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I. Introduction

The tasks facing administrative regulatory agencies[1] are enormous in complexity, volume, and urgency. Their missions pursuant to the "public interest" and "just and reasonable" standards in enabling statutes[2] are ill-defined. Moreover, agencies often regulate hundreds of entities with different financial and operating characteristics, and must address the different demands of many types of consumers. To make matters worse, the approaches and conclusions applied by agencies in the past may no longer satisfy statutory purposes in light of changing technologies and market conditions. Agencies would be hard-pressed to perform their statutory functions even if they had unlimited staff, data, and other resources.[3] Yet, regulators have never enjoyed this luxury, and

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1. Although this article deals only with the doctrine of administrative inconvenience as it is invoked by one regulatory agency, a large body of law has developed regarding the doctrine's use by other agencies. *See, e.g.*, Stanley v. Illinois, 405 U.S. 645, 656-57 (1972):

> The establishment of prompt efficacious procedures to achieve legitimate state ends is a proper state interest worthy of cognizance in constitutional adjudication. But the constitution recognizes higher values than speed and efficiency. Indeed, one might fairly say of the Bill of Rights in general, and the Due Process clause, in particular, that they were designed to protect the fragile values of a vulnerable citizenry from the overbearing concern for efficiency and efficacy that may characterize praiseworthy government officials no less, and perhaps more, than mediocre ones.
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> Procedure by presumption is always cheaper and easier than individualized determination. But when, as here, the procedure forecloses the determinative issues . . . , when it explicitly disdains present realities in deference to past formalities, it therefore cannot understand, it needlessly risks running roughshot over the important interests . . . It therefore cannot stand.

2. *See, e.g.*, Communications Act of 1934, 47 U.S.C. §§ 151, 201, 202, 205 (1982); Note, *Natural Gas Regulation: The Conflict in the Application of the Just and Reasonable Standard*, 12 Tulsa L.J. 293 (1976).

3. See the discussion of limitations in applying cost-benefit analysis to complex regu-

their resources are likely to become far more strained because of budget cuts.

In light of their limited capabilities, agencies frequently invoke, explicitly or implicitly, the "doctrine of administrative inconvenience." Under this doctrine regulators apply short-cuts in their analyses, procedures, and findings even though more extensive efforts probably would yield more thorough evaluations and, perhaps, "better" results. Agencies justify their truncated efforts on the grounds that they lack the resources necessary to undertake more extensive efforts, and that the costs of further efforts (including delays in reaching decisions) would outweigh the benefits.[4]

Of course, every such agency decisionmaker must set priorities on how to employ the agency's resources, and every such decision can be criticized for incomplete analysis. However, there exist some statutory mechanisms designed to help agencies employ their limited resources most effectively.[5] Despite regularly finding flaws in the analyses performed by agencies, appellate courts, recognizing the agencies' limited resources, tend to uphold results which fall within a broad "zone of reasonableness"[6] or which are the product of an agency's expertise.[7] This approach reflects judicial

latory choices in S. BREYER, REGULATION AND ITS REFORM 152-53 (1982); Lavey, *Ending Structural Separation for Telephone Companies*, 18 U. CONN. L. REV. 81 (1985).

4. *See* Texas E. Transmission Corp. v. Federal Energy Regulatory Comm'n, 769 F.2d 1053, 1063 & n.16 (5th Cir. 1985) ("measurement would provide no more than an occasional and small variation in an allowance").

5. For example, through accounting orders and refund provisions, agencies can allow tariffs to go into effect without thorough evaluation but also protect consumers against unreasonable charges. *See* United States v. City of Fulton, 106 S. Ct. 1422, 1429-30 (1986); Trans Alaska Pipeline Rate Cases, 436 U.S. 631, 655 (1978); United States v. Chesapeake I.O. Ry., 426 U.S. 500, 514 (1976); Mobil Oil Corp. v. Federal Power Comm'n, 417 U.S. 283, 321 (1974); 47 U.S.C. § 204 (1982); Authorized Rates of Return for the Interstate Services of AT&T Communications and Exchange Telephone Carriers, CC Docket No. 84-800, Phase I, FCC 85-527, at 8-9 (released Sept. 30, 1985).

6. *See* Permian Basin Area Rate Cases, 390 U.S. 747, 770 (1968); Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 601-03 (1944).

