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CONSTANT SURVEILLANCE: A MODERN REGULATORY TOOL

FRANCIS X. WELCH†

Introduction

THE RECENT REPORT of the Administrative Conference contains some thirty recommendations for making the regulatory agencies of the United States government function more effectively. Special stress was placed on proposals to simplify and speed up the handling of matters pending before these agencies and, in support of this, it was noted that during the fiscal year 1960 alone "approximately 80,140 formal proceedings for the determination of private rights and obligations had been commenced before more than 100 boards, commissions, and other agencies of the government."¹

In the field of more or less conventional regulation of interstate public utility operations, as distinguished from various other forms of regulation exercised by numerous other federal agencies, emphasis was also placed upon the delay in rate making. Recommendations to remedy these faults include the following: (1) requiring rate applicants to support each rate filing with detailed data justifying the rate; (2) developing standardized data relating to costs or other matters which would be admissible; (3) attempting by rule making or policy statements to formulate specific standards or principles to be applied in rate cases; and (4) encouragement of negotiated settlements. The conference also recommends the elimination of "hearing by interludes" in favor of a continuous uninterrupted proceeding. Generally the recom-

† Editor, Public Utilities Fortnightly, Washington, D.C.; Professor of Public Utility Law, Georgetown University Law Center, 1962-63; LL.B., 1926, LL.M., 1927, Georgetown University.


² Id. at 25.

³ The reference here is to the jurisdiction of such federal agencies as that of the Interstate Commerce Commission (over railroads and motor carriers), the Federal Power Commission (over gas and electric utilities), the Federal Communications Commission (over interstate telephone, telegraph, and other communications carriers), the Civil Aeronautics Board (over commercial airlines), and the Securities and Exchange Commission (over public utility holding companies and their affiliates).

⁴ See n. 1, supra, Recommendation No. 19.

(340)
mendations urge the reduction of the scope of rate proceedings and shortening of their duration.

There is little quarrel with these four propositions as worthy general objectives. Yet, upon careful reading, it is apparent that the first and second items, above, relate to the development of data and evidence to support the alternatives proposed in the third and fourth items. These alternatives are: the disposal of specific cases according to pre-ordained rules of policy and the settlement of such cases by less formal negotiation.

In other words, if the staggering case load of these regulatory tribunals is to be shaped to manageable proportions, obviously cases will have to be restricted to those properly prepared and supported, and the best way to do this is by rule making. On the other hand, if the mechanics of informal settlement and negotiation are to be encouraged, the best way to go about it is to foster a system of routine reporting and disclosure by regulated utilities which will amount to a continuous surveillance conducive to give-and-take agreements on a narrowed range of factual differences.

These alternatives are in no sense competitive or conflicting. But they are alternatives. They are different paths to the same end — the disposition of the regulatory case load in an effective manner compatible with the overall public interest. But which path is to be preferred under given circumstances of a particular case, or class of cases, is a fundamental problem which confronts these regulatory commissions — as the case loads mount to such fabulous proportions that the traditional case-by-case approach falls further and further behind the avalanche of new filings. In addition there is the pressure of other and relatively more important policy making and administrative duties of these commissions, which were never intended to function solely as regulatory courts grinding out specific decisions in the same manner as courts of law.

This is also a problem of increasing urgency in the regulatory field. It amounts to a balancing of the requirements for disposition of specific cases under the traditional hearings-findings-and-decisions approach, as compared with a continuous form of a determination based on a regulatory policy of general and constant inspection.

There is more to this than the old dichotomy tritely labeled by the semantic tags of "rule making" and "adjudication," used to describe the total regulatory process. The increasing urgency for balancing a

5. Dr. Mark S. Massel, senior staff member, The Brookings Institution, in THE REGULATORY PROCESS, 1961, page 1, complains that these time-worn alternatives completely overlook "the important processes of policy formulation, negotiation, and administration."
regulatory agency's indulgence in erratic full-dress adversary-type proceeding, as against less formal but regular determinations of regulated industry performance in the public interest, stems from the plain fact that our dynamic public utility industries are becoming more and more complex and expanded. Trying to "fix" such operations (as of a date certain) in terms of property investment, allowable expenses and earnings, etc., through formal proceedings with all the accouterments of general notice and publicity, proper pleadings, intervening and protesting parties, hearings based on examination and cross-examination by counsel, specific findings, and ultimate decisions becomes more and more like trying to take a precise picture of something that simply will not stand still.

**Formal versus Informal Regulation**

Informal regulation, or "regulation by negotiation" as it is sometimes called, had a relatively early start in the United States and for a good reason. The reason was the increasing delay, expense, and difficulty of major formal contested rate proceedings which invariably found their way into the appellate courts. Because of the complexity of these matters, and the frequent necessity for the appellate courts to remand them to the commission for further findings or supplemental action, it was not uncommon during the earlier years of commission regulation for these cases to be shuttled back and forth for a decade or more.\(^6\)

Writing twenty-five years ago in favor of interim or temporary rate making (as a sort of time-saving alternative to formal rate making), the present chairman of the Federal Power Commission, Joseph C. Swidler, complained that complicated court rules on rate-making valuation had made "rate regulation almost hopelessly cumbersome and expensive. The expense of single rate cases has not infrequently run into seven figures, and anywhere from a year to a decade or more

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6. The frustration and futility which attended the interminable litigation in these so-called "old-age" rate cases during the twenties and thirties, one of which lasted fourteen years, found vigorous expression on the highest court. In his concurring opinion in St. Joseph Stock Yards Co. v. United States, 298 U.S. 38, 73 (1936), Mr. Justice Brandeis ticks off a number of cases which had gone back and forth between the courts and commissions. In McCart v. Indianapolis Water Co., 302 U.S. 419, 435 (1938), Mr. Justice Black, dissenting, said: "This case is an illustration of the almost insuperable obstacles to rate regulation today. It involves a single company supplying water to a single community. It does not present the difficulties of a far-flung utility system covering much territory with many separate corporate creatures. Nevertheless, this particular case has already consumed more than six years and is apparently destined to remain suspended for six more years."
may be required before commissions and courts have finally passed upon them.”

