1989). Therefore, NARUC, as an organized entity, announced its intention to participate as an invervenor in the proceedings in order to actively participate in the process determining which of the principles and procedures would be adopted and employed by the FCC for separating and allocating plant investment, revenues, operating expenses, taxes and depreciation reserves between intrastate and intrastate operations of the Bell System.

Furthermore, the FCC once again altered the original plan of cooperative proceedings. It divided them into two phases, assigning separations issues to the second phase. This meant that possibilities of reducing jurisdictional MTS disparities were indefinitely postponed. The FCC was determined to control the extent to which the states would be allowed to actively engage in the "cooperative" investigation.

NARUC filed a request asking to have separations issues made the first order of business. Denying the request, the FCC issued a counterproposal which recommended the formation of a working committee of technical experts of interested part

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parties for the purpose of bringing together their divergent viewpoints and narrowing as many issues as possible before there would be a reconsideration of advancing the issue of interjurisdictional separations to phase one of the investigation (1965 Proceedings, p. 473).

NARUC complied. NARUC organized technical experts from among state and federal commission staff members, representatives from the Bell System, the independents (United States Telephone Association), Western Union, and another federal agency: the General Service Administration. NARUC facilitated the purpose of the language of Subsection 410(b) by continuously making available to the FCC the services, records, and cooperation of state commission staff persons, thus conserving the resources of the federal agency. But to what extent was the federal agency facilitating state regulation?

Although the FCC was persuaded to hear the proposals prepared by the technical experts' group, the FCC refused to accept the methods which appeared to have the greatest promise of addressing aspects of cost allocation which seemed fundamental to addressing the MTS disparity problem for both interstate and intrastate service categories: a state-by-state allocation of local exchange central office components based on how they were actually used for the origination and completion of toll message connections. The FCC claimed the rejected methods constituted such radical alterations to the Separations Manual that to consider them would require a separate proceeding for proposed rule-making (1968 Proceedings, p. 457, 459).

Furthermore, the Interim Decision and Order issued by the FCC (Docket No. 16238 [July 5, 1967]) had widespread effects for the states. As a result of the order, the revenue requirements of more than twenty states were increased in 1969, with projections that they would increase again in 1970 (1969 Proceedings, p. 497). Then in January, 1969 (Docket No. 17975) the FCC issued another order which eliminated a provision of previously operational separations methods. Its effect was to assign a higher unit cost for the Long Lines-Associated company jointly used central office equipment to the intrastate jurisdiction, thereby cancelling out the 1962 methods which reduced MTS disparities. NARUC officials saw the FCC's actions as the thorough perversion of the premise of federal-state cooperation. Furthermore, the federal agency appeared to violate Subsections 221(c) (requiring the FCC to hold a separate hearing whn the federal agency determined whether or not common carrier property would be classified as used in interstate or foreign telephone toll service) and Subsection 221(d) (restricting the descretion of the federal commission to only that part of the property determined to be used in interstate or foreign telephone toll service).

Meanwhile, the associated companies announced their intentions to file for rate increases to meet an additional $500 million aggregate revenue requirement for intrastate services. The Bell companies used accelerating inflation as the justification for increasing the revenue requirement. Still, the overall performance of the Bell Systems' earnings pushed the rate of return to 8.36 percent, more than ten percent above the 7 to 7.5 percent range authorized by the FCC as a return on interstate operations (1969 Proceedings, p. 137).

Again, NARUC went to the FCC to ask the federal agency to realign the separations manual according to the recommendations devised by the joint staff of technical experts and supported by the subcommittee studying separations and toll rate disparities. NARUC's President Harry T. Westcott sent a letter to FCC Chairman Rosel H. Hyde on September 18, 1969. This time NARUC was addressing problems in terms of local exchange rates as well as MTS disparities. The letter had a strongly worded message which complemented a pro-consumer atmosphere currently swirling about congressional corridors. The letter asked the FCC to reconsider the terms of its approach to separations matters, saying (1969 Proceedings, p. 137):

> **...[I]t is very important, in furthering the accomplishment of the broad national goals of benefiting consumers and of resisting inflation, for the FCC to cooperate with the State commissions by seeking to reduce the cost of local telephone service by the reallocation method here urged** [emphasis mine].
>
> **Obviously, the average user of telephone service is benefited more by fixing his flat monthly charge for service at the lowest practicable level rather than by reductions in interstate toll rates--rates which are generally**

> **paid by a more affluent class of users. The lower the flat monthly charge the more accessible telephone service is to the economically depressed and to others who are severely disadvantaged by inflation. Furthermore, the value of telephone service increases proportionately with the number of telephone users, and the more users the lower the cost of service for each user** [emphasis mine].
>
> **Enclosed is supporting technical material regarding our proposed reallocation of Bell System property and expenses** [emphasis mine].

With the standard solicitude taken by earlier FCC chairmen, Rosel Hyde answered President Westcott's letter. He made it clear that the proposal submitted by the technical experts group which was rejected two years earlier would be given little chance of approval if revived and presented to the FCC for reconsideration. It would be "promptly" sent to the agency's analysts. When they found time to reexamine the proposal, and if they discovered merits of the mothodology, then and only then would the the Common Carrier Bureau ask to have the proposals placed on a formal agenda for reconsideration by the commissioners. All this would take time...a long time. Hyde said, among other things (p. 129):

> **The Commission** fully shares the concern of Mr. Westcott and **believes that all reasonable measures should be taken to avoid increases in the costs of consumer services subject to our respective jurisdictions.** At the same time, you will appreciate that constraints of law and sound regulatory policy require that separation procedures should be premised on acceptable and rational principles of cost allocation, and that such procedures cannot be predicated solely upon considerations of shifting revenue requirements from one jurisdiction to another. We are therefore prepared to undertake promptly appropriate consideration of the merits of the

> suggested revision in the allocation procedures applicable to central office equipment. To this end, **we are recommending...a study and analysis of [your] proposed revision and upon consideration of the joint report and recommendation the Commission will determine promptly what further action may be warranted with respect thereto** [emphasis mine].

When the FCC looked at the costs of consumer services subject to federal jurisdiction, they looked at consumers who were the large volume business users who could leave the interstate network unless their federally supervised rates were also spared the deleterious effects of inflation (Schiller, 1982). Hyde ended his letter to Westcott saying the Commission would not take action with respect to NARUC's petition requesting a change in the separations rules, but the FCC chairman promised the agency's "full cooperation in arriving at an early resolution of these matters" (1969 Proceedings p. 140). Hyde's promise of "cooperation" was tantamount to dimissing the problems confronting the states.

President Westcott reported that NARUC's leadership was prepared to seek a solution to the question of "full cooperation" and a "resolution of these matters" that went beyond Rosel Hyde's office. The North Carolinian addressed the 1969 Denver convention with the language of political gamesmanship (p. 9):

> ...**Our approach to regulatory problems this year has been an offensive approach.** In the beginning we set out to get on the offense and stay on the offense if we were to put some points on the scorebord [emphasis mine].

Chairman Warren G. Magnuson of the Senate Commerce Committee introduced a bill to amend Section 2 rather than

Section 410 on April 22, 1969 (Federal-State Communications Joint Board Act of 1969, S. 1917, 90th Cong., 2d Sess.; H.R. 12150, a companion bill, was introduced by Congressman Fred B. Rooney of Pennsylvania.) The proposed amendment was one of ten bills written solely by NARUC and submitted as a package to Congress for the purpose of addressing regulatory problems in several fields of commerce. Not surprisingly, two of the members of NARUC's Ad Hoc Committee organized to write and direct the progress of the bills were State Commissioners Francis Pearson of Washington and George Bloom of Pensylvania. Magnuson and Rooney introduced all of the proposals. Was Senator Magnuson persuaded that it was time for concerted federal-state cooperation on separations issues and MTS disparities because NARUC could show him that the prices paid by his State of Washington constituents for daytime person-to-person MTS were more than 100 percent higher than prices they paid for interstate MTS? (<u>1967 Proceedings</u>, p. 101).

NARUC claimed that state commissions should have at least a minority voice in making a determination about how 100 percent of the aggregated investment in property devoted to the nationwide telephone network (almost $31 billion in 1967) should be separated between federal and state jurisdictions when the portion devoted interstate and foreign service amounted to $8.1 billion (<u>1969 Proceedings</u>, p. 156). If adopted, the legislation (proposed Subsections 2[c]-2[i] would create a seven-member board composed of <u>four</u>

FCC commissioners designated by the FCC and three state commissioners nominated by NARUC and appointed by the FCC. The joint board would have sole administrative authority under the Communications Act of 1934 to adopt and amend separations procedures. An order of the joint board would be deemed an order of the FCC for purposes of judicial review. Although the proposal sounded curiously like the original provision of Subsection 410(a), it was far more deliberately drafted to include details about appointments, tenure, funding, and the discretion the joint board would have with regard to the weight of its decisions on interstate or foreign communication toll service (the full text can be found in the 1969 Proceedings, pp. 157-159).

Two weeks after the NARUC Annual Convention in 1969, and shortly before Senate hearings were to begin, the FCC announced another negotiated reduction of interstate toll rates for the Bell System amounting to $237 million (November 5, 1969). At the same time the Bell System was seeking rate increases totaling over $500 million for intrastate toll and local exchange services. NARUC had no problem marshalling the states' troops to the Congressional hearings on proposed Section 410(c). Paul Rodgers reported that fifty-one state commission representatives from thirty-two States were present at Senate Commerce Committee hearings on the joint board proposal in December. Fifty state commission representatives from thirty states were present for the House hearings held the following February (1970 Proceedings, p. 17).

The FCC's newly appointed Chairman Dean Burch came to the Capitol accompanied by the Chief of the Common Carrier Bureau Bernard Strassburg to oppose H.R. 12150. Burch could not explain why the FCC's behavior seemed to be contrary to legislative intent to promote federal-state cooperation. When Rhode Island's Congressman posed questions to Burch, he deferred to Strassburg. A portion of the examination of the FCC officials follows: (Joint Board for Telephone Separations: Hearings on H.R. 12150 Before the Committee on Interstate and Foreign Commerce Subcommittee on Communications and Power, 91st Cong. 2d Sess., 131, 132 [February 25, 1970]).

> MR. TIERNAN; On page 12 of your statement you make reference to the present law that allows you, as you say, the procedures for a Joint Board which has long been utilized. Can you tell me when the Joint Board was last utilized?
>
> MR. BURCH: Are you talking about the FCC?
>
> MR. TIERNAN: Yes, sir.
>
> MR. STRASSBURG: We have never used the Joint Board because we have used the informal procedure.
>
> MR. TIERNAN: But the law does provide for the Joint Board so you feel by cooperative proceedings you do not need to have a Joint Board?
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> MR. BURCH: That has been my understanding. Also, the procedure has long been utilized by the Interstate Commerce Commission.
>
> MR. TIERNAN: You have the same authority under Section 410. I know the ICC has used it and yet the FCC has not.

MR. STRASSBURG: Perhaps one observation that may be relevant, Mr. Tiernan, is in the ICC you are dealing with motor carrier routes very often and you are dealing with other transportation routes which involve just a few States. It is easy to convene a Joint Board under this pattern of a representative from each of the States involved, but here we are dealing with all jurisdictions.

MR. TIERNAN: When you have this cooperative representation, whom do you have there? Don't you feel with a respresentative group more or less appointed by NARUC you have what we are talking about enacting and what you say is practiced by the legislative act?

MR. STRASSBURG: We deal with a representative group of experts from the States who in turn report to a communications committee of the NARUC who in turn report to a larger executive committee of the NARUC and who in turn report to the annual convention of the NARUC....

Tiernan's probe continued until Strassburg declared that the federal agency did not believe Section 410 could work as Congress intended it to. Strassburg said it would improbable to expect anyone among the state commissioners who would place the collective interest of all states beyond the self-interest of the policies of the commissioner's own state (at 131). Until NARUC brought the issue forward, Congress was generally unaware of how poorly the existing cooperative mechansisms functioned. It was very difficult to appreciate the extent of interjurisdictional rate-making problems of the states when interstate telephone prices were declining, use was increasing, and local exchange rates seemed almost universally affordable.