7. *See* Federal Communications Comm'n v. WNCN Listeners Guild, 450 U.S. 582, 596 (1981); North Am. Telecommunications Ass'n v. Federal Communications Comm'n, 772 F.2d 1282, 1288 (7th Cir. 1985) (Posner, J.) ("Everyone is making guesses; the principles of judicial review of administrative action require deference to the agency's guesses."); WJG Tel. Co. v. Federal Communications Comm'n, 675 F.2d 386, 389 (D.C. Cir. 1982) ("If a figure selected by an agency reflects its informed discretion, and is neither patently unreasonable nor 'a dictate of unbridled whim,' then the agency's decision adequately satisfies the standard of review.") (quoting Stereo Broadcasters, Inc. v. Federal Communications Comm'n, 652 F.2d 1026, 1031 (D.C. Cir. 1981)); Administrative Procedure Act, 5 U.S.C. § 706 (1982) (allows courts to set aside agency action if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law").

awareness of the fact that strict review could paralyze regulatory processes.

On the other hand, this article argues that appellate courts should take a "hard look"[8] at regulatory orders which use administrative inconvenience as the basis for applying or deciding to apply truncated and aberrant procedures. Although it is clear that agencies must consider plausible alternatives in choosing a course of action,[9] agencies often point to impracticality and administrative burdens in rejecting such alternatives.[10] Appellate courts have difficulty second-guessing agencies as to their available resources, and as to whether and how they should be applied in particular cases. Moreover, the truncated approach may make an agency's record inadequate for an appellate court to determine whether the results fall within the zone of reasonableness.

Invocations of administrative inconvenience together with aberrant methodologies should constitute a "danger signal" warranting closer appellate review.[11] At some point, the guesswork, simplistic analyses, and aggregations of even a hard-working agency with limited resources must be overturned because they fail to meet a standard of reasoned decisionmaking. Budget cuts should not be viewed as legislative amendments to regulatory statutes, amendments which necessarily increase the risks to both regulated firms and consumers.

Sections II through IV of this article examine the doctrine of administrative inconvenience as invoked in two recent orders by

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8. *See* United Church of Christ v. Federal Communications Comm'n, 707 F.2d 1413, 1425 n.23 (D.C. Cir. 1983); Greater Boston Television Corp. v. Federal Communications Comm'n, 444 F.2d 841, 852 (D.C. Cir. 1970)(changes in policy require a commission to provide "reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored"), *cert. denied*, 403 U.S. 923 (1971); Leventhal, *Environmental Decisionmaking and the Role of the Courts*, 122 U. PA. L. REV. 509 (1974); Sunstein, *Deregulation and the Hard-Look Doctrine*, 1983 S. CT. REV. 177.

9. *See* Aeronautical Radio, Inc. v. Federal Communications Comm'n, 642 F.2d 1221, 1231 (D.C. Cir. 1980), *cert. denied*, 451 U.S. 920 (1981); National Citizens Comm. for Broadcasting v. Federal Communications Comm'n, 567 F.2d 1095, 1110-15 (D.C. Cir. 1977); Pillai v. Civil Aeronautics Bd., 485 F.2d 1018, 1029 (D.C. Cir. 1973).

10. *See* Farmers Union Cent. Exchange, Inc. v. Federal Energy Regulatory Comm'n, 734 F.2d 1486, 1513-14 (D.C. Cir.), *cert. denied*, 105 S. Ct. 507 (1984); Amendment of Section 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry), FCC 86-252, at 56-60 (released June 16, 1986) (delays, costs and uncertainties of market power analyses).

11. *See* United States Church of Christ v. Federal Communications Comm'n, 707 F.2d 1413, 1425 (D.C. Cir. 1983) ("abrupt shifts in policy . . . constitute 'danger signals' that the Commission may be acting inconsistently with its statutory mandate") (quoting Joseph v. Federal Communications Comm'n, 404 F.2d 207, 212 (D.C. Cir. 1968) (Leventhal, J.)).

the Federal Communications Commission (the "FCC") dealing with common carriers' rates. Section II describes an FCC order prescribing a charge level based on a shot in the dark or, most sympathetically, "*reasoned* guesswork."[12] The D.C. Circuit Court of Appeals upheld this order based upon the administrative inconvenience which would be involved in establishing a charge through reliable empirical analysis.[13] Next, section III evaluates the FCC's decision to prescribe a uniform authorized rate of return to multiple carriers with diverse financial and operating characteristics. A court could well find that claims of administrative inconvenience ring hollowly in this order, and that this treatment should be reversed. Finally, section IV contrasts the invocations of administrative inconvenience in the two proceedings set forth in sections II and III.