These “old-age rate cases” were clearly the result of the traditional judicial approach. This assumed that a utility rate case was just like other cases before the court — essentially adversary proceedings such as civil damage suits in which there had to be a plaintiff and a defendant each striving for every possible advantage, technical or otherwise. Such an approach also assumes that neither “side” shows any of its cards to the other “side.” Strict courtroom rules of evidence were employed. The best lawyers (and best witnesses) had the best results. But the overall public interest sometimes was lost in the shuffle.

The plain fact is that such rate cases are not truly adversary proceedings, and should not be made so, either by court trial practices or formal commission procedures. The public utility rate case theoretically does not have either proponents or opponents in the strict legal sense of contesting parties. It may, and generally does, inspire differences of opinion. These differences often require careful deliberation and finely wrought decisions before they can be resolved by the regulatory authorities. But it is nevertheless fundamental to the basic concept of public utility regulation that the overall public interest is the prime objective and the ultimate goal of every rate case.

It was, doubtless, in reaction to the overjudicialization of regulation that an early concept of regulation by negotiation and informal procedures has gathered strength since the late twenties. This movement has received tremendous impetus through the introduction of better and more uniform classifications of accounts, regular monthly or other reliable periodic reports, continuous inventories, and other businesslike disclosure procedures.

Under informal proceedings, commission and utility staff people need not regard each other as enemies, to be told as little as possible if even on speaking terms. The formal rate case, of course, must be kept in reserve. It might be compared with the essential right to strike in labor negotiations, always ready to be used when negotiations collapse. Yet, under the new dispensation, the rate case can become simply the occasional but less frequent difficult controversy, raising its head for judicial inspection out of a constant stream of continuous adjustments based on well-understood reporting and analytical techniques supported by accepted principles.

James M. Landis, formerly President Kennedy’s chief adviser on regulatory matters, condemned the inordinate delay which character-
izes the disposition of adjudicating procedures before our regulatory agencies as follows:

... The tendency here is again further to judicialize the administrative process and, in the opinion of many observers, to over-judicialize it to a point where stagnation is likely to set in. More recently a less legalistic approach has been taken; namely, to treat the agency as more of a managerial mechanism so as to free it in its broader aspects from the burdens entailed by judicial requirements. ...

... But if judgments of regulatory agencies in many fields such as rates are, in truth, business judgments rather than judgments conforming to a legal theory, techniques which do not rest upon the tedious process of examination and cross-examination and which underlie honest business judgments made by the industries may have a value in the handling of substantially the same problem by the agencies. ...

Prior to the Final Report of the Administrative Conference, it received from its own committee on rule making an extensive report which included the following recommendation on the encouragement of settlements in rate cases:

Encouragement of settlement. The beneficial aspects of prompt settlement of rate cases are obvious. The primary dangers involve the possible sacrifice of the public interest in order to avoid formal proceedings or to make a paper record of accomplishment. On balance, the committee is impressed with the possibilities of the use of settlement procedures in connection with rate filings and suspensions, and urges that agencies make more extensive use of this technique as a method of reducing the volume of formal actions the agency must process as a result of suspensions. Of course, the agency must make it perfectly clear to all interested persons that if complaints are filed against rates accepted after settlement negotiations, such complaints will be considered on their merits.

This committee report also touched on the desirability of consultation with staff during the decisional stage and also the desirability of blending the rule-making function with adjudication in the development of rate policies. Some regulatory agencies — notably the SEC — transfer the bulk of their work into the framing of generalized rules so as to reduce litigation and promote informal procedures. Others — notably the NLRB — prefer to "play it by ear," so to speak, avoiding

10. Id. at 54.
general rule making and tending to develop or improvise policy in the
process of deciding numerous contested cases.

The practice varies with other federal commissions, depending to
a large extent on governing statutes and the inherent characteristics of
the jurisdiction exercised. Thus, contested cases are rare before the
FCC but commonplace under the ICC. The FPC has so far followed
different methods with two different statutes it administers, the Federal
Power Act (under which there have been relatively few contested cases)
and the Natural Gas Act (under which the commission has been
forced into the uncomfortable position of the *Old Woman Who Lived
in a Shoe*).

*A Tale of Two Commissions*

Mere mention of the relative practices of the FPC and FCC
brings to mind a striking comparison of the formal case-by-case ap-
proach with the less formal system of constant surveillance based on
regular reports and conference adjustments. It is an impressive fact
that only twice, in its twenty-nine years of jurisdiction over interstate
long-distance telephone rates, has FCC had to resort to the initiation of
formal complaints; in both of those cases settlements by way of rate
reductions were made before the full-dress proceedings were completed.
During that period there were twenty-two interstate message rate re-
ductions (including the recent "after nine" $1 maximum country-wide
rate effective April 1, 1963) and only one general increase — all done
by informal conference proceedings.11

11. The chairman of the FCC, Newton N. Minow, in a letter to Senator Pastore
(Democrat, Rhode Island) dated May 2, 1962, stated:

> Whenever, in the judgment of the commission, it has appeared that overall
> earnings were at a level to warrant rate reductions, the commission has generally
> been successful in obtaining rate reductions that appeared warranted without
> conducting protracted and costly hearings. By this means, the benefits of the
> reductions are promptly made available to the public. Since 1935, there have
> been a large number of reductions, with only one general increase in long-
> distance telephone rates. The reductions have amounted to hundreds of millions
> of dollars in annual savings to the public. The most recent — amounting to
> some $50 million — became effective in September, 1959. It is noteworthy that
> interstate long-distance telephone rates are 19 per cent lower than they were
> in 1940. It is also noteworthy that all major interstate rate reductions were
> the result of action initiated by the commission.