Strassburg was interviewed to gain his perspective of of the contemporaneous environment in which he appeared with

Burch before Congress. When asked why there were no formal federal-state joint boards appointed to investigate telephone industry rate structures prior to the adoption of Subsection 410(c), Strassburg said the Communications Act was deficient in so far as the statute left NARUC without the necessary authority to appoint a panel of cooperators to co-determine the outcome of formal investigations (personal comments to me, 1989). He recalls an early separations proposal he worked out with Knowles Davis, of the Georgia Commission in 1951 which called for formal co-determination of separations procedures under a single uniform nationwide schedule of message toll rates to cover the cost of both state and interstate toll service. It was formulated by members of the NARUC-FCC Special Telephone Committee's staff members, chaired by Knowles Davis of the Georgia Commission, Strassburg, and others.

Strassburg confirms Gabel's assessment of outcome of "The Davis Plan" (pp. 70-72). AT&T set forth eight reasons for opposing the Davis Plan. Among them was a standard cliche once used by the railroad companies: The plan would encroach upon state jurisdiction. Furthermore, Strassburg says it was proposed at a time when FCC professional staff members held Paul Walker's political accumen in low esteem. While he advocated federal-state cooperation, FCC attorneys were advising newly appointed commissioners not to jeopardize the federal agency's autonomous rate-making pr

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prerogatives by inviting the state commissioners to participate in joint rate-making decisions.

Following the conclusion of the congressional hearings, FCC Chairman Dean Burch asked for a deferment on further action on the pending legislation. As a gesture of reconciliation, Burch suggested that separations proposals be considered by a federal-state joint board in a letter sent to NARUC on March 17, 1970 (1971 U.S. Code of Cong. and Ad. News, 92d Cong., 1st sess. 1511, 1514). After procedural rules were agreed upon between FCC Chairman Burch and NARUC President Francis Pearson, on May 19, 1970, the FCC adopted a Notice of Proposed Rule Making and Order Convening a Joint Board in Docket No. 18866 to consider changes of FCC rules relating to jurisdictional separations by adapting, for the first time since 1956, the available mechanisms provided by Subsection 410(a). In doing so, the "experimental" formal joint board strained the provisions of the Act because the existing language of Section 410 did not deal with NARUC-designated appointments. (The 1970 Proceedings give summaries of the procedures adopted by the FCC and NARUC to facilitate the experimental joint board and the history of its activities [pp. 54-64; also see 23 FCC 2d 465]).

On October 7, 1970, the NARUC-FCC joint board reached an agreement on a proposed amendment to Section 410, which, in effect adopted the federal-state joint board procedures used in FCC Docket No. 18866. Paul Rodgers informally calls

Subsection 410(c) the "Black Horse Tavern Compromise" because that's where he met for lunch and to work out a deal with the Common Carrier Bureau's Bernard Strassburg which amended NARUC's original legislative proposal. NARUC's executive committee understood that the FCC would launch stiff opposition to the clause which made the decisions of joint boards administratively final as the original language of Subsection 410(a) had done when the Communications Act was adopted in 1934 (personal communication from Rodgers, May 28, 1985; see also 1970 Proceedings, p. 185).

Subsection 410(c) was adopted in the summer of 1971 (H.R. 7048: Federal-State Communications Joint Board Act, 92d Cong., 1st Sess.; Pub. L. No. 92-131). FCC Chairman Burch appeared before the House Subcommittee on Communications and Power to support H.R. 7048. Burch said Hearing on...H.R. 7048, p. 3 [June 29, 1971]):

> ...**The original Separations Manual came into being in 1947 through...cooperative efforts. A number of substantial revisions in separations procedures have occurred since then through the joint efforts of the State commissins and the FCC** [emphasis mine].
>
> **Without dwelling on past history, it is sufficient to note that the Commission opposed earlier versions of the bill which would have made the decision of the joint board final primarily because it would have removed from the Commission the sole responsibility of determining interstate communications common carrier rates. The Commission indicated, however, that it intended to continue to cooperate with NARUC in further refining procedures in jurisdictional separations matters** [emphasis mine].

Burch was as candid as he was when hearings were held two years earlier. He said most of the economies in the telephone industry had been made through the technological improvements to message toll service which the consumer could not be expected to understand that when the newspapers reported that the FCC was lowering rates. He went on to say (at 5):

> For that reason, the **State commissioners**, and very rightly, **wanted to participate in the entire separations area**, not only that portion which deals with the States, but that portion which deals in the interstate field, **because quite obviously when we [at the FCC] determine that x percent of plant may be charged to the interstate field we have in effect determined the amount that applies in the interstate field, because the balance is intrastate.** So the State commissioners felt, and rightly enough, that they should be a part of that process [emphasis mine].

NARUC's First Vice President and Chairman of the Executive Committee George Bloom spoke also in support of the restructured amendment which now fit with the provisions of Section 410 rather than Section 2. Bloom said (at 9):

> **We believe the FCC has been too prone over the years to regard our nationally integrated communications system as bing divided into parts--interstate and intrastate--and to shower the economies of long-distance circuitry upon the interstate callers instead of flowing the benefits through to the far more numerous and less affluent local callers** [emphasis mine].

Bloom's assessment of the FCC's inattentiveness to the effects of its actions on intrastate telephone traffic is reminiscent of the delemma encountered by ICC commissioners McChord, Meyer and Clements evaluated decades earlier the failure of Texas commissioners to recognize the impact of intrastate rate procedures on interstate railroad traffic. Curiously, it was state commissioners rather than federal commissioners who were saying that communications system was "nationally integrated" rather divided into parts. In the Congressional hearings held on H.R. 12150 and H.R. 7048 it was NARUC, for the states, speaking about the unfair rate discrimination and social equity issues rather than the FCC.

The compromise legislation provided that the FCC "shall refer any proceeding regarding the jurisdictional separation of common carrier property and expenses between interstate and intrastate operations" and "may refer any other matter relating to common carrier communications of joint Federal-State concern to a Federal-State Joint Board." Although joint boards are not administratively final, as they would have been under the pre-1956 language of Subsection 410(a) or under the terms of the 1969 proposal to amend Section 2, the mechanisms of Subsection 410(c) have been engaged almost continuously since 1971 to reconcile interjurisdictional rate-related issues. In each instance, there is a formal, common record established, making coordinated regulatory policies more acceptable to the federal courts.

In his address to the Las Vegas convention, NARUC President Francis Pearson spoke about the "Future Role of Regulation" (1970 Proceedings, pp. 9-18) Pearson introduced "Competition" as one of several matters which would deserve attention of concerns as the course of regulation moved beyond the 1960s and into the 1970s. He used the example of the FCC's newly established sets of rules attendant to the the Carterfone Decision (13 FCC 2d 420 [1968]) and the MCI Decision (18 FCC 2d 953 [1969]). Said Pearson (p. 16):

> **...[T]hese decisions could lead to certain benefits by encouraging entities other than the established utilities and manufacturers to enter the communications field....The regulator is, I believe, placed in a special position of importance and must...understand the new and dynamic factors which have been unleashed. In short, responsible regulation must allow the telephone companies to change to meet the competition under a new set of rules. If we stymie utilities in competitive areas such as these, we will weaken them unnecessarily at a time when conditions demand they remain strong and viable. Further, regulators must be vigilant to insure that the special benefits which will accrue to the limited members of business and individuals as a result of these decisions will not place burdens on the general body of utility users** [emphasis mine].

Pearson's last major concern was that of "Federal-State Jurisdiction." It was a redundant theme at NARUC convenations since the emergence of the Shreveport doctrine and federal preemption of states' rate-making practices. He said one of the prime responsibilities of state regulation in the 1970s would be to alter the trend of federal encroachment into the intrastate regulatory sphere of influence by replacing it with increased federal-state regulatory cooperation. In the tradition of state regulators who were his forerunners as NARUC presidents, Pearson said (p. 17):

> **...The opportunity for cooperation...is unlimited....Where there is an overlap in jurisdiction, these problems must be resolved through Federal-State cooperation, not by**

> **unilateral actions by any one regulatory agency** [emphasis mine].
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> ....
>
> The problems we will face with the Federal government and the Federal agencies are in part the result of the failure to understand the integral part regulation must play to achieve national and economic goals. The problems which we will face in the 1970's are of such magnitude--that **the full extent of our efforts should be to provide solutions--rather than divert** part of this **energy to maintaining Federal-State** jurisdictional **boundaries of authority**...[emphasis mine].
>
> ...As regulators, **we must indicate that we understand the problems of service, of social responsibility, and of the environment. We must communicate what the cost of such solutions will be. We must get cooperation to work toward achieving an adequate solution for the mutual benefit** [emphasis mine].

NARUC's Chairman of the Committee on Communications, and Vice-chairman of the Georgia Commission delivered the text of a memorial resolution for Walter R. McDonald, who continued to be an active Georgia public service commissioner until his death. A member of NARUC for 48 years, McDonald was the keeper of an institutional memory of the origins and applications of Subsection 13(3) of the Transportation Act, of New Deal interpretation of dual regulation and the promises of federal-state cooperation for the telephone industry (1971 Proceedings, pp. 277, 278). McDonald, who overcame the handicap of total blindness to render decades of public service when natural monopoly theory within the federal and state spheres of regultory authority had supplanted an earlier competitive era in the telephone industry.

The "old war horse" died in on February 25, 1971. Walter McDonald lived just long enough to see the reemergence of competition in the telephone industry. Competition reintroduces uncertainties absent under the public utility paradigm. The Carterfone Decision, the MCI Decision, and the 1971 Specialized Common Carrier Decision (29 FCC 2d 870) ushered in the reconfiguration of the telephone industry, and the reconfiguration of regulatory policy for federal and state officials who have been delegated shared responsibility and dual authority for providing rapid, efficient, nationwide telephone service available so far as possible to all the people of the United States (Section 151).

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CHAPTER IX

A PERSPECTIVE OF THE FINDINGS AS THEY RELATE TO THE STATED THESIS

Acknowledgment of Selective Bias In the Presentation of Evidence

A review of each of the Annual Proceedings of the conventions held by the National Association of Railroad and Utilities Commissioners from 1889 to 1971 was conducted in search of the political and/or economic factors contributing to the development of the statutory provisions of Section 410 of the Communications Act. The volumes of the Annual Proceedings address interrelated reports and discussions on various topics dealing with several separate fields of public utility regulation. Therefore, for each of the volumes reviewed, the problem of my own selective bias doggedly challenged the progress of presenting a reliable historical view of the evolution of the federal-state intergovernmental relationship and the mechanisms for interjurisdictional cooperation which were legitimized in the language of Section 410.

Data from each volume of the Proceedings was aggregated and reviewed. Selections of reports and/or commentaries were chosen for further evaluation. Text describing efforts made to reconcile interjurisdictional regulatory conflicts through either informal federal-state conferences and committees, or through appeals to the federal courts were noted and compiled. It became necessary to organize the selected information into a narrative demonstration of evidence which would address the basic research question: What political and/or economic circumstances contributed to the development of the statutory provisions of Section 410?

In reply to the foundation question and each of its subsets, commentaries were woven together with my personal perspective. This strategy was applied in Chapters V--VIII because the statements made by federal and state officials who attended the annual NARUC conventions reveal the origins of Section 410. The commissioners spoke of mutual regulatory goals and the necessity of establishing a pragmatic working relationship among themselves. Finally, Subsection 410(c) acknowledges the special intergovernmental relationship fostered by NARUC's leadership across the years. Some commentaries were chosen because they represent the views of officials who were prepared to discuss the limits of cooperative interaction. As might be expected, among the commissioners certain individuals assumed greater roles in the movement toward a stronger intergovernmental relationship than others. Their statements demonstrate direct linkage between cooperative endeavors associated with the dual regulation of the railroad industry which were adapted to dual regulation of the telephone industry. Hence, they were contributors to the evolution of ideas actions which led to the statutory development of Section 410.