II. CHARGE BASED ON "REASONED GUESSWORK"

This section discusses a controversial FCC decision to impose a charge level based on guesswork rather than careful empirical studies and concrete data. The appellate court reviewing this decision noted that one cannot "divorce the difficulty of the regulatory dilemma from the reasonableness of its resolution,"[14] and upheld the decision on the basis that the FCC had applied "*reasoned* guesswork" in the face of time pressures and difficult, costly measurement problems.[15] The court further observed that it was not the FCC's burden to demonstrate that it had done "the best that could be done, but only that what it has done is reasonable under difficult circumstances."[16]

A. Background

In 1983 the FCC decided to impose a twenty-five dollar surcharge on most local connections for interstate telephone private lines ("special access" lines).[17] The revenues from this

12. National Ass'n of Regulatory Utility Comm'rs v. Federal Communications Comm'n, 737 F.2d 1095, 1141 (D.C. Cir. 1984), *cert. denied*, 105 S. Ct. 1224 (1985) (emphasis in original).

13. *Id.* at 1142.

14. *Id.* at 1141.

15. *Id.*

16. *Id.*; *see also* MCI Telecommunications Corp. v. Federal Communications Comm'n, 627 F.2d 322, 340 (D.C. Cir. 1980) (relevant standard is just and reasonable, not perfection).

17. MTS and WATS Market Structure: Third Report and Order [hereinafter cited as MTS and WATS], 93 F.C.C.2d 241, *recon.*, 97 F.C.C.2d 682, 711-22 (1983), *further recon.*, 97 F.C.C.2d 834, 837-76, *aff'd in part sub nom.* National Ass'n of Regulatory Util-

surcharge were to recover part of the costs of certain exchange facilities which are used by some special access customers as well as other customers.[18] Previously, private line customers had not contributed to the costs of these facilities. This surcharge prescription occurred in an order which attempted to establish a more efficient, less discriminatory system for recovering the costs of local telephone facilities.[19]

The FCC recognized that imposing no additional charge on private line customers would constitute discrimination between private line services and other (switched) services, and would cause inefficient substitution from switched services to other services.[20] However, the record in the FCC proceeding did not provide a methodology to identify the special access customers using these exchange facilities or to estimate the amount of their interstate switched usage. Although exchange telephone companies generally are able to measure such usage for switched services, they are typically unable to measure usage for special access services.[21] Thus, the obvious cure for the discrimination—imposing the same charge per unit of usage of the facilities on the various services—was not technologically feasible.

The FCC decided that an estimated flat surcharge on most special access lines was more reasonable and less discriminatory than continuing to impose no charge for such usage pending the development of new measurement technologies.[22] Given this decision, the FCC had three options for establishing the surcharge.

ity Comm'rs v. Federal Communications Comm'n, 737 F.2d 1095 (D.C. Cir. 1984), *cert. denied*, 105 S. Ct. 1224 (1985). The FCC subsequently narrowed the range of special access lines subject to this surcharge. Clarification of Sections 69.5 and 69.115 of the Rules of the FCC, 50 Fed. Reg. 12,254, *recon.*, 50 Fed. Reg. 42,707 (1985).

18. This configuration of special access lines and other exchange facilities became known as the "leaky PBX" phenomenon.

19. MTS and WATS, *supra* note 17, 93 F.C.C.2d at 278, 97 F.C.C.2d at 712 ("our intention in this proceeding is to have all interstate users of exchange access pay the same charge for the same service . . . ."). The revenues from the surcharge were to help cover the costs of non-traffic-sensitive local exchange facilities, such as local loops and telephone poles. Although use of these facilities by special access customers did not create the costs, customers of other interstate services were making heavy contributions for these facilities and their usage did not create the costs either. *See also* WATS-Related and other amendments of Part 69 of the Commission's Rules, FCC 86-115 (released Mar. 21, 1986) (change in charges to eliminate discrimination between WATS-access lines and other dedicated lines).

20. MTS and WATS, *supra* note 17, 97 F.C.C.2d at 714.

21. *Id.* at 713-14.

22. *Id.* at 870-72.