We think this record indicates that informality in procedure cannot be
equated with ineffectiveness in achieving results. Nor are informal procedures
necessarily less effective than the more time-consuming formal procedures. On
the contrary, as the Deputy Director of the Bureau of the Budget, Elmer B.
Staats, stated in 1960, in testimony before the Subcommittee on Administrative
Practice and Procedure of the Senate Committee on the Judiciary, agencies
may use formal hearing processes in areas where "modern fact-gathering and
data-processing techniques would provide better information more quickly
and at less cost."

*(Hearings, U. S. Senate Subcommittee on Communications, 87th Cong. 392. The
two formal proceedings commenced by the FCC were Docket No. 6053, June
5, 1941, and Docket No. 6468, Nov. 20, 1942.)*
While this has been going on, a sister commission, the FPC, has had to give up and throw in the sponge in attempting to fix natural gas producer rates on a case-by-case formal hearings-findings-and-opinion approach. The admission of former FPC Chairman Kuykendall\(1\) that it would take eighty-five years with a tripled staff to catch up with its case load, plus the more recent aggressive approach by the “Kennedy commission” under Chairman Swidler to break bottlenecks through geographical area price fixing and settlement procedures, is the best evidence that good and sound regulation can be achieved in other ways than by starting out each case as if it were a mortal judicial combat to be fought without quarter to the last appellate ditch if necessary.

It should be added that the plight of the FPC in the producer rate case debacle was not of its own choosing, but rather an unexpected (and not entirely welcomed) inheritance from the majority opinion of the United States Supreme Court in the *Phillips* decision of 1954.\(13\)

Since that frustrating peak of over 4,000 producer cases which drew the attention of President Kennedy,\(14\) the FPC has struck out boldly on a new course. By a combination of informal settlements of key pipeline and producer cases and the more forthright approach of fixing natural gas producer rates almost automatically, on the basis of geographical area price standards, the present commission under the leadership of Chairman Swidler appears to be making some headway in its own “battle of the bulge.”\(15\) Not the least benefit of such informal procedure was the speedy termination and final disposition of cases which, once agreed upon, no longer continued to bounce around in the appellate courts.\(16\)

**Early Informal Rate Procedures**

The technique for informal settlement of utility rate cases goes back, however, before the activity of the federal commissions in this field.\(17\) It goes back to the state regulatory commissions in the twenties.

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\(12\) Senate Comm. on the Judiciary, Report on Regulatory Agencies to the President-Elect 6 (Comm. Print 1960).


\(15\) In its annual report to Congress for 1962, the FPC noted that the pending producer case load was down to 2,355, still a formidable backlog for any agency.

\(16\) The 1962 annual report of the FPC observed that $380 million in refunds to gas consumers were put into effect within eighteen months. It stated: “Agreed upon refunds were made at once. New lower rates were put into effect immediately, eliminating the time for decision and the possible delays and uncertainties of litigation on appeals to the courts ... and substantially all settlements included moratoriums on future increases.”

The secretary of the Pennsylvania Public Service Commission, John G. Hopwood, estimated that in that one state electric rates alone had been reduced twenty-five million dollars between the years 1914 through 1928 through informal procedures. This is a much more impressive sum when due consideration is given to the much greater purchasing power of the dollar of that era and the relatively small volume of utility operations compared with the present day. He added:

The sum of money saved to the public or all parties concerned by these methods of co-operation in lieu of litigation amounts to several hundred thousand dollars, but the benefits therefrom in actual accomplishment cannot easily be estimated in dollars and cents any more than can the benefits of peacetimes be compared on the dollar and cent basis with times of war.18

Another early witness to the efficacy of "regulation by negotiation" was the former chairman of the District of Columbia Public Utilities Commission, John W. Childress, who was able to point to electric rate reductions averaging in the order of a half-million dollars per year between 1926 and 1929 for the nation's capital city alone. He stated in a magazine article, describing the mechanics of reviewing and settlement used:

It seems to me that the attitude of understanding and compromise which has been the policy of the commission all along has brought about a better feeling and an actual saving of money to the people of the District of Columbia in the power company case and the telephone case and bids fair to accomplish the same in the near future where the transit lines are concerned. . . .19

As early as 1918 the Board of Public Utility Commissioners of New Jersey permitted a street railway company to increase fares without formal hearings, having been satisfied that the proposed rates were just and reasonable.

Settlements and negotiations in the regulatory area, however, have this much in common with settlements and negotiations in civil suits. They must depend for successful results on the effectiveness of the supporting data brought to the bargaining table. The very early efforts of regulatory commissions along this line did not, admittedly, have the

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19. Childress, Regulation by Negotiation, III PUB. UTIL. FORT. 693, 697 (June 13, 1929). The New Jersey streetcar fare increase noted was affirmed by the New Jersey supreme court in O'Brien v. Board of Public Utility Com'r., 105 Atl. 132, 134 (1918).
advantage of systematic data, regularly accumulated and analyzed, that has been provided under the Uniform Systems of Accounts and regular monthly and other reports during the past two or three decades.