This presentation makes no pretense of addressing all of the factors which contributed to the circumstances addressed by the organization of the evidence. Several sources of information were examined. However, the *Proceedings* are a selective archival representation of the give and take intergovernmental relationship which developed between federal and state regulators who saw merit in coordinating separate telephone service rate-making activities as they tried to administer the laws of their delegated spheres of jurisdictional authority.

Reconciliation of the Thesis with the Findings

The evidence set forth in Chapters V -- VII offer ample support for the two propositions of the thesis statement: (a) Section 410 of the Communications Act of 1934 is a provision favoring the appointment of joint boards to facilitate those rate-making procedures associated with dual regulation of the United States' domestic telephone industry, and (b) it symbolizes an intergovernmental relationship called "cooperative federalism" by New Deal era scholars. Although the first premise appears obviously true a reading of Section 410, it is within the realm of scholarly activities to probe beyond the obvious to determine if there are indeed exceptions to that which appears to be an obviously true statement. Evidence found in the *Proceedings* and in collateral documents gives greater indication that the premises are true than to recommend otherwise. It has further established that the language of Section 410 emerged as compromises blending lofty aims of cooperative federalism with political expediency for those who have been required to interpret the interjurisdictional obligations of the Communications Act.

NARUC was formed to facilitate the general purposes of the Transportation Act of 1887. Federal and state organized to pool their intellectual resources to address issues associated with the disparate demands placed upon state and ICC officials charged first with responsibility to regulate the railroad industry and then other public utility-like industries. They were committed to the idea that certain vital services must remain accessible and affordable for the largest number of people as possible at the same time the private ownership of the supply of these services received just compensation for performing services government itself would otherwise be required to assume in order to sustain the support of the people. Whether essential public services are provided competitive suppliers or monopoly suppliers, government retains an interest in securing an environment where the services are readily available, and affordable.

Members of NARUC, as government officials, sought to reduce the effects of disruptive influences in the marketplace which degrade anticipated service standards or jeopardize the public's perception of their continued availability and affordability. It may be that the foremost event in the course of federal-state regulatory cooperation which led to the adoption of Section 410 occurred when state railroad commissioners accepted ICC Chairman Thomas Cooley's invitation to come to Washington to discuss how officials from the separate jurisdictional spheres of authority could collaborate in the development of standard procedures and standard laws which would facilitate dual regulation of the railroads.

Developments in the intergovernmental relationship which led to the adoption of Section 410 were dependent upon the activities of people who thought it was possible to exercise more effective regulation of the telephone industry by integrating the regulatory resources of state and federal commissions rather than assigning rate-making responsibilities to one federal "super-agency." The developments were accelerated whenever state officials perceived threats to their legitimate rate-making prerogatives.

As the evidence from the Annual Proceedings from 1889 forward indicates, federal and state commissioners were given to commentary revealing deeply shared sentiment that their separate and combined responsibilities required mechanisms for intergovernmental cooperation which represented unique and important experiments promoting pragmatic constitutional federalism in the United States. Federal and state officials who have regulated the railroad and the telephone industries have recognized practical problems associated with placing restraints on the behavior of giant corporations who control the supply of services considered vital to the economic and social well-being of society. It was through their mutual desire to collaborate that they were able to mobilize severely limited administrative resources to countervail coordinated strategies organized by railroad companies to oppose government restraints on profit maximization.

As long as federal law accorded only weak rate-making authority to the ICC to correct unjust discriminatory railroad rate-making practices, federal and state members of NARUC found it satisfactory to meet informally to negotiate issues where the rules established by officials of one jurisdiction created overlapping effects in another. Terms of the Hepburn Act (originally encouraged by NARUC) altered the informal relationship because railroad companies discovered that they could delay the application of rate schedules ordered by either the state or federal commissions by claiming that rules ordered by state jurisdictions encroached on the authority of the federal jurisdiction. By manipulating the federal court system, railroaders established and then exacerbated an adversarial relationship between the ICC and the state commissions.

By the second decade of the twentieth century, experienced federal and state officials were beginning to realize that there was a legal void which limited the extent to which they could formalize joint intergovernmental action to reconcile rate-making differences between jurisdictions through the auspices of NARUC. Concurrently the ICC and finally the Supreme Court were called upon to evaluate the overlapping effects of Texas freight tariffs on Louisiana shippers. Federal law was clear: Unjust discrimination impairing interstate trade, resulting from any source, was unlawful. The ICC's responsibility was to prevent the exercise of those unlawful discriminations exercised by companies engaged in interstate trade even to the extent that the intrastate which would otherwise appear to be reasonable must be set aside.

Although there is no reason to believe that Justice Hughes was an enemy of intrastate rate-making authority, the opinion he rendered in the Shreveport Rate Case resurrected the old antagonisms associated with the premises of dual federalism. Those conflicts generally had been in abeyance during a transitory period when state governments led the movement toward greater control of public service industries. Hughes himself had been a leader in the State of New York's public utility reform movement.

The aftermath of the Shreveport decision placed great strains on the informal federal-state "spirit of cooperation." Because it was common for members of the ICC to be appointed from the ranks of NARUC's leading state commissioners, the federal agency's Chairman Balthasar H. Meyer played a critical role in restoring a semblance of intergovernmental cooperation. He asked Congress to sanction formal federal-state proceedings which would permit representatives of the separate jurisdictions to address interjurisdictional rate-related issues. It was during the period from 1914 to 1922 that NARUC, as an association, assumed a more assertive role as a collective organization before Congress representing public interest through the activities of the state railroad and public service commissioners. It was also during this period that it became apparent to the states that the rate-making autonomy they exercised for intrastate telephone rates was as readily amenable to federal preemption as railroad rates had been. Political collaboration between the ICC commissioners and NARUC's leadership was employed to persuade Congress to adopt Subsection 13(3) of the Transportation Act of 1920--the forerunner of Section 410 of the Communications Act of 1934.

In the years from 1914 to 1922 state commissioners realized that procedures which had been applicable to railroad regulation required modification to meet the specific conditions associated with the performance of the telephone industry. Transportation issues rather than communications issues continued to take priority at the ICC, leaving the function of setting interstate rates largely to the purview of AT&T rather than close regulatory supervision by either federal or state jurisdictions. This is not to say that the ICC was indifferent to telephone oriented issues. The Transportation Act assigned general

responsibilities to the ICC in matters involving accounting procedures for all common carriers engaged in interstate as well as intrastate business. But there appeared to be no federal imperative directed to the issue of interstate telephone rates. The state commissions demonstrated a genuine willingness to assist the ICC in matters of accounting and depreciation although the federal agency threatened preemption of state depreciation practices. The states attempting to exercise telephone rate supervision discovered that their progress was impeded by the petitions brought to the federal courts requesting review of state orders on the basis of either jurisdiction or procedure.

NARUC was somewhat successful in its plan to more actively participate in ICC rule-making using the general language provided by Subsection 13(3) to become involved in certain rate investigations undertaken by the federal agency. The ICC and NARUC negotiated a formal agreement to abide by a cooperative plan of interaction. NARUC formed a standing committee to facilitate the plan. Oklahoma Corporation Commissioner Paul A. Walker was its chairman for nearly a decade.

When Congress became determined to exercise supervision of AT&T's rate-related activities, it did so without appreciation for the intrinsic differences applicable to the economics and technologies of transmission of electrical power, point-to-point telephone service, and broadcast radio. In the sweeping reformation of the federal

government's involvement in these industries, the states understood that their intrastate telephone rate-making authority was at jeopardy. But by the late 1920s, NARUC's leadership was better prepared to mount a legislative campaign to sustain the role of the states in the regulation of rates for telephone services than it had been able to do when the Transportation Act diminished intrastate railroad rate-making authority.

Following a strategy designed by its general solicitor, John Benton, the states, as individual entities and through NARUC, persuaded the New Deal era's Congress to write limitations on the extent to which the FCC would be permitted to preempt the rate-making autonomy of the states. The states were able to assure Congress that they were in a better position to encourage expansion of local exchange services at affordable rates than a federal commission would be in a position to do. Furthermore, interstate revenues provided only a minor amount of AT&T's aggregated revenues in the 1930s. To facilitate dual regulation, Congress was persuaded also to look upon Subsection 13(3) of the Transportation Act as a model for resolving interjurisdictional conflicts which would otherwise become the purview of the federal courts and which seemed to confound the successful progress of dual regulation of the accelerating growth of the industry's power in the nationwide economy.

Members of NARUC saw the Communications Act itself as what Elazer described as a "contractural tie" binding the states and the FCC in a cooperative arrangement through the joint enforcement of federal and state rules. Paul Walker's appointment to the FCC seemed to further reduce the likelihood of conflicts and misunderstandings between officials of the federal and state regulatory agencies but that was not to be the case. What NARUC, and perhaps Walker, failed to realize was that Subsections 410(a) and 410(b) did not provide for NARUC's direct participation in the appointment of joint boards, and that seven commissioners, not one, would determine whether or not joint boards would be appointed for formal rate investigations. Section 410, as it was written into the original Act remained an experiment in "cooperative federalism" with the characteristics described by the Iowa Law Review (above, p. 58).

Congress made it possible for the FCC to assume a leadership role which would translate the symbolic idealism of cooperative federalism into a functional federal-state working relationship through the language of Section 410. The original provisions of Subsection 410(a), flawed as they may have been in their composition, permitted the FCC to share interjurisdictional rate-making authority with the states. The language was sufficiently broad to authorize the FCC to engage state officials as representative partners who would negotiate with the FCC and industry representatives to determine how interstate rate-making practices would produce the least disruptive effects on intrastate rates. This was something the FCC did not wish to do.

Instead, the federal agency moved to weaken the original language of 410(a) by amendment in 1956. In a skilled maneuver circumventing NARUC resistance, the FCC implied that the states would have greater involvement in formal rate-making proceedings if the federal commissioners retained authority to veto joint board decisions. With hope that the states would be included as partners in the issues where federal decisions involved overlapping effects for intrastate rates, NARUC's leadership acquiesced to the FCC's veiled promise of more direct cooperation toward joint federal-state policy making.

The stance adopted by the FCC indicates that federal officials characterized the federal-state relationship as hierarchal with a perception that FCC rule making always superseded intrastate practices. Indeed, the FCC exercised exclusivity with regard to interstate rate making, regardless of the political or economic consequences for the states. With the view that the states were subservient in rate matters, an attitude developed among FCC officials that formal cooperative federal-state joint proceedings enabled the states to encroach upon the federal agency's sphere of authority. Whatever the symbolic implications of Section 410 were, the FCC was determined to diminish its functional importance until Congress required the federal agency to do otherwise.

The FCC relegated "cooperation" to the mechanisms provided by Subsection 410(b): informal federal-state committees organized by NARUC. By doing so, the federal agency retained control of the outcome of committee deliberations. FCC also reduced the likelihood that the position introduced by the states in formal joint rate-making hearings would attract the attention and/or support of congressional committees in advance of FCC orders on controversial matters. From the FCC's view, implementation of the joint committee structure under Subsection 410(b) did not require the semblance of true bargaining to bring closure to an issue. Prior to 1970, 410(b) led to some meeting of the minds; but it was only nominally effective as a mechanism for the resolution of fundamental problems (such as the MTS disparities).

Subsection 410(b) provided <u>pseudo arenas</u> as distinguished from <u>effective</u> structures to actuate ideals of cooperative federalism. Study committees facilitated communication between federal and state officials. However, the recommendations made by the committees were often received by the FCC with no formal action required of the federal agency. The committees had only the power of persuasion, which was weaker than the persuasive power of AT&T according to Gabel. Although interjurisdictional cooperation took on great importance for state commissioners, it was far less important to members of the FCC. (See the statement of FCC Chairman E. William Henry, above, pp. 229-330.) Review of the data indicates that while federal agency officials spoke approvingly of federal-state cooperation, their behavior belied a pro-active commitment to the philosophy of cooperative federalism prior to 1970.