B. *Options*

As one option, the FCC could have undertaken a proceeding for the purpose of estimating the average use of other exchange facilities in conjunction with a special access line. In such a proceeding, the FCC could have solicited data from carriers and customers based on special studies, and even conducted a study on its own or through a consultant. This course of action would have involved additional burdens on the FCC, delays in imposing a charge, and continued discrimination. On the other hand, the FCC has recently conducted several proceedings involving difficult empirical issues and costly studies, including inquiries into bypass of exchange facilities,[23] the effects of certain federal decisions on local telephone rates and telephone penetration,[24] the market power of American Telephone and Telegraph Co. ("AT&T"),[25] and the effects of policies regarding shared tenant services.[26]

Second, the FCC could have required exchange carriers to conduct studies of the special access lines that they provide. The carriers could then be required to file tariffs with surcharges based on the estimated usage of other exchange facilities by those lines. These tariffs would explain the methodologies used in the sample studies, and would be subject to comments by interested parties and review by the FCC. The FCC concluded that such studies would be costly and time consuming, but expressed its expectation that exchange telephone companies would soon replace the twenty-five dollar surcharge with charges based on actual usage measurements.[27] The FCC, however, chose not to delay implementing the surcharge pending such measurements, and not to establish a procedure or schedule for future measurements.[28] In contrast to this decision, the FCC recently required sample measurements to de-

23. Bypass of the Public Switched Network, report of the Federal Communications Commission's Common Carrier Bureau (Dec. 19, 1984); *see also* United States General Accounting Office, Telephone Bypass (Feb. 1986).

24. MTS and WATS Market Structure: Further Report on the Effects of Federal Decisions on Universal Telephone Service, FCC 84-636 (released Jan. 4, 1985); Petition of State of Michigan Concerning the Effects of Certain Federal Decisions on Local Telephone Service, 96 F.C.C.2d 491 (1983).

25. Long-Run Regulation of AT&T's Basic Domestic Interstate Services, 95 F.C.C.2d 510 (1983).

26. Policies Governing the Provision of Shared Telecommunications Services, FCC 86-26 (released Jan. 27, 1986) (notice of inquiry; summary appears at 51 Fed. Reg. 4536-37 (1986)).

27. MTS and WATS, *supra* note 17, 97 F.C.C.2d at 722.

28. In fact, no exchange carrier has yet filed a tariff replacing the $25 surcharge with usage measurements.

velop charges for other "unmeasurable" traffic.[29]

The third option available to the FCC, and the one it adopted, was to designate twenty-five dollars as the surcharge without undertaking any sampling or other empirical analysis. In support of this figure, the FCC estimated the percentage of special access lines that make use of certain exchange facilities, and the average usage by such lines.[30] The FCC relied on its "best judgment" (including data on interstate usage by quite different customers) in developing "fair" and "conservative" estimates.[31] Again without any empirical analysis, the FCC stated its belief that the twenty-five dollar charge was sufficiently low that it would not impose unreasonable cost burdens on special access customers or cause them inefficiently to replace special access lines with "bypass" facilities.[32]

In upholding this prescription, the D.C. Circuit Court of Appeals refused to press the FCC to perform additional analyses.[33] According to the court, the twenty-five dollar surcharge fell within the agency's broad discretion because (1) the prescription evidenced the FCC's reasoned judgment based on its expertise; (2) the record contained no alternative methodology to rebut the FCC's claims that measurements would be costly and time consuming; (3) the record did not show that the result was unreasonable; and (4) the surcharge level was implemented temporarily to alleviate discrimination while the FCC searched for more precise charges.[34] Of course, given the truncated approach taken by the FCC, there was little in the record to support a positive determination by the court that twenty-five dollars fell within the zone of reasonableness.

Under these conditions, the court held that the FCC's truncated empirical analysis was reasonable.[35] Though the agency's guesswork was aberrant in comparison to the detailed studies required

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29. *See* MTS and WATS Market Structure, 101 F.C.C.2d 1222, 1232-33 (1985) (Third Reconsideration Order); Petition of Ameritech Operating Companies for Waiver of Feature Group A Usage Surrogate Requirements, Mimeo No. 2788 (released Feb. 24, 1986); National Exchange Carrier Ass'n, Mimeo No. 1727, at 5 (released Dec. 31, 1985) ("it is our goal to ensure that rates for services which cannot be measured reflect actual usage patterns as accurately as possible"); National Exchange Carrier Ass'n, Mimeo No. 6564 (released Aug. 23, 1985).