It is significant, however, that as early as 1936 the Federal Communications Commission, in announcing a long-distance nation-wide telephone rate reduction said that "Under the informal methods which have been adopted the expected large savings to the public will become available at once, rather than being delayed by hearings, arguments, and possible litigation, as has been the situation in many rate proceedings in the past."20

FCC Commissioner Rosel H. Hyde, more recently,21 had occasion to refer to the prior efforts of the FCC to build up an automatic and systematic reporting and reviewing procedure designed for the very purpose of checking on telephone company performance. Hyde stated:

One of the first projects of the newly created Federal Communications Commission in 1934 was an investigation of the telephone industry, which was a very broad investigation in respect to all of its operations.

But, before it was concluded, the commission resorted to negotiations in order to make immediately available the changes in rates and regulations which the investigation indicated might be appropriate. And, as a result of that investigation, the commission adopted a policy, not an exclusive policy, but a pretty general policy of trying to maintain a system of continuous regulation that would keep abreast of changes from year to year rather than have the commission resort to tremendous hearings which could last several years and which could delay — or which could end up at a time when the conditions which prompted the investigation might not be current.

This does not mean that the FCC has surrendered or even laid aside at any time its statutory right to institute formal proceedings where the process of continuous surveillance does not produce satisfactory results. On this subject, former FCC Chairman John C. Doerfer said:

We shall, of course, continue our practice of maintaining a continuing surveillance over these matters. You may rest assured that the commission will promptly take appropriate action by formal proceedings or otherwise as may be necessary should the

20. FCC Release 19117, December 2, 1936. FCC Chairman James Lawrence Fly similarly stated in referring to another rate reduction: "I believe this is another example of the constructive results which can be accomplished when government and industry sit around the conference table in an atmosphere of mutual respect and good faith." (N.Y. Times, June 5, 1941.)

circumstances indicate that such action is required in order to protect the interest of the public in just and reasonable telephone rates.\textsuperscript{22}

The same reservation behind the use of the instrument of formal procedure was noted by the present FCC chairman, Newton N. Minow:

This is not to say that the commission is committed to a policy of always refraining from the use of formal proceedings in the regulation of interstate telephone service. The considerations which bear upon the choice between formal and informal proceedings are many and varied, and the only rule we have followed is to adopt the procedure which seems to us best calculated to protect the public interest in light of the circumstances presented at any particular time. For example, on several occasions where the use of our informal procedures was initially unsuccessful in bringing about the results which the commission sought to achieve, the commission instituted formal rate reduction proceedings through the issuance of show-cause orders. In each instance, this action led to a satisfactory resolution of the matter without the need to proceed with the hearings.\textsuperscript{23}

\textit{Legality of Informal Procedures}

The question of whether utility rates must or should be fixed after formal investigation may depend on whether hearings are actually required by statute. Section 203(b) of the Communications Act of 1934 permits rate changes to become effective without hearings, after notice. Sections 204 and 205 authorize, but do not require, hearings. Nor is there any constitutional requirement that the public or the users of the service be afforded a hearing since they do not have any vested interest in fixed rates.\textsuperscript{24}

It must be kept in mind that the consuming public still has the protection of the regulatory commission itself. On the other hand, it must be admitted that none of the statutes, federal or state, literally provide for rate fixing by the informal process of constant surveillance — that is to say, without the holdings of formal hearings. The widespread use of such procedure, therefore, has grown and expanded on a permissive basis. This is done under two alternative forms of statutory controls. First, and by far the most numerous, are the laws of twenty-

\textsuperscript{22} Letter to Representative Emanuel Celler (Democrat, New York), June 24, 1958, chairman of the House Judiciary Committee.

\textsuperscript{23} Letter dated May 2, 1962, to Chairman John O. Pastore (Democrat, Rhode Island), Senate Commerce Committee, Subcommittee on Communication. \textit{Hearings on Satellite Communications Legislation}, 87 Cong. 392.

\textsuperscript{24} The most recent of many decisions on this would appear to be Los Angeles v. California Pub. Utilities Commission, 359 U.S. 119 (1959), where the state commission had granted a telephone company rate relief without public hearings.
eight states\textsuperscript{25} which — like sections 203 and 204 of the federal Communications Act — permit utility rate changes to be made, either upward or downward, by the mere filing of revised schedules or tariffs with the regulatory authorities in control.

In several other states,\textsuperscript{26} while no increase may be made except upon a showing and finding by the commission that the increase is justified, there is still no actual requirement that a hearing be held by the commission. The California commission’s refusal to hold hearings under such circumstances was upheld by the United States Supreme Court in a 1958 case.\textsuperscript{27} In Ohio, the commission is required to issue a report on applications for rate changes and, if objections are made, to set the case down for hearings. Even here, however, the commission can and has given effect to agreements reached between the parties.\textsuperscript{28}

In the remaining states, the statutes would either seem to require hearings or have not been clearly construed in this regard.\textsuperscript{29} Whether, of course, hearings and formal procedures are desirable, aside from the legality of less formal methods, are always matters within the discretion of the regulatory authority. As the United States Supreme Court said in \textit{Federal Power Commission v. Hope Natural Gas Co.},\textsuperscript{30} “the fixing of 'just and reasonable' rates involves a balancing of the investor and consumer interests.” The real question, therefore, is whether that balance can best be attained by formal proceedings or by other methods.