The ICC allocated the preponderance of its resources to railroad-related issues rather than telephone regulation. As had been the case with the ICC, it appears as if the FCC, required by Congress divide attention between broadcast and point-to-point communications issues, allocated fewer resources to the regulation of the telephone industry than to the development of radio and television services during the 1940s and the 1950s when the states were monitoring rapid expansion of local exchange services and the growth of intrastate message toll service. However, it must be remembered that state commissioners, as their federal counterparts, were charged with regulating rapid growth for a variety of public utility oriented services. With those factors in mind, it should not come as a great surprise that AT&T was able to manipulate the regulatory agenda in a manner appearing to confound the public policy processes.

The federal perspective of telephone regulation was that it was working successfully during the twenty years following the adoption of the Communications Act. With each reduction in interstate rates, use of interstate MTS increased. Local exchange subscribership increased as well. The FCC functionally rejected the states' premise that interjurisdictional MTS disparities seriously hindered the achievement of the overall aims of dual regulation.

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Presuming that federal law prevented the states from frustrating the goals of the federal agency, the FCC appeared to be disinterested in the goals of the states: uniform interstate and intrastate MTS rates. However, the states used the MTS disparity problem as a focal point to demonstrate the FCC's failure to effectively implement the existing provisions of Subsections 410(a) or 410(b). They demonstrated to Congress the practical utility of actualizing the philosophy of cooperative federalism through the appointment of formal federal-state joint boards.

Principal framers of the original versions of Subsections 410(a) and 410(b) seemed to incorporate the ideals of cooperative federalism, yet those ideals foundered prior to 1970. The stance taken then by the FCC meant the promises of "unity and integration" (above, p. 64) of policies devised and practiced within and among the respective spheres of government necessarily fell short of accomplishment with regard to dual regulation of the telephone industry under the public utility paradigm.

Congressional adoption of Subsection 410(c) removed some of the barriers to effective federal-state cooperation which the FCC had steadily erected for three decades. By requiring the FCC to appoint joint boards whenever its actions may have overlapping effects for state rate regulation, Congress opened the gates of the inter-jurisdictional public policy arena to the states, offering them an opportunity to demonstrate the talent and objectivity of state officials who would be able to participate in the establishment of a common record of proceedings about matters of multijurisdictional import in cooperative rather than adversarial circumstances. Subsection 410(c) elevates the status of cooperative federalism simply because it reduces the degree of structural imbalance which otherwise exists between the power of the FCC and the power of the states in the overall nationwide decision making process. Asymmetry existed when cooperation remained the permissive discretion of the federal agency, making cooperative federalism illusory with respect to telephone regulation. Subsection 410(c) enhances the potential of public policy partnership between the federal government and the states.

Federal and state officials have different perspectives and experiences which make it difficult to establish an effective arena in which bargaining can proceed (Schelling, T. C., 1960, The Strategy of Conflict). However, those problems were taken into account by Congress and contributed to the reason why provisions for dual regulation were written into the Communications Act, and why the language of Section 410 was included as it has been. Because regulatory power has been delegated to both federal and state officials, they ought to be required to seek alternative routes to resolution of overlapping matters than hasty resort to either reliance on federal preemption and the federal-state litigation likely to follow it.

Although FCC orders challenged by the states have typically been upheld by the courts, the FCC may be unwise to rely solely on the comparative strength gained by litigation to impose its will on state government agencies. This is especially so in a period when the public utility paradigm continues to be a pervasive model for supervision of local exchange services and rates. In the contemporary environment, the public utility paradigm is juxtaposed with unproven practices associated with a nebulous mode called "regulated competition" applicable to providers of interstate and intrastate interexchange services. It remains the responsibility of state regulators to sustain affordable local service at rates which provide just and reasonable compensation to the local network service provider with the least possible impediment to the progress of competition among interexchange carriers.

Ironically, Congress not only restated a commitment to dual regulation and to the ideals of cooperative federalism when it adopted Subsection 410(c) in 1971, it did so at a time when restructuring of the nationwide telephone industry began an irreversible forward momentum. Perhaps Congress moves cautiously to amend the Communications Act because it is uncertain whether or not the FCC sustains a full appreciation of the local importance citizens give to <u>their</u> interpretation of universal telephone service. By distributing the regulatory burden among federal and state officials, Congress diffuses repercussions it might otherwise experience if the FCC were the sole agency responsible for the allocation of joint costs associated with providing local exchange and interstate and intrastate services. The procedures, although reconfigured by competition in the interexchange markets, are as vitally important to the process of determining interexchange and local exchange pricing policies today as they were in 1970.

Subsection 410(c) adds substantial weight to the states' claim that the FCC's encroachment upon their legitimate rate-making prerogatives. It appears to have permitted the states to have a significant positive role in the formulation of policies to accommodate the least disruptive effects of the continuing reconfiguration of the nationwide telecommunications infrastructure. The states individually and collectively exercise considerable control over what kind of networks are built within their borders by means of the kinds of regulations, tax laws, and the business climate they create.

In most states, the public service commissions continue to act as the agents for customers of local exchanges. Congress would be on weak ground if the traditional interests of local exchange customers were permitted to be swept away by arbitrary actions of the FCC. Negotiations among players must take place to secure a fair distribution of regulated and unregulated services. Subsection 410(c) provides for a common record established by a panel of federal and state commissioners who attempt to reconcile the sometimes competing interests and goals of the states and the FCC who share the responsibility of supervising a rapidly diversified nationwide telecommunications industry where point-to-point voice grade telephone services continues to play a vital role in the welfare of society.

Recommendations for Additional Research

There have been no major amendments to the Communications Act which alter the basic relationship between the states and the FCC with regard to the status of dual regulation; it seems relevant to investigate the status of federal-state cooperation with regard to rate-making issues since 1970. This study has made no attempt to evaluate the efficacy of joint boards. It seems appropriate to conduct a policy study toward that end, choosing among one of several dockets when mechanisms of Subsection 410(c) have been employed.

Perhaps it is not necessary to examine the record for a detailed account of the occasions when mechanisms of Section 410 were employed prior to 1970 to evaluate the effective-ness of Subsection 410(c). For archival reasons, however, completion of the undone task deserves further consideration.

APPENDIX A

SECTION 410 (a)(b)(c)

Immunity from prosecution granted by this chapter is as extensive as the testimony and is not limited to proceedings or questions growing out of this chapter and extends to both federal and state prosecutions. In re Lazarus, D.C.Cal.1967, 276 F.Supp. 434; In re Loughran, D.C.Cal.1967, 276 F.Supp. 393.

When a witness claims privilege against self-incrimination when questioned about possible violation of this chapter, subsec. (*l*) of this section granting absolute immunity to the witness is self-executing. In re Loughran, D.C.Cal.1967, 276 F.Supp. 393.

Witnesses who declined to answer questions concerning possible violations of federal statutes, including this chapter on grounds of self-incrimination before grand jury would be granted immunity from prosecution and compelled to answer questions. Id.

"Transactional immunity" granted by this section affords the witness protection from prosecution for or conviction of the offense related to the testimony, and is not limited to the use of the particular testimony or the fruits thereof. State v. Kenny, 1975, 342 A.2d 189, 68 N.J. 17.

9. Grand jury proceedings

Since original grand jury investigation in which defendant testified clearly was based on a violation of Communications Act, defendant's immunity under section of that Act prevented any type of prosecution based on any transaction, matter or thing to which he testified. U.S. v. Gebhard, C.A.Cal.1970, 426 F.2d 965.

Under this section, describing class of witnesses to whom statutory immunity attaches as being composed of persons compelled to testify in any cause or proceeding, criminal or otherwise, based upon any alleged violation of this chapter, it is the "proceeding", and not necessarily the indictment or indictments resulting therefrom, which must be based upon this section, and grand jury proceeding is a "proceeding" ("criminal" in nature), for purposes of this section. Marcus v. U.S., C.A.Del.1962, 310 F.2d 143, certiorari denied 83 S.Ct. 933, 372 U.S. 944, 9 L.Ed.2d 969.

A witness cannot control scope of grand jury investigation or challenge relevancy of questions asked, and it was not error for court, directing witness to answer questions, in exchange for immunity conferred by this section, to direct witness to answer all questions and not merely those having to do with violations of this chapter. Id.

9a. —— Refusal to testify

The purpose of imprisonment of grand jury witness who refused to answer questions put to him after he was granted the immunity conferred by this section was to coerce him to answer questions and was not to punish him for his failure to answer. In re Grand Jury Investigation of Giancana, C.A.Ill.1965, 352 F.2d 921, certiorari denied 86 S.Ct. 437, 382 U.S. 959, 15 L.Ed.2d 362.

The record, in contempt case against grand jury witness who refused to answer questions put to him after he was granted the immunity conferred by this section failed to show that the questions were irrelevant. Id.

Where witness before grand jury declined to answer question concerning possible violations of federal statutes, including this chapter on grounds of self-incrimination, district court had duty to invoke its civil contempt power. In re Lazarus, D.C.Cal.1967, 276 F.Supp. 434; In re Loughran, D.C.Cal.1967, 276 F.Supp. 393.

Where witness before grand jury declined to answer questions concerning possible violations of federal statutes, including this chapter, district court would invoke its civil contempt power by issuing order recognizing and confirming the immunity automatically granted to witness under this chapter and would compel witness to answer questions before grand jury and if witness refused to comply, district court would hold him in civil contempt and commit witness to jail until he complied with court order and answered questions. In re Lazarus, D.C.Cal.1967, 276 F.Supp. 434; In re Loughran, D.C.Cal.1967, 276 F.Supp. 393.

Where witness refused to testify before grand jury concerning possible violations of federal statutes including this chapter even after witness had been granted immunity from prosecution, witness would be held in civil contempt of court and be ordered imprisoned for the term of the grand jury or until he answered questions before grand jury. In re Lazarus, D.C.Cal.1967, 276 F.Supp. 434.

10. Production of documents

Any failure of Commission to promulgate rules governing procedures for investigative proceedings did not preclude Commission from compelling parties being investigated to produce documents and give testimony, where such failure was not prejudicial. F.C.C. v. Schrieber, C.A.Cal.1964, 329 F.2d 517, modified on other grounds 85 S.Ct. 1459, 381 U.S. 279, 14 L.Ed.2d 383.

11. Evidence

UHF television station which sought evidentiary hearing on its objection to two proposed community antenna television systems failed to present sufficient evidence to show that UHF development might be deferred by the operations, or to establish that existing television service was threatened by the proposed operations. Indiana Broadcasting Corp. (WANE-TV) v. F.C.C., 1968, 407 F.2d 681, 132 U.S.App.D.C. 218.

§ 410. Joint boards and commissions

(a) State joint boards; reference of communication matters; composition; jurisdiction, powers, duties, and obligations; conduct of proceedings; force and effect of joint board actions; members: nomination, appointment, and rejection; allowances for expenses

Except as provided in section 409 of this title, the Commission may refer any matter arising in the administration of this chapter to a joint board to be composed of a member, or of an equal number of members, as determined by the Commission, from each of the States in which the wire or radio communication affected by or involved in the proceeding takes place or is proposed. For purposes of acting upon such matter any such board shall have all the jurisdiction and powers conferred by law upon an examiner provided for in section 3105 of Title 5, designated by the Commission, and shall be subject to the same duties and obligations. The action of a joint board shall have such force and effect and its proceedings shall be conducted in such manner as the Commission shall by regulations prescribe. The joint board member or members for each State shall be nominated by the State commission of the State or by the Governor if there is no State commission, and appointed by the Federal Communications Commission. The Commission shall have discretion to reject any nominee. Joint board members shall receive such allowances for expenses as the Commission shall provide.

(b) State commissions; conferences with Commission regarding matters of carriers subject to their jurisdiction; joint hearings; cooperation with Commission

The Commission may confer with any State commission having regulatory jurisdiction with respect to carriers, regarding the relationship between rate structures, accounts, charges, practices, classifications, and regulations of carriers subject to the jurisdiction of such State commission and of the Commission; and the Commission is authorized under such rules and regulations as it shall prescribe to hold joint hearings with any State commission in connection with any matter with respect to which the Commission is authorized to act. The Commission is authorized in the administration of this chapter to avail itself of such cooperation, services, records, and facilities as may be afforded by any State commission.

(c) Federal-State Joint Board; reference of proceedings regarding jurisdictional separation of common carrier property and expenses between interstate and intrastate operations and other matters relating to common carrier communications of joint concern; jurisdiction, powers, duties, and obligations; recommendation of decisions; State members; presence at oral arguments and nonvoting participation in deliberations; composition; Chairman

The Commission shall refer any proceeding regarding the jurisdictional separation of common carrier property and expenses between interstate and intrastate operations, which it institutes pursuant to a notice of proposed rulemaking and, except as provided in section 409 of this title, may refer any other matter, relating to common carrier communications of joint Federal-State concern, to a Federal-State Joint Board. The Joint Board shall possess the same jurisdiction, powers, duties, and obligations as a joint board established under subsection (a) of this section, and shall prepare a recommended decision for prompt review and action by the Commission. In addition, the State members of the Joint Board shall sit with the Commission en banc at any oral argument that may be scheduled in the proceeding. The Commission shall also afford the State members of the Joint Board an opportunity to participate in its deliberations, but not vote, when it has under consideration the recommended decision of the Joint Board or any further decisional action that may be required in the proceeding. The Joint Board shall be composed of three Commissioners of the Commission and of four State commissioners nominated by the national organization of the State commissions as referred to in sections 302(b) and 305(f) of Title 49, and approved by the Commission. The Chairman of the Commission, or another Commissioner designated by the Commission, shall serve as Chairman of the Joint Board.

(As amended Sept. 30, 1971, Pub.L. 92-131, § 2, 85 Stat. 363.)

Codification. In subsec. (a), "section 3105 of Title 5" was substituted for "section 11 of the Administrative Procedure Act (5 U.S.C. 1010)" on authority of section 7(b) of Pub.L. 89-554, Sept. 6, 1966, 80 Stat. 631, section 1 of which enacted Title 5, Government Organization and Employees.

Sections 302(b) and 305(b) of Title 49, referred to in subsec. (c), were repealed by Pub.L. 95-473, § 4(b), Oct. 13, 1978, 92 Stat. 1467, as part of the repeal of the Interstate Commerce Act and the incorporation of the provisions of that Act into subtitle IV of revised Title 49, Transportation. For distribution of former sections of Title 49 into the revised Title 49, see distribution tables preceding section 1 of Title 49.

1971 Amendment. Subsec. (c). Pub.L. 92-131 added subsec. (c).

Short Title. Section 1 of Pub.L. 92-131 provided that: "This Act [enacting subsec. (c) of this section] may be cited as the 'Federal-State Communications Joint Board Act'."

Legislative History. For legislative history and purpose of Pub.L. 92-131, see 1971 U.S.Code Cong. and Adm.News, p. 1511.

Code of Federal Regulations

Access charges, see 47 CFR 69.1 et seq.

APPENDIX B

TEXT OF <u>LOUISIANA V. FCC</u>

Syllabus

LOUISIANA PUBLIC SERVICE COMMISSION *v.* FEDERAL COMMUNICATIONS COMMISSION ET AL.

APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 84-871. Argued January 13, 1986—Decided May 27, 1986*

The Communications Act of 1934 (Act) grants to the Federal Communications Commission (FCC) broad authority to develop and regulate "interstate and foreign commerce in wire and radio communication," 47 U. S. C. § 151, but also provides that "nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service," § 152(b). In 1980 and 1981, the FCC issued orders changing its prior rules concerning practices for depreciating telephone plant and equipment. Subsequently, upon the petition of private telephone companies, the FCC ruled that § 220 of the Act, which expressly directs the FCC to prescribe depreciation practices, operated to pre-empt inconsistent state depreciation regulations for intrastate ratemaking purposes, and that, as an alternative ground, federal displacement of state regulation was justified as being necessary to avoid frustration of validly adopted federal policies. The Court of Appeals affirmed.

Held: Section 152(b) bars federal pre-emption of state regulation over depreciation of dual jurisdiction property for intrastate ratemaking purposes. Pp. 368-379.

(a) Sections 151 and 152(b) are naturally reconciled to define a national goal of the creation of a rapid and efficient telephone service, and to enact a *dual* regulatory system to achieve that goal. P. 370.

(b) Neither the legislative history of § 152(b) nor the Act's structure supports the view that the words "charges," "classifications," and "practices," as used in § 152(b), were intended to refer only to "customer charges" for specific services and not to depreciation charges. Those words are terms of art that are to be interpreted by reference to the

*Together with No. 84-889, *California et al.* v. *Federal Communications Commission et al.;* No. 84-1054, *Public Utilities Commission of Ohio et al.* v. *Federal Communications Commission et al.;* and No. 84-1069, *Florida Public Service Commission* v. *Federal Communications Commission et al.*, on certiorari to the same court.

trade to which they apply, and thus they embrace depreciation. Pp. 371–373.

(c) There is no merit to the argument that § 152(b) does not control because the plant involved is used interchangeably to provide both interstate and intrastate service, and that § 152(b)'s reservation of authority to state commissions should be confined to intrastate matters that do not substantially affect interstate communication. Although state regulation will generally be displaced to the extent that it stands as an obstacle to the accomplishment of the full purposes and objectives of Congress, a federal agency may pre-empt state law only when and if it is acting within the scope of its congressionally delegated authority. Here, § 152(b) constitutes a congressional *denial* of power to the FCC to require state commissions to follow FCC depreciation practices for intrastate ratemaking purposes, and the FCC may not take "pre-emptive" action merely because it thinks such action will best effectuate federal policy. Moreover, the Act itself establishes a process designed to resolve "jurisdictional separations" matters, by which process it may be determined what portion of an asset is employed to produce or deliver interstate as opposed to intrastate service, 47 U. S. C. § 410(c). Thus it is possible to apply different rates and methods of depreciation to plant once the correct allocation between interstate and intrastate use has been made. Pp. 373–376.

(d) Nor is there merit to the argument that § 220, which directs the FCC to prescribe the classes of property for which depreciation charges may be included under operating expenses in fixing rates, and which prohibits carriers from departing from FCC-set regulations respecting depreciation, requires automatic pre-emption of all state regulation respecting depreciation. The meaning of § 220 is not so unambiguous or straightforward as to override § 152(b)'s command that "*nothing* in this chapter shall be construed to apply or to give the Commission jurisdiction" over intrastate service. Pp. 376–378.

737 F. 2d 388, reversed and remanded.

BRENNAN, J., delivered the opinion of the Court, in which WHITE, MARSHALL, REHNQUIST, and STEVENS, JJ., joined. BURGER, C. J., and BLACKMUN, J., dissented. POWELL and O'CONNOR, JJ., took no part in the consideration or decision of the cases.

Lawrence G. Malone argued the cause for appellant in No. 84–871 and petitioners in Nos. 84–889, 84–1054, and 84–1069. With him on the briefs for petitioners in No. 84–889 were *David E. Blabey, Margery F. Baker, Janice E. Kerr, J. Calvin Simpson, Gretchen Dumas, Jack*

Shreve, Steven W. Hamm, Raymon E. Lark, Jr., Christopher K. Sandberg, Philip Stoffregen, Patrick Nugent, Frank J. Kelley, Attorney General of Michigan, *Louis J. Caruso,* Solicitor General, *Don L. Keskey* and *Leo H. Friedman,* Assistant Attorneys General, *Lynda S. Mounts, Stuart J. Bassin, William Paul Rodgers, Jr., Joel B. Shifman, Kenneth O. Eikenberry,* Attorney General of Washington, *Larry V. Rogers,* Assistant Attorney General, *Irwin I. Kimmelman,* Attorney General of New Jersey, *Carla Vivian Bello,* Deputy Attorney General, *Joseph I. Lieberman,* Attorney General of Connecticut, *William B. Gundling, Peter J. Jenkelunas,* and *Phyllis E. Lemell,* Assistant Attorneys General, *Brian Moline, Howard C. Davenport, Lloyd N. Moore, Jr., Steven M. Schur,* and *Robert Waldrum. Michael R. Fontham, Marshall B. Brinkley, William S. Bilenky, Paul Sexton, Anthony J. Celebreeze, Jr.,* Attorney General of Ohio, *Robert S. Tongren* and *Mary R. Brandt,* Assistant Attorneys General, and *Richard P. Rosenberry* filed briefs for appellant in No. 84–871 and petitioners in Nos. 84–1054 and 84–1069.

Solicitor General Fried argued the cause for the federal parties. With him on the brief were *Deputy Solicitor General Wallace, Christopher J. Wright, Jack D. Smith, Daniel M. Armstrong,* and *Jane E. Mago.*

Michael Boudin argued the cause for respondents American Telephone and Telegraph Co. et al. With him on the brief for the American Telephone and Telegraph Co. et al. were *Donald Mcg. Rose, John Wohlstetter, W. Preston Granbery, Albert H. Kramer, Mark J. Mathis, D. Michael Stroud, Vincent L. Sgrosso, William O'Keefe, Carolyn C. Hill, Thomas J. Reiman, Alfred Winchell Whittaker,* and *John B. Messenger. William R. Malone, Richard McKenna,* and *Philip A. Lacovara* filed a brief for GTE Service Corp. et al.†

†Briefs of *amici curiae* urging reversal were filed for the State of Alabama et al. by *Charles A. Graddick,* Attorney General of Alabama, and

JUSTICE BRENNAN delivered the opinion of the Court.

In these consolidated cases, we are asked by 26 private telephone companies and the United States to sustain the holding of the Court of Appeals for the Fourth Circuit that orders of the Federal Communications Commission (FCC or Commission) respecting the depreciation of telephone plant and equipment pre-empt inconsistent state regulation. They are opposed by the Public Service Commissions of 23 States, backed by 30 *amici curiae*, who argue that the Communications Act of 1934 (Act), 48 Stat. 1064, as amended, 47 U. S. C. § 151 *et seq.*, expressly denied the FCC authority to establish depreciation practices and charges insofar as they relate to the setting of rates for intrastate telephone service.

Respondents suggest that the heart of the cases is whether the revolution in telecommunications occasioned by the federal policy of increasing competition in the industry will be thwarted by state regulators who have yet to recognize or

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Stephen L. Skipper, William James Samford, Jr., and *Susan Shirock DePaola;* for the State of Louisiana et al. by *William J. Guste, Jr.*, Attorney General of Louisiana, *Richard M. Troy* and *J. David McNeill III*, Assistant Attorneys General, *John L. Gubbins, Philip S. Shapiro, Barry Zitser, Corrine K. A. Watanabe*, Attorney General of Hawaii, *Ronald Shigekane*, Deputy Attorney General, and *Brian Burnett*, Assistant Attorney General of Utah; for the State of Maine et al. by *William E. Furber, James E. Tierney*, Attorney General of Maine, *Joseph G. Donahue, Mary L. Vanderpan*, Assistant Attorney General of South Dakota, *Michael J. Bowers*, Attorney General of Georgia, *James O. Llewellyn*, Senior Assistant Attorney General, *Michael J. Henry*, Assistant Attorney General, *Steven Clark*, Attorney General of Arkansas, *John Doehm*, Assistant Attorney General of Nebraska, *John E. Archibold*, Special Assistant Attorney General of Colorado, *Kirk J. Emge*, and *Ellyn Elise Crutcher;* for the National Conference of State Legislatures et al. by *Benna Ruth Solomon* and *Joyce Holmes Benjamin;* and for the Telephone Ratepayers Association for Cost-Based and Equitable Rates by *Jack L. Landau.*

Briefs of *amici curiae* urging affirmance were filed for MCI Telecommunications Corp. by *Laurence H. Silberman* and *Henry D. Levine:* and for the United States Telephone Association by *Jack E. Herington, Joseph R. Fogarty, H. Russell Frisby, Jr.*, and *Marcia Spielholz.*

accept this national policy and who thus refuse to permit telephone companies to employ accurate accounting methods designed to reflect, in part, the effects of competition. We are told that already there may be as much as $26 billion worth of "reserve deficiencies" on the books of the Nation's local telephone companies, a reserve which, it is insisted, represents inadequate depreciation of a magnitude that threatens the financial ability of the industry to achieve the technological progress and provide the quality of service that the Act was passed to promote. Petitioners answer that the Act clearly establishes a system of dual state and federal authority over telephone service. They contend that the Act vests in the States exclusive power over intrastate ratemaking, which power, petitioners argue, includes final authority over how depreciation shall be calculated for the purpose of setting those intrastate rates. Petitioners note also that the Due Process Clause of the Fourteenth Amendment necessarily represents a check on the power of the States to set depreciation rates at what would amount to confiscatory levels, and that respondents therefore overstate the danger of the States crippling the financial vitality of phone companies.