\textbf{The Mechanics of Constant Surveillance}

In mid-1938, the Federal Communications Commission announced the results it had made of a study which indicated that the high degree of integration in the telephone industry in the United States (the Bell system, alone, doing ninety per cent of the business) demanded “the erection of continuous regulatory machinery of great competency and efficiency.” This commission report specifically condemned “a purely judicial attitude” and recommended the development of informal and continuous methods:

Many of the problems of interstate telephone rate regulation are continuing in nature, calling at all times for frank, informal

\textsuperscript{25} The author has checked the following state laws in this category: Alabama, Arkansas, Colorado, Connecticut, Delaware, Illinois, Kentucky, Maine, Maryland, Massachusetts, Mississippi, Missouri, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont, Virginia, Washington, West Virginia, and Wyoming.

\textsuperscript{26} Arizona, California, Idaho, Kansas, Ohio, and Utah.


\textsuperscript{29} Florida, Georgia, Indiana, Louisiana, Michigan, Montana, Nebraska, New York, North and South Dakota. No rate jurisdiction exists in Iowa or Texas.

\textsuperscript{30} 320 U.S. 591 (1944).
discussion between company and commission representatives. The atmosphere of the council table seems ordinarily much more conducive to the development of positive results in such matters than does the adversary air which tends to surround most formal proceedings. The aspect of a game or contest which inevitably envelopes the respective advocates (be they lawyers, accountants, engineers, or what not) in formal rate cases makes for bickering and bitterness, as well as for delay and expense.

If the essential factors can be soundly defined and weighted, and if their factual background can be fully and frankly developed, the positive and direct methods of informal negotiation should prove effective, and desired ends should be attainable with a minimum expenditure of time, money, and effort. Only through some such concept of regulatory functions can an end apparently be brought to the sorry spectacle of "ten-year rate cases." *In rate making, time is always of the essence,*31 and certain of the state commissions are today making notable progress in the development of informal regulatory machinery.

Interstate telephone rates have grown up almost wholly outside the boundaries of regulation, and particularly careful scrutiny of schedules and basic practices is therefore essential, in the public interest. The very absence of a background of federal regulatory experience renders basic factual development especially important. Though informal methods are still on trial, and are to be judged wholly from the standpoint of their practical results, there will always be time for formal proceedings, if and when the more direct and expeditious methods fail.32

Pursuant to this policy, the FCC and the Bell system33 have worked out routines for the regular submission of reports. All Bell system operating companies, including American Telephone and Telegraph Company, comply with these arrangements.

Special reports are furnished to the FCC pursuant to rules and regulations adopted and all Bell companies, of course, comply with the Uniform System of Accounts prescribed by the commission. In addition, there are monthly, quarterly, and semiannual reports filed with the FCC, which include comprehensive operating and financial information. Special reports, as issued or at the time of occurrence, are likewise furnished along with all inter- and intrasystem publications, technical or otherwise, news releases, etc. The whole picture adds up to a gigantic expanding industrial operation performing in a "gold fish bowl" of regulatory scrutiny.

32. FINAL REPORT OF THE TELEPHONE RATE AND RESEARCH DEPARTMENT 68 (June 15, 1958).
33. Some of the larger independent (non-Bell) telephone companies follow similar routines.
Continuous Surveillance in Action

With such a wealth of factual and statistical information constantly flowing into FCC headquarters in Washington as well as to FCC field offices in New York, St. Louis, and San Francisco, the commission has at its disposal at all times a veritable fluoroscope of Bell telephone system operating performance. The Common Carrier Bureau is thereby enabled to review and make recommendations for commission action. These are usually the prelude to a request for conferences with the company officials. The agenda for those conferences is decided and prepared, and in the final stages the full commission may sit to hear the informal and uninhibited discussion by company spokesmen and experts called in to explain the company's position under various topics on the agenda. The Common Carrier Bureau of the commission staff is, of course, present and participating.

Such conferences, therefore, are not to be confused with any star-chamber proceedings or "deals" in smoke-filled rooms. On the contrary, with the up-to-date "gold fish bowl" conditions under which present-day utility companies must exist, there is far more disclosure, far more room for give-and-take and for a real meeting of the minds than under the traditional formal system of adversary parties playing their cards as close to their vests as possible. These are entirely open proceedings to the extent of hearing facts and arguments from all interested parties which the commission feels have something useful to contribute.

Perhaps better than any attempt of this writer to describe what goes on at these hearings, a representative excerpt from the actual transcript of a general meeting on long-distance rates before the FCC on September 19 and 20, 1962, will give the reader a better idea of the nature of these sessions. Present at this meeting were the full commission, six members of the staff's Common Carrier Bureau, eleven Bell system company officials, attorneys, and staff, and three outside experts. The meeting had been set up as the result of a letter from FCC Chairman Minow, dated July 25, 1962, calling attention to the Commission's continuing evaluation of the system's level of earnings and inviting the company to prepare a presentation for a subsequent meeting.

An opinion or general statement of the company's position was made by Edward B. Crosland, AT&T vice president, followed by statements from three other vice presidents, the company's chief engineer, treasurer, and revenue requirements chief — each dealing with his own specialty. After each statement, there was interrogation by the commission and staff.
Following the Bell System presentation, the Commission staff engaged two independent consultants to study and present their views on the considerations involved in determining the required earnings for the interstate telephone operations. Their testimony was presented on December 13, 1962 and Company witnesses presented rebuttal testimony on January 4, 1963. As a result of these meetings, the FCC announced that interstate station-to-station toll rates would be reduced to a maximum of $1.00 coast-to-coast after 9:00 p.m. This reduction, offset in part by an increase in person-to-person rates which had gotten out of line with increasing labor costs, resulted in a net $30 million annual saving to the public.

Because this paper deals essentially with the informal surveillance procedure itself, however, the flavor of this type of presentation might best be exemplified by a statement and questions of one of the outside experts, Harold Leventhal, Washington attorney and utility specialist, who had made a statement to the commission on the efficacy of such informal procedure. Following his direct presentation, Commissioner Craven during the interrogation asked this question:

**Commissioner Craven:** . . . This goes to the matter of procedures. As I see it we have two general courses of action with respect to the procedures. One is a formal public hearing to determine the reasonable rate of return — I am only talking about rate of return — and the others are informal negotiations or informal hearings such as this to determine whether rates should be maintained or modified. Have you any preference, from a legal standpoint, to either of these procedures and I want to call it to your attention that the members of the Congress and others have criticized the commission very severely for not engaging in a formal public hearing in which there should be, as one of the issues, the determination of a reasonable rate of return.

**Mr. Leventhal:** I would like to address myself to that question in light of a more extended statement if I may, but I will get to it, Commissioner. I don't suppose any serious student of public administration has been other than concerned with the whole problem of what to do with the problem of formal regulatory hearings. Reference was made yesterday [September 19, 1962] to the fact that among other things for one year I served as Executive Officer of a Task Force of the Hoover Commission which looked into operations of the regulatory commissions. And we came then to certain conclusions. The task force report was broader on this point than the final report of the Hoover Commission, the problem of making them a more effective means of regulation.

More recently of course [James M.] Landis has written a very informative document on this subject in his report of Decem-

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There have been studious hearings before a sub-committee of the Senate Judiciary Committee. There have of course also been hearings in the House Committee on Interstate and Foreign Commerce. In my opinion there are such formidable problems of running a rate hearing that if the central facts can be obtained another way I think there are great advantages in doing that. I don't mean for a moment to say that a commission should act without hearings and investigations. On the contrary I am on record in print as indicating that a large part of the failure of commissions or certain aspects of the failures of commissions have been that they have adopted a passive approach to a number of matters before them and taken up individual cases as they came up like courts and have failed to develop general approaches and form affirmative approaches to the public interest and have also failed to carry on investigations where they should be enlightening.

I am not against investigations. At the time we have two excellent examples of investigation going on by the Securities and Exchange Commission. The investigation of the over-the-counter market is still in the form of a staff investigation. The open hearing phase has not begun. And to show the flexibility available, the commission had this analysis of the functioning of mutual funds turned over to a study group. . . . So I think of the commission as furthering an important element of public policy in carrying on sophisticated investigations, perhaps not as dramatic as the Congress itself can undertake. The seminal investigations of the Federal Trade Commission back in the late 1920's and early 1930's which involved the public utility field were, of course, illuminating. So the commission does need information, but if a process of informal approach — and I don’t particularly, Mr. Commissioner, say this is informal that we are having now. This is on the record and—

THE CHAIRMAN: Go ahead.

COMMISSIONER CRAVEN: No parties other than the company and the commission are present.

MR. LEVENTHAL: Yes. The commissioners are present, the staff is present, these are not cocktail party conferences. But a less formal method of gathering facts seems to me to have enormous advantages. The commission has to make the judgment at the end of the road whether this approach is one that is getting at the information that it needs. So far as the particular aspect of a rate of return hearing is concerned this would tend to be a more manageable kind of hearing than a full-dress rate regulatory hearing, that is true. And indeed it is because of that that the Federal Power Commission has been trying to break up some of its regulatory proceedings and to offer as a separate segment the rate of return aspect of it. . . .
A reference was made during this presentation to the general passenger fare investigation by the Civil Aeronautics Board, which dismissed a rate case in 1953 stating that, although there had been no such proceeding in fourteen years of the board's existence, "Any inference that the board is therefore uninformed with respect to relationships of fare and other significant economic aspects of the industry is a gross non sequitur."

Ironically, however, the House Judiciary Antimonopoly Subcommittee suggested thereafter that the CAB should institute a general passenger fare investigation and it did so in May 1956. The case went on for four and a half years. By the time of the decision, however, much of the testimony was hopelessly out of date and the economic picture had changed so completely that not a single major airline in the country was able to earn as much as the amount (10.5 per cent return on investment) which the commission found to be fair and reasonable for the industry as a whole. Developments during the lag of formal proceedings had made the findings in the case virtually useless and obsolete.

The Interstate Commerce Commission had a somewhat similar experience in its formal reproduction cost valuation proceedings following the *O'Fallon* decision by the United States Supreme Court in 1929. Only one of these nut-and-bolt-type valuations was even completed — that for the Baltimore & Ohio Railroad, and it was out-of-date before it was finished. Thereafter the commission abandoned such proceedings.

**Authoritative Commentary on Continuous Surveillance**

As will be seen from the foregoing discussion, much of the virtue of continuous surveillance lies in the flexibility of the process and the lack of rigid restrictions which necessarily hedge about formal procedure. The commitment to precedent, the doctrine of stare decisis, does not hang about the neck of the regulatory authority like an

34. General Passenger Fare Cases, C.A.B. (Docket E-7376, 1953).
albatross whenever suggestions are made to explore new avenues of approach.