In deciding these cases, it goes without saying that we do not assess the wisdom of the asserted federal policy of encouraging competition within the telecommunications industry. Nor do we consider whether the FCC should have the authority to enforce, as it sees fit, practices which it believes would best effectuate this purpose. Important as these issues may be, our task is simply to determine where Congress *has* placed the responsibility for prescribing depreciation methods to be used by state commissions in setting rates for intrastate telephone service. In our view, the language, structure, and legislative history of the Act best support petitioners' position that the Act denies the FCC the power to dictate to the States as it has in these cases, and accordingly, we reverse.

I

The Act establishes, among other things, a system of dual state and federal regulation over telephone service, and it is the nature of that division of authority that these cases are about. In broad terms, the Act grants to the FCC the authority to regulate "interstate and foreign commerce in wire and radio communication," 47 U. S. C. § 151, while expressly denying that agency "jurisdiction with respect to . . . intrastate communication service . . . ." 47 U. S. C. § 152(b). However, while the Act would seem to divide the world of domestic telephone service neatly into two hemispheres—one comprised of interstate service, over which the FCC would have plenary authority, and the other made up of intrastate service, over which the States would retain exclusive jurisdiction—in practice, the realities of technology and economics belie such a clean parceling of responsibility. This is so because virtually all telephone plant that is used to provide intrastate service is also used to provide interstate service, and is thus conceivably within the jurisdiction of both state and federal authorities. Moreover, because the same carriers provide both interstate and intrastate service, actions taken by federal and state regulators within their respective domains necessarily affect the general financial health of those carriers, and hence their ability to provide service, in the other "hemisphere."

In 1980 and 1981, the FCC issued two orders that ultimately sparked this litigation. In the 1980 order the FCC changed two depreciation practices affecting telephone plant. *Property Depreciation*, 83 F. C. C. 2d 267, reconsideration denied, 87 F. C. C. 2d 916 (1981). First, the order altered how carriers could group property subject to depreciation. Because carriers employ so many individual items of equipment in providing service, it would be impossible to depreciate each item individually, and property is therefore classified and depreciated in groups. The order permitted companies the option of grouping plant for depreciation purposes based on its estimated service life (the "equal life" approach). This replaced the FCC's prior practice of requiring companies to classify and depreciate property according to its year of installation (the "vintage year" method). This change was made to allow depreciation to be based on smaller and more homogeneous groupings, which, the FCC concluded, would result in more accurate matching of capital recovery with capital consumption.

The 1980 order further sought to promote improved accounting accuracy by replacing "whole life" depreciation with the "remaining life" method. Under remaining life, and unlike the treatment under a whole life regime, if estimates upon which depreciation schedules are premised prove erroneous, they may be corrected in midcourse in a way that assures that the full cost of the asset will ultimately be recovered.

The third FCC-mandated change in plant depreciation was announced in a 1981 order, and involved the cost of labor and material associated with the installation of wire inside the premises of a business or residence. The new rule provided that this so-called "inside wiring" no longer be treated as a capital investment to be depreciated over time, but rather as a cost to be "expensed" in the year incurred. *Uniform System of Accounts*, 85 F. C. C. 2d 818.

Later in 1981, the National Association of Regulatory Utility Commissioners (NARUC) petitioned the FCC for a "clarification" of its order respecting inside wiring. Specifically, NARUC sought a declaration that the FCC's order did not restrict the discretion of state commissions to follow different depreciation practices in computing revenue requirements and rates for intrastate services.

On April 27, 1982, the FCC issued a memorandum opinion and order in which it agreed with NARUC that its order respecting the depreciation of inside wiring did not preclude state regulators "from using their own accounting and depreciation procedures for intrastate ratemaking purpose[s] . . . ." *Uniform System of Accounts*, 89 F. C. C. 2d 1094, 1095. In reaching this conclusion, the FCC declared that it had not intended the 1981 order to "have any preemptive effect that does not arise by operation of law," and added that "[n]o policy of this Commission would be furthered by requiring state commissions to adhere to the rules we have adopted for the purposes of computing the interstate revenue requirement." *Id.*, at 1097. The FCC then examined the language and legislative history of sections of the Act dealing with jurisdiction and depreciation and found that they did not support the position that unwilling state commissions either were required by operation of law or could be required in the discretion of the FCC to follow all accounting and depreciation methods prescribed by the Commission. Two commissioners issued a written dissent in which they argued that the FCC had, in its 1981 order, intended to pre-empt inconsistent state depreciation practices, and that deference to the States was especially inappropriate where an important federal policy—that of nuturing a "brave new world" of competition in the industry—was at stake.

Respondents petitioned for reconsideration of the order, and the FCC reversed itself and held that § 220 of the Act, which deals expressly with depreciation, does operate automatically to pre-empt inconsistent state action where the Commission has acted to prescribe depreciation rates for a carrier. *Amendment of Part 31*, 92 F. C. C. 2d 864 (1983). As an alternative ground in support of pre-emption, the FCC asserted that federal displacement of state regulation is justifiable under the Act when necessary "to avoid frustration of validly adopted federal policies." *Id.*, at 875. Applying this standard to the facts before it, the FCC then found pre-emption appropriate. It noted that "adequate capital recovery is important to 'make available, so far as possible, to all the people of the United States a rapid, efficient, Nationwide, world-wide wire and radio communication service with adequate facilities at reasonable charges . . .' 47 U. S. C. 151," and that "[s]tate depreciation rate prescriptions that do not adequately provide for capital recovery in the competitive environment, which constitutes this Commission's policy in those markets found capable of supporting competition, would frustrate the accomplishment of that policy and are preemptable by this Commission." 92 F. C. C. 2d, at 876.

The Fourth Circuit affirmed. *Virginia State Corporation Comm'n* v. *FCC*, 737 F. 2d 388 (1984).[1] It acknowledged that the Act "does reserve to the states the authority to prescribe rates for intrastate telephone service," but determined that "reservation [of authority] is not to be read as preserving the states' sphere of intrastate jurisdiction at the expense of an efficient, viable interstate telecommunications network." *Id.*, at 392. The court then noted that the FCC had intended to pre-empt state practices, held that the authority to do so was statutorily entrusted to the FCC, and found that the regulations at issue were reasonably designed to ensure that federal objectives would not be frustrated. The Court of Appeals did not reach the Commission's holding that § 220 of the Act automatically operates to pre-empt state-prescribed depreciation at odds with depreciation ordered by the FCC. We granted certiorari to review the decision of the Court of Appeals. 472 U. S. 1025 (1985).[2]

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[1] Exclusive jurisdiction over final FCC orders lies with the courts of appeals. 28 U. S. C. § 2342(1).

[2] We originally postponed jurisdiction in No. 84–871, which came to us by way of appeal, rather than certiorari. A potential jurisdictional issue in that case arose as a result of the contention of the Government and the telephone companies that an appeal did not lie under 28 U. S. C. § 1254(2) because the decision of the Court of Appeals did not expressly strike down any particular state ratemaking order.

We need not address or resolve whether an appeal is proper in No. 84–871. The Louisiana Public Service Commission has asked that its jurisdictional statement be treated as a petition for a writ of certiorari, and we clearly have certiorari jurisdiction under 28 U. S. C. § 1254(1) to decide the case. We have, moreover, granted the petitions for certiorari in

II

Both the petitioners and the respondents characterize this litigation as one in which two different persons seek to drive one car, a condition the parties agree is unsatisfactory.[3] Where the parties disagree is with respect to who ought to be displaced from the controls. In order to address the contentions, it is appropriate to consider not only the structure of the Act and how it divides authority, but also the nature and function of depreciation as a component of utility regulation.

Depreciation is defined as the loss in service value of a capital asset over time. In the context of public utility accounting and regulation, it is a process of charging the cost of depreciable property, adjusted for net salvage, to operating expense accounts over the useful life of the asset. Thus, accounting practices significantly affect, among other things, the rates that customers pay for service. This is so because a regulated carrier is entitled to recover its reasonable expenses and a fair return on its investment through the rates

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Nos. 84–889, 84–1054, and 84–1069, 472 U. S. 1025 (1985). In accordance with our customary practice, see, *e. g.*, *Renton* v. *Playtime Theatres, Inc.*, 475 U. S. 41, 43–44, n. 1 (1986), we dismiss the appeal in No. 84–871 and, treating the papers as a petition for certiorari, grant the writ of certiorari.

[3] Petitioners suggest that overreaching by the FCC has resulted in a situation where one person has a foot on the accelerator of a car while another person is attempting to steer. Tr. of Oral Arg. 9, 21. Although it is not evident from the metaphor whether petitioners' position is that the hand or the foot belongs to the FCC—whether, in other words, the FCC has stepped on the States' authority, or, heavy-handedly grabbed the wheel—the notion is that it is the States' responsibility under the Act to value property and to ascertain a rate base, and that it is inconsistent to confer depreciation authority—which is, according to the States, integrally bound up with valuation considerations and the determination of the rate base—on the FCC.

The respondents assert that this is "the case of two hands on the steering wheel," *id.*, at 40, by which, presumably, they mean to suggest that the hands belong to two different entities. Their position is that it makes no sense to have both the FCC and the state regulators depreciating the same piece of plant in two different ways.

it charges its customers, and because depreciation practices contribute importantly to the calculation of both the carrier's investment and its expenses. See *Knoxville* v. *Knoxville Water Co.*, 212 U. S. 1, 13–14 (1909). See generally, 1 A. Priest, Principles of Public Utility Regulation (1969); P. Garfield & W. Lovejoy, Public Utility Economics (1964); 1 A. Kahn, Economics of Regulation (1970).

The total amount that a carrier is entitled to charge for services, its "revenue requirement," is the sum of its current operating expenses, including taxes and depreciation expenses, and a return on its investment "rate base." The original cost of a given item of equipment enters the rate base when that item enters service. As it depreciates over time—as a function of wear and tear or technological obsolescence—the rate base is reduced according to a depreciation schedule that is based on an estimate of the item's expected useful life. Each year the amount that is removed from the rate base is included as an operating expense. In the telephone industry, which is extremely capital intensive, depreciation charges constitute a significant portion of the annual revenue requirement recovered in rates; the parties agree that depreciation charges amount to somewhere between 10% to 15% of the intrastate revenue requirement.

In essence, petitioners' argument is that the plain and unambiguous language of § 152(b) denies the FCC power to compel the States to employ FCC-set depreciation practices and schedules in connection with the setting of intrastate rates. In part, that section provides:

> "[N]othing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier . . . ."

Petitioners maintain that "charges," "classifications," and "practices" are "terms of art" which denote depreciation and accounting, and thus that the question presented by these cases is expressly answered by the statute. They argue also that the legislative history shows on a more general level that § 152(b) was intended to reserve to the States exclusive regulatory jurisdiction over intrastate service, especially intrastate ratemaking, and that given the importance of depreciation to ratemaking, to require state regulators to follow FCC depreciation practices would frustrate the statutory design of preserving the States' ratemaking authority over intrastate service. Petitioners maintain that to confer this power on the FCC would be, in effect, to write the jurisdictional limitation of § 152(b) out of the Act.

Where petitioners focus on § 152(b), respondents' principal argument is that this litigation turns on § 220 of the Act, which they insist constitutes an unambiguous grant of power to the FCC exclusively to regulate depreciation. Their argument is that once the FCC has acted pursuant to that section, States are automatically precluded from prescribing different depreciation practices or rates. Section 220(b) states:

> "The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers shall not, after the Commission has prescribed the [classes] of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its

> operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses."