"Show me one case in which this has been done" is the frequent challenge of counsel when a proposal is made to follow an unfamiliar path. This is always a fair question in a formal proceeding under traditional rules of evidence. But it is not the spirit in which Telstar was launched. Dynamically expanding public services, such as our own gas, electric, and telephone utilities, need all the room human imagination can devise in weighing the impact of their performance on our national economy. New methods, different formulae, alternative standards, and shifting guide lines are all permissible within the discretionary ambit of the regulatory expertise when conference methods are used. As Elmer B. Staats, of the Bureau of the Budget, told a Senate Judiciary subcommittee on administrative practice and procedure:

There is evidence that formal hearing processes are used where modern fact-gathering and data-processing techniques could provide better information more quickly and at less cost. And this, by the way, is one of the points which Judge Prettyman, I think, pointed out as a task for the Conference on Administrative Procedure.

It has been suggested that the use of such techniques, in lieu of excessive reliance on formal procedure, would better serve the public interest, including especially the interests of the regulated industries. . . .

A primary objective of Congress when it created certain regulatory agencies was to permit the application of "expertise" — that is, judgment informed by broad knowledge and experience. Yet formal procedure makes it extremely difficult for hearing examiners or even the commissions themselves to obtain the assistance of staff experts in conducting hearings and reaching decisions on the complex economic and social issues involved in certain kinds of regulatory cases.88

Furthermore, the conference method lends itself to a briefer, clearer record uncluttered by extraneous exhibits and duplications of testimony. Conferees bargaining in good faith are their own best "policemen of the record" because they want to make the most effective and persuasive impression in the shortest time for obvious reasons. Professor Kenneth C. Davis of the University of Minnesota Law School tells of a "spectacular" experience of the ICC in a railroad valuation which was started with formal hearings — one which lasted 137 days without

88 Hearings, 87th Cong., 28, 29 (Nov. 29, 1960).
getting anywhere. After formal hearings were disregarded, conference methods were employed with “overwhelming success.” He concluded:

The same commission that points with pride to such splendid achievement also provides some of the outstanding examples of procedural monstrosities. Some of the rule-making procedures more nearly resemble the procedures of a murder case than sensible methods for determining subsidiary legislative policies. In a case involving maximum hours for drivers of buses and trucks, the carriers contended for twelve hours and the unions for ten. Instead of trying to constitute itself a catalytic agent for compromise, the ICC conducted formal adversary hearings in eight or ten cities, took some 8,000 pages of testimony with hosts of stupendous exhibits, required witnesses to swear to the truth of comprehensive statistical compilations which they could not possibly know of their own knowledge, and made a “decision.” Other agencies handle similar problems with ease and dispatch by mediatory methods. 39

Of course, the more recent use of so-called “canned testimony” in formal regulatory proceedings has cut down the actual trial time a great deal. This is done by publishing and distributing direct testimony in advance of hearings. Indeed, it is doubtful if formal hearings in complicated regulatory proceedings could be conducted these days without “canned testimony.” But it has its limitations. For one thing it is often a product previously prepared, or “canned,” by counsel; yet a product which the actual witnesses are called upon to defend via cross-examination. There is some truth in the rather facetious comment that “canned testimony” is a system whereby the lawyers do the testifying and the witnesses do the arguing. Then, too, there is the temptation for counsel to dump everything into the printed record he can lay his hands on, despite duplication or irrelevancy, since there is little restriction except his own sense of restraint in the first instance. 40 True, the examiner or hearing commissioner can toss out the excess baggage on motion to strike. But this remedy is too often in the nature of closing the barn door and places a lot of reliance on the hearing officer’s courage and initiative.

Some authorities on regulatory law are even shifting to the position that conference methods may become mandatory if modern regulatory authorities are to keep pace with the demands of their public service obligation. Dr. Mark S. Massel puts it this way:

39. DAVIS, ADMINISTRATIVE LAW TREATISE (1958). Professor Davis devotes an entire section (4.11) to the benefits of what he calls “informal adjudication.”

40. The verbose burden of “canned testimony” on our long-suffering examiners recalls the comment of the old-fashioned housewife who was asked what she did with an excess fruit crop during canning season: “I can what I can,” she said, “and what I can’t can, I can’t!”
The rule-and-adjudication categories overlook a great bulk of regulatory activities. Many, if not most, agencies must exercise their functions mainly through negotiation and administrative decisions. Those that are charged with promoting and expanding the industries that they regulate must consider possible industry reactions even when they make decisions that have judicial overtones.

There are reasonably persuasive indications that the work of many agencies would bog down if informal negotiations were discontinued. Further, a requirement that all actions must fit into the groove of rigid, formal procedures would cause unnecessary harm to many individuals and companies. If the Federal Trade Commission were compelled to discontinue its stipulation and consent order procedures, it would have to forego a major part of its activity. At the same time, the publicity and expense connected with its formal proceedings would hurt many companies that had innocently slipped into technical violations that have no substantial competitive consequences.41

Professor Walter Gellhorn of Columbia University says in his report to the Attorney General's Committee on Administrative Procedure:

\[\ldots\text{even where formal proceedings are fully available, informal procedures constitute the vast bulk of administrative adjudication and are truly the lifeblood of the administrative process. No study of administrative procedure can be adequate if it fails to recognize this fact and focus attention upon improvement at these stages.}\][42]

The distinction between regulatory process and other controversies in this respect was well stated by Justice Felix Frankfurter:

Since these agencies deal largely with the vindication of the public interest and not the enforcement of private rights, this court ought not to imply hampering restrictions, not imposed by Congress, upon the effectiveness of the administrative process. One reason for the expansion of the administrative agencies has been the recognition that procedures appropriate for the adjudication of private rights in the courts may be inappropriate for the kind of determinations which administrative agencies are called upon to make.43

**Results in Telephone Rate Making**

The increasing complexity of both federal and state regulation in the public utility field has shown the need for more flexible imaginative
and resourceful determination of economic facts and conclusions in gauging the performance of these vital public services.