Respondents assert that their understanding of § 220(b) is bolstered by other substantive provisions of § 220. They note, for example, that under § 220(g), once the FCC has prescribed the "forms and manner of keeping accounts," it is "unlawful . . . to keep any other accounts . . . than those so prescribed . . . or to keep the accounts in any other manner than that prescribed or approved by the Commission," and that subsections (d) and (e) of § 220 provide for civil and criminal penalties for failing to keep accounts as determined by the Commission. Moreover, § 220(h) permits the FCC in its discretion, if it finds such action to be "consistent with the public interest," to "except the carriers of any particular class or classes in any State from any of the requirements" under the section "in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates." Respondents argue that this provision strongly suggests that unless the FCC affirmatively acts to waive or delegate its authority, *i. e.*, to "except" carriers from its regulation, then under § 220(h) the States impliedly cannot adopt inconsistent regulations. Respondents also assert that § 220(i) makes clear that the role of the States in depreciation is essentially advisory only. That section provides that the FCC, before exercising its authority, "shall notify" the state commissions and provide an opportunity to the States to "present [their] views" and also instructs the FCC to "consider such views and recommendations." According to respondents, "Congress gave the states an opportunity to present their views because it expected them to be bound by the resulting prescriptions." Joint Brief for Listed Private Respondents 14 (Joint Brief). In sum, the position of respondents is that "Congress clearly intended that there be one regime—rather than multiple regimes—of depreciation for each subject carrier. The FCC was given responsibility for establishing such a regime, and its depreciation decisions have to be respected unless and until it relinquishes authority to the states in individual instances. The states' interest is recognized but their role is confined to providing their 'views and recommendations.'" *Ibid.*

Although respondents rely primarily on § 220 to support pre-emption, they also urge as an alternative and independent ground the reasoning relied on by the Court of Appeals, namely that the FCC is entitled to pre-empt inconsistent state regulation which frustrates federal policy. It is in the context of this argument that respondents most forcefully contend that state regulators must not be permitted to jeopardize the continued viability of the telecommunications industry by refusing to permit carriers to depreciate plant in a way that allows for accurate and timely recapturing of capital. This argument, which is pressed especially by the Solicitor General, relies largely on § 151, which in broad terms directs the FCC to develop a rapid and efficient national telephone network.

III

The Supremacy Clause of Art. VI of the Constitution provides Congress with the power to pre-empt state law. Preemption occurs when Congress, in enacting a federal statute, expresses a clear intent to pre-empt state law, *Jones* v. *Rath Packing Co.*, 430 U. S. 519 (1977), when there is outright or actual conflict between federal and state law, *e. g.*, *Free* v. *Bland*, 369 U. S. 663 (1962), where compliance with both federal and state law is in effect physically impossible, *Florida Lime & Avocado Growers, Inc.* v. *Paul*, 373 U. S. 132 (1963), where there is implicit in federal law a barrier to state regulation, *Shaw* v. *Delta Air Lines, Inc.*, 463 U. S. 85 (1983), where Congress has legislated comprehensively, thus occupying an entire field of regulation and leaving no room for the States to supplement federal law, *Rice* v. *Sante Fe Elevator Corp.*, 331 U. S. 218 (1947), or where the state law stands as an obstacle to the accomplishment and execution of the full objectives of Congress. *Hines* v. *Davidowitz*, 312 U. S. 52 (1941). Pre-emption may result not only from action taken by Congress itself; a federal agency acting within the scope of its congressionally delegated authority may pre-empt state regulation. *Fidelity Federal Savings & Loan Assn.* v. *De la Cuesta*, 458 U. S. 141 (1982); *Capital Cities Cable, Inc.* v. *Crisp*, 467 U. S. 691 (1984).

In the present cases, two of these "varieties" of pre-emption are alleged. As noted above, respondents argue that § 220 by its terms confers exclusive regulatory power over depreciation on the FCC, thus raising a claim that Congress has expressly manifested a clear intent to displace state law. In addition, respondents maintain that the refusal of the States to accept the FCC-set depreciation schedules and rules will frustrate the federal policy of increasing competition in the industry, and thus that state regulation "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." In our view, the jurisdictional limitations placed on the FCC by § 152(b), coupled with the fact that the Act provides for a "separations" proceeding to determine the portions of a single asset that are used for interstate and intrastate service, 47 U. S. C. § 410(c), answer both pre-emption theories.

The critical question in any pre-emption analysis is always whether Congress intended that federal regulation supersede state law. *Rice* v. *Sante Fe Elevator Corp.*, *supra*. The Act itself declares that its purpose is "regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges . . . ." 47 U. S. C. § 151. In order to accomplish this goal, Congress created the FCC to centralize and consolidate the regulatory responsibility that had previously been the province of the Interstate Commerce Commission and the Federal Radio Commission under predecessor statutes. See generally McKenna, Pre-Emption Under the Communications Act, 37 Fed. Comm. L. J. 1, 12–18 (1985). To this degree, § 151 may be read as lending some support to respondents' position that state regulation which frustrates the ability of the FCC to perform its statutory function of ensuring efficient, nationwide phone service may be impliedly barred by the Act.

We might be inclined to accept this broad reading of § 151 were it not for the express jurisdictional limitations on FCC power contained in § 152(b). Again, that section asserts that "nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service . . . ." By its terms, this provision fences off from FCC reach or regulation intrastate matters—indeed, including matters "in connection with" intrastate service. Moreover, the language with which it does so is certainly as sweeping as the wording of the provision declaring the purpose of the Act and the role of the FCC.

In interpreting §§ 151 and 152(b), we are guided by the familiar rule of construction that, where possible, provisions of a statute should be read so as not to create a conflict. *Washington Market Co.* v. *Hoffman*, 101 U. S. 112 (1879). We agree with petitioners that the sections are naturally reconciled to define a national goal of the creation of a rapid and efficient phone service, and to enact a *dual* regulatory system to achieve that goal. Moreover, were we to find the sections to be in conflict, we would be disinclined to favor the provision declaring a general statutory purpose, as opposed to the provision which defines the jurisdictional reach of the agency formed to implement that purpose.

Respondents advance a number of arguments to counter the view that § 152(b) forbids the FCC to prescribe depreciation practices and charges in the context of ratemaking for intrastate service. We address each in turn.

A

Respondents assert that the legislative history of § 152(b), as well as the structure of the Act, shows that "charges" and "classifications" refer only to "customer charges," not depreciation charges, and thus that § 152(b) does not purport to limit the FCC power to regulate depreciation. They seek to support this narrow reading of § 152(b) by noting that the words "charges," "classifications," "practices," and "regulations" appear throughout the Act in contexts where it is clear that what is meant is charges which relate directly to carriers' rate and service relationships with their customers, rather than depreciation or accounting charges. See §§ 201–205. Reading the sections *in pari materia*, we are told, makes it apparent that Congress was concerned in § 152(b) with preserving state autonomy over the rates charged by carriers for specific services, not over depreciation. According to respondents, this reading is bolstered by the legislative history of the section, which reveals that the provision was proposed by state regulators in reaction to this Court's decision in the so-called *Shreveport Rate Case, Houston, E. & W. T. R. Co.* v. *United States*, 234 U. S. 342 (1914), which held, among other things, that the Interstate Commerce Commission had the power to order an increase in specific intrastate railroad rates charged to customers in order to avoid discrimination against interstate commerce. "In other words, Section 2(b)(1) was from the outset concerned with protection against federal preemption of the states' setting of individual customer charges for specific intrastate services." Joint Brief 34.

We reject this narrow reading of § 152(b). "Charges," "classifications," and "practices," are terms often used by accountants, regulators, courts, and commentators to denote depreciation treatment, see, *e. g., United Railways & Elec-*

tric Co v. *West*, 280 U. S. 234, 262 (1930); *Smith* v. *Illinois Bell Telephone Co.*, 282 U. S. 133, 158 (1930); Wheat, The Regulation of Interstate Telephone Rates, 51 Harv. L. Rev. 846, 859 (1938); A. Kahn, Economics of Regulation (1970), and in accordance with the rule of construction that technical terms of art should be interpreted by reference to the trade or industry to which they apply, *Corning Glass Works* v. *Brennan*, 417 U. S. 188 (1974), we find that they do embrace depreciation. It is worth noting that the FCC itself, in the very orders underlying this litigation, used "charges" to mean "depreciation charges." *E. g.*, *Property Depreciation*, 83 F. C. C. 2d, at 275.

Nor does the *Shreveport Rate Case* carry the load that respondents ask of it. In that case, this Court interpreted the constitutional and statutory authority of the Interstate Commerce Commission to include the power to regulate, indeed, set, intrastate rates in order to prevent discrimination against interstate traffic. It is certainly true, as respondents assert, that when Congress was drafting the Communications Act, § 152(b) was proposed and supported by the state commissions in reaction to what they perceived to be the evil of excessive federal regulation of intrastate service such as was sanctioned by the *Shreveport Rate Case;* but we find no authority in the legislative history to support respondents' position that the sole concern of the state commissioners was with "protection against federal preemption of the states' setting of individual customer charges for specific intrastate services." Joint Brief 34. Rather, the legislative history reveals that representatives from the industry and the States were fully aware that what was at stake in the Act were broad powers to regulate, including, but not limited to, the setting of individual rates, and that "[t]he question of an appropriate division between federal and state regulatory power was a dominating controversy in 1934." McKenna, 37 Fed. Comm. L. J., at 2. In other words, while we agree that provisions in both the Senate and House bills were designed to overrule the *Shreveport Rate Case*, we are not persuaded that it was anyone's understanding that this "overruling" could or should be accomplished by merely including in the Act one section which forbade the FCC to establish specific rates for certain intrastate services; had this been the intention, it would hardly have been necessary to deny the FCC the jurisdiction over "charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service . . . ." Presumably, it would have sufficed simply to deny the FCC jurisdiction over "rates." In sum, given the breadth of the language of § 152(b), and the fact that it contains not only a substantive jurisdictional limitation on the FCC's power, but also a rule of statutory construction (". . . nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to . . . intrastate communication service . . ."), we decline to accept the narrow view urged by respondents, and hold instead that it denies the FCC the power to pre-empt state regulation of depreciation for intrastate ratemaking purposes.

B

Accordingly, we cannot accept respondents' argument that § 152(b) does not control because the plant involved in this case is used interchangeably to provide both interstate and intrastate service, and that even if § 152(b) does reserve to the state commissions some authority over "certain aspects" of intrastate communication, it should be "confined to intrastate matters which are 'separable from and do not substantially affect' interstate communication." Joint Brief 36. With respect to the present cases, respondents insist that the refusal of the States to employ accurate measures of depreciation will have a severe impact on the interstate communications network because investment in plant will be recovered too slowly or not at all, with the result that new investment will be discouraged to the detriment of the entire network. Numerous decisions of the Courts of Appeals are cited as authority for the proposition that § 152(b) applies as a jurisdictional bar to FCC pre-emptive action only when two factors are present; first, when the matter to be regulated is purely local and second, when interstate communication is not affected by the state regulation which the FCC would seek to pre-empt. *E. g.*, *North Carolina Utilities Comm'n* v. *FCC*, 537 F. 2d 787 (CA4), cert. denied, 429 U. S. 1027 (1976); *North Carolina Utilities Comm'n* v. *FCC*, 552 F. 2d 1036 (CA4), cert. denied, 434 U. S. 874 (1977); *Puerto Rico Telephone Co.* v. *FCC*, 553 F. 2d 694 (CA1 1977); *New York Telephone Co.* v. *FCC*, 631 F. 2d 1059 (CA2 1980).

The short answer to this argument is that it misrepresents the statutory scheme and the basis and test for pre-emption. While it is certainly true, and a basic underpinning of our federal system, that state regulation will be displaced to the extent that it stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress, *Hines*, 312 U. S., at 67, it is also true that a federal agency may pre-empt state law only when and if it is acting within the scope of its congressionally delegated authority. This is true for at least two reasons. First, an agency literally has no power to act, let alone pre-empt the validly enacted legislation of a sovereign State, unless and until Congress confers power upon it. Second, the best way of determining whether Congress intended the regulations of an administrative agency to displace state law is to examine the nature and scope of the authority granted by Congress to the agency. Section 152(b) constitutes, as we have explained above, a congressional *denial* of power to the FCC to require state commissions to follow FCC depreciation practices for intrastate ratemaking purposes. Thus, we simply cannot accept an argument that the FCC may nevertheless take action which it thinks will best effectuate a federal policy. An agency may not confer power upon itself. To permit an agency to expand its power in the face of a congressional limitation on its jurisdiction would be to grant to the agency power to override Congress. This we are both unwilling and unable to do.

Moreover, we reject the intimation—the position is not strongly pressed—that the FCC cannot help but pre-empt state depreciation regulation of joint plant if it is to fulfill its statutory obligation and determine depreciation for plant used to provide interstate service, *i. e.*, that it makes no sense within the context of the Act to depreciate one piece of property two ways. The Communications Act not only establishes dual state and federal regulation of telephone service; it also recognizes that jurisdictional tensions may arise as a result of the fact that interstate and intrastate service are provided by a single integrated system. Thus, the Act itself establishes a process designed to resolve what is known as "jurisdictional separations" matters, by which process it may be determined what portion of an asset is employed to produce or deliver interstate as opposed to intrastate service. 47 U. S. C. §§ 221(c), 410(c). Because the separations process literally separates costs such as taxes and operating expenses between interstate and intrastate service, it facilitates the creation or recognition of distinct spheres of regulation. See *Smith* v. *Illinois Bell Telephone Co.*, 282 U. S. 133 (1930). As respondents concede, and as the Court of Appeals itself acknowledged, 737 F. 2d, at 396, it is certainly possible to apply different rates and methods of depreciation to plant once the correct allocation between interstate and intrastate use has been made,[4] Brief for Respondent

[4] Thus, these cases are readily distinguishable from those in which FCC pre-emption of state regulation was upheld where it was *not* possible to separate the interstate and the intrastate components of the asserted FCC regulation. See, *e. g.*, *North Carolina Utilities Comm'n* v. *FCC*, 537 F. 2d 787 (CA4), cert. denied, 429 U. S. 1027 (1976), and *North Carolina Utilities Comm'n* v. *FCC*, 552 F. 2d 1036 (CA4), cert. denied, 434 U. S. 874 (1977) (Where FCC acted within its authority to permit subscribers to provide their own telephones, pre-emption of inconsistent state regulation prohibiting subscribers from connecting their own phones unless used ex-

GTE 36, just as it is possible to determine that, for example, 75% of an employee's time is devoted to the production of intrastate service, and only one quarter to interstate service, and to allocate the cost of that employee accordingly. Respondents maintain that if the FCC and the States apply different depreciation practices to the same property, then the "whole purpose of depreciation, which is to match depreciation charges of the equipment with the revenues generated by its use," will be frustrated. *Ibid.* But this is true and a concern only to the degree that the principles, judgments, and considerations that underlie depreciation rules reflect only "real world" facts, rather than choices made by regulators partially on the basis of fact and partially on the basis of such factors as the perceived need to improve the industry's cash flow, spur investment, subsidize one class of customer, or any other policy factor. What is really troubling respondents, of course, is their sense that state regulators will not allow them sufficient revenues. While we do not deprecate this concern, § 152(b) precludes both the FCC and this Court from providing the relief sought. As we so often admonish, only Congress can rewrite this statute.

C

We also reject respondents' argument that § 220, which deals specifically[5] and expressly with depreciation, requires

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clusively in interstate service upheld since state regulation would negate the federal tariff).

[5] Respondents maintain that since "[s]pecific terms prevail over the general," *Fourco Glass Co.* v. *Transmirra Products Corp.*, 353 U. S. 222, 228 (1957), and § 220 deals specifically with depreciation, the general language of § 152(b) should not be read to bar FCC regulation of depreciation. The rule of construction cited by respondents is simply inapplicable in the context of these cases. First, § 152(b) deals with jurisdiction, and thus addresses a different subject than § 220, which respondents correctly characterize as involving depreciation. Thus, while § 152(b) may be more "general' than § 220, the sections are not general or specific with respect to each other. Second, § 152(b) not only imposes jurisdictional limits on the power of a federal agency, but also, by stating that nothing in the Act shall

automatic pre-emption of all state regulation respecting depreciation. As noted above, § 220 directs the FCC to prescribe the classes of property for which depreciation charges may be included under operating expenses, and prohibits carriers from departing from FCC-set regulations respecting depreciation. While it is, no doubt, possible to find some support in the broad language of the section for respondents' position, we do not find the meaning of the section so unambiguous or straightforward as to override the command of § 152(b) that "*nothing* in this chapter shall be construed to apply or to give the Commission jurisdiction" over intrastate service. We note, for example, that a very strict reading of § 220—which is what respondents urge and upon which they ultimately rely—is simply untenable. There can be no dispute, for example, regarding the fact that taxing authorities of the Federal Government are entitled to require the carriers to employ, for tax purposes, depreciation practices and schedules different from those which might be ordered by the FCC for interstate ratemaking purposes. We are advised by petitioners that carriers do, as a routine matter, keep "separate" books in this connection. Were respondents' reading of § 220 correct, this practice would violate the Act, and taxing authorities would be compelled to compute taxation on the basis of depreciation schedules employed by the FCC for ratemaking purposes. Moreover, despite the sweeping language of § 220, nowhere does it even allude to, let alone expressly refer to, depreciation as a component of state ratemaking. Nor is the word "pre-emption" used.

It is thus at least possible, as some petitioners argue, that the section was intended to do no more than spell out the authority of the FCC over depreciation in the context of interstate regulation. It is similarly plausible, as other

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be construed to extend FCC jurisdiction to intrastate service, provides its own rule of statutory construction. In other words, the Act itself, in § 152(b) presents its own specific instructions regarding the correct approach to the statute which applies to how we should read § 220.

petitioners contend, that the section, which is captioned "Accounts, records, and memoranda," was addressed to the plenary authority of the FCC to dictate how the carriers' books would be kept for the purposes of financial reporting, in order to ensure that investors and regulators would be presented with an accurate picture of the financial health of the carriers. In any event, we need not, in order to decide these cases, define fully the scope of the section, and we hold only that § 220 does not operate to pre-empt state depreciation regulation for intrastate ratemaking purposes.[6]

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[6] Respondents insist that the legislative history of the section proves that it was intended to provide the FCC with power to pre-empt state regulation over depreciation practices. They rely in particular on the fact that Congress, in drafting § 220, reenacted, almost verbatim, § 20(5) of the Interstate Commerce Act, 49 U. S. C. App. § 20(5), which, respondents contend, had already been construed to require the ICC to prescribe depreciation for both telephone companies and railroads. *Telephone and Railroad Depreciation Charges*, 118 I. C. C. 295 (1926). Respondents note further that during hearings on an early version of the Act, state commissioners testifying before Congress argued that reenactment of § 20(5) and other provisions would permit the FCC to usurp "[a]ll matters of depreciation . . . without regard to the action upon the same subject by the State Commission." Hearings on S. 6 before the Senate Committee on Interstate Commerce, 71st Cong., 2d Sess., pt. 15, p. 2243 (1930) (resolution of Montana Commission). They also note that state regulators did manage—initially—to persuade the drafters of the Act to add a new § 220(j), which expressly permitted the States to prescribe their own depreciation practices for the purposes of determining intrastate rates. The fact that this section was rejected by the Conference Committee, despite the strong support of the States, we are told, is strong evidence that Congress intended to preserve in the FCC the broad power over depreciation that had been conferred on the ICC.

We are not persuaded. First, § 20(5) of the Interstate Commerce Act had never been interpreted to prohibit state commissioners from requiring carriers to keep additional records for the purposes of intrastate ratemaking. As the FCC itself noted in its 1982 order denying preemption, *Uniform System of Accounts*, 89 F. C. C. 2d 1094, 1101, it was only in dictum that the ICC suggested that it possessed authority under § 20(5) to prescribe depreciation for all property that might be used in interstate commerce, and that dictum did not even purport to address

Like many statutes, the Act contains some internal inconsistencies, vague language, and areas of uncertainty. It is not a perfect puzzle into which all the pieces fit. Thus, it is with the recognition that there are not crisp answers to all of the contentions of either party that we conclude that § 152(b) represents a bar to federal pre-emption of state regulation over depreciation of dual jurisdiction property for intrastate ratemaking purposes.

For the reasons stated above, the judgment of the Court of Appeals for the Fourth Circuit is reversed, and the cases are remanded for further proceedings consistent with this opinion.

It is so ordered.

THE CHIEF JUSTICE and JUSTICE BLACKMUN dissent.

JUSTICE POWELL and JUSTICE O'CONNOR took no part in the consideration or decision of these cases.

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whether federal prescription of depreciation would pre-empt the States from prescribing additional depreciation practices for its regulatory purposes. Moreover, that is how this Court read the ICC order. *Smith* v. *Illinois Bell Telephone Co.*, 282 U. S. 133, 159 (1930). And in *Northwestern Bell Telephone Co.* v. *Nebraska State Railway Comm'n*, 297 U. S. 471, 478 (1936), we expressly left open whether an ICC prescription, if issued, would be pre-emptive of state regulation.

Moreover, while it is true that Congress rejected the state-proposed § 220(j), again, as the FCC noted in its order denying pre-emption, respondents make too much of too little. "The record of the Congressional hearings indicates little more than that the supporters of original section 220(j) believed that the provision was desirable to resolve a previous unsettled point of law under the predecessor provision of the Interstate Commerce Act. . . . At most, this legislative history indicates that the 1934 Congress was not sure whether reenactment of the Interstate Commerce Act language would or would not preempt state accounting and depreciation rules and did not choose to resolve the question at that time." 89 F. C. C. 2d, at 1103, 1106.

APPENDIX C

DEIL S. WRIGHT'S MODELS OF INTERGOVERNMENTAL RELATIONS IN THE UNITED STATES

Wright, D. S. (1985) Models of national/state/local relations (Chapter 6). In O'Toole, L. J., Jr. (Ed.), American Intergovernmental Relations, pp. 58-66.

(at p. 58):

6. MODELS OF NATIONAL/ STATE/LOCAL RELATIONS

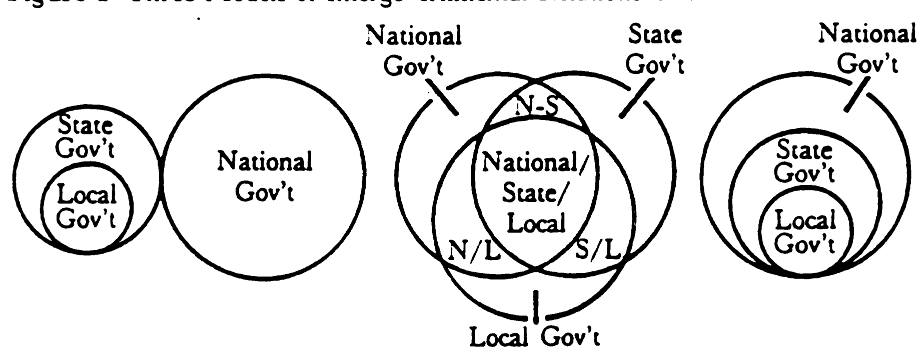
Deil S. Wright

... We can now formulate some simplified models of IGR [intergovernmental relations]. Figure 1 represents graphically three models of authority relationships among national, state, and local jurisdictions in the United States. These models, like most simple models, fall far short of displaying the complexities and realities of governance in several respects—for example, numbers and types of entities, numbers and variations in personnel, fiscal resources, and so on. The three models express visually the three generic types of authority relationships that can exist between political entities—the absence of authority (autonomy), dominant authority (hierarchy), equal authority (bargaining). Despite its simplicity, each model, by concentrating on the essential features of a possible IGR arrangement, guides us in formulating hypotheses. (No two models, of course, will generate identical sets of hypotheses.) By testing these hypotheses we can discover which model best fits the U.S. political system as it operates today.

. . . .

(at p. 59):

Figure 1 Three Models of Intergovernmental Relations in the United States



Designation:	Coordinate	Overlapping	Inclusive
Relationship:	Independent	Interdependent	Dependent
Authority Pattern:	Autonomy	Bargaining	Hierarchy

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