Judging by results accomplished, the record of the FCC in relying mainly on conference procedures to fix the nation's long-distance telephone rate is a blue-ribbon exhibit. Interstate long-distance telephone rates today are nineteen per cent lower than they were in 1940, even though prices generally have more than doubled. Long haul calls have benefited even more from rate reductions. For example, a weekday station-to-station three-minute call between New York and San Francisco costs $2.25 today, compared with $6.40 in 1940. (Effective April 4, 1963, the station-to-station three-minute rate for calls between 9 P.M. and 4:30 A.M. will be $1 maximum regardless of distances from coast to coast.) During the period of FCC regulation there have been some fifty negotiated changes in rates. While some of these have involved increases, the net savings to the public from all of them total over one billion dollars annually, based on 1962 volumes of business. In addition, as a result of separations changes (i.e., reclassifying plant, expenses, and revenues between intrastate and interstate business), there have been equivalent reductions in intrastate revenue requirements totalling more than $250 million annually, based on 1962 volumes of business.

Despite an overall reduction in interstate rates and despite the fact that intrastate rates have been increased far less than the cost of living, the Bell system post-war growth rate of seven and one-half per cent has been more than double that for the economy as a whole — half again as much as the five per cent annual increase which many regard as a necessary objective. In 1960, Bell system construction expenditures were eight per cent of the total spent by all businesses, even though its revenues were less than two per cent of the private portion of the Gross National Product. Thus regulation by constant surveillance has been in conformity with the policy of the Communications Act.

Conclusion

Regulation of public utilities is a branch of administrative law which has never stood still and never should. It has been growing and shifting in concepts and methods ever since it emerged as a bundle of loose principles and vague guide lines in the wake of the early Granger decisions in the latter part of the nineteenth century. 44 Despite its admitted success in developing the best and most public service for the people of the United States, as compared with government monopoly

44. Notably, Munn v. Illinois, 94 U.S. 113 (1877).
services in most of the rest of the world, it has always been essentially a pragmatic and evolutionary process. It did not spring full blown, like Pallas Athena from the mind of Zeus. Instead, it was hammered out in the crucible of trial and error and constant refinement.

Following the bare requirement, in Smyth v. Ames in 1898, that reasonable rates must be fixed on a fair base of property value devoted to public service, regulation steadily evolved into a rough but workable statutory pattern when the two pioneer state laws (New York and Wisconsin) established public service commissions in 1907.

Regulation, as we know it today, did not reach its present stage of practical operation without some false steps. Strewn along the wayside of bygone years, we can look back and see the wreckage of many once promising ideas, such as the Wisconsin indeterminate franchise or the Washington, D.C., plan for an automatic sliding scale, a profit-sharing system of rate making.

The idea of a system of constant surveillance of utility performance instead of formal procedure for rate making, however, is no untried newcomer to the regulatory scene. As mentioned earlier in this article, it started quietly in the late twenties and early thirties as a reaction to so-called "old-age rate cases" which had been kicking around the appellate courts for years, sometimes a decade or more, under more formal procedures.

This, it is submitted, has been shown to be a valuable, modern, regulatory tool increasingly compatible with the swift growth and complicated economic patterns developed by the dynamic public utility industry operations in the United States. Perhaps, the most valuable feature of constant surveillance is its ready accommodation to the careful consideration of new and varied techniques and standards for measuring utility performance. Some of these may be here to stay. Some may be tried and found wanting. The use of the controversial cost-of-money test, based on earnings-to-price ratios of utility securities (to gauge the allowable return) is a case in point. The use of comparisons of earnings of other companies and industries in making the return allowance is another example.

These and other more traditional factors can all be weighed more seriously and deliberately at the conference table than within the rigid format of formal proceedings, and rules of pleading and evidence. The guiding principles of regulation might well be viewed as a supporting trellis on which more than one theoretical vine can blossom at the same time.

time. The United States Supreme Court certainly recognized this sixty-five years ago when it offered a choice of seven criteria in determining fair value for rate making in the *Smyth v. Ames* decision. Subsequent experience eventually showed that only two of these — original cost and present fair value — were of general or lasting practical use. But the highest court in 1898 was obviously not even trying to lay down any restrictive formula. On the contrary, it seemed to encourage alternative paths to the same goal.

And so, in subsequent years, the regulatory commissions have availed themselves of alternative methods to test and double check different findings and theories. It follows that they can do this more freely and effectively when they are not hampered in their deliberations by procedural restrictions of commitments to formal precedent. With the much greater reliance and responsibility placed by the United States Supreme Court on the so-called "expertise" of the regulatory commissions, the availability of more precise and useful instruments of disclosure and negotiation becomes most essential for the regulatory authorities. Furthermore, as already noted in this article, constant surveillance does not surrender the ultimate recourse to formal procedures, when conference methods fail to reach satisfactory results.

There will always be rate cases; and in times of volatile inflation there are likely to be more rather than less. This is mainly because some of the early regulatory statutes were mechanically geared to a formal sequence of filed tariffs, suspensions, and thereafter a mandatory period of investigation and findings. In most instances, however, regulatory commissions, both state and federal, are not hamstrung nor condemned by the strict letter of their laws to formal protracted rate proceedings in each case involving a general rate change.