30. MTS and WATS, *supra* note 17, 97 F.C.C.2d at 719-21.

31. *Id.* at 720.

32. *Id.* at 719.

33. National Ass'n of Regulatory Utility Comm'rs v. Federal Communications Comm'n, 737 F.2d 1095, 1139-42 (D.C. Cir. 1984), *cert. denied*, 105 S. Ct. 1224 (1985).

34. *Id.* at 1140-42.

35. *Id.* at 1141 ("Of course we would prefer a more precise equation.").

by its own rules to support charges,[36] the court found that the FCC's conclusion about the costs, delays, and administrative burdens of other methodologies was plausible. We will return to this proceeding in section IV when we contrast it with a less credible invocation of administrative inconvenience.

III. ONE AUTHORIZED RATE OF RETURN FOR DIVERSE CARRIERS

This section analyzes the FCC's decision to prescribe one authorized interstate rate of return for all exchange telephone companies despite their diversity. A primary reason cited by the FCC for this approach was the administrative inconvenience of prescribing individual rates of return for any of these carriers.[37]

A. Background

A rate of return below a company's cost of capital impairs its ability to attract capital for increasing the efficiency of and expanding its plant. Insufficient earnings for a regulated firm eventually lessen the quality of its services and may cause it to charge higher rates than would be required with new, efficient facilities.[38] Even a fairly small difference in the prescribed rate of return for one of the eight large holding companies of exchange carriers—the seven Bell Regional Holding Companies and GTE Corp.—causes a difference of several million dollars in revenues for that company and in interstate telephone charges. These eight firms provide about ninety percent of interstate access services.[39]

The record in this proceeding was filled with comments by parties stating that a unitary prescription for these carriers would yield unreasonable results.[40] Moreover, these comments described methodologies for establishing multiple prescriptions that would

36. 47 C.F.R. § 61.38 (1985).

37. Authorized Rates of Return for the Interstate Services of AT&T Communications and Exchange Telephone Carriers, CC Docket No. 84-800, Phase II, 51 Fed. Reg. 1795 (1986), *corrected*, 51 Fed. Reg. 4597 (1986) [hereinafter cited as Authorized Rates of Return]. While this article examines only the group prescription determined in this order, other aspects of this order have been criticized in petitions for reconsideration and deserve careful analysis.

38. *See generally* M. GORDON, THE COST OF CAPITAL TO A PUBLIC UTILITY (1974); A. KAHN, THE ECONOMICS OF REGULATION 42-54 (1970); R. MORIN, UTILITIES' COST OF CAPITAL (1984).

39. *See* UNITED STATES TELEPHONE ASSOCIATION, TELEPHONE STATISTICS 1985 at 4, 8 (1985).

40. Authorized Rates of Return,, *supra* note 37, 51 Fed. Reg. at 1796 n.20 (citing comments of Bell-South, GTE, Pacific Telesis, and Southwestern Bell).

purportedly yield more reasonable results without excessive administrative burdens.[41] In fact, some parties pointed out that the data requested by the FCC for setting a unitary prescription would allow it to establish an individual prescription for each Bell Regional Holding Company with no additional burden, or even less burden, on the agency.[42]

Before evaluating the invocation of administrative inconvenience in this proceeding, it is helpful to understand the history of FCC rate of return prescriptions. Until the AT&T divestiture on January 1, 1984,[43] AT&T and the roughly 1400 exchange telephone companies provided interstate services through a voluntarily formed joint enterprise.[44] AT&T filed one tariff with the FCC for all of the services provided by the joint enterprise, and AT&T and the exchange companies divided the revenues by a method which allowed each company to earn the same rate of return on its capital.[45] AT&T and its wholly owned Bell Operating Companies accounted for a dominant share of the enterprise's capital.[46]

Given AT&T's domination of the single enterprise which provided interstate services, the FCC quite reasonably prescribed a single rate of return based on AT&T's cost of capital.[47] This rate was then applied by the enterprise to the interstate services of all the exchange telephone companies. Yet even this single prescription imposed a heavy burden on the FCC; extensive hearings were conducted, there was conflicting expert testimony (especially on the cost of equity), and the FCC retained its own consultants.[48] Consequently, the FCC undertook represcriptions only after

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41. *See* comments cited in note 40 *supra*.

42. The FCC denied petitions to reconsider its decision to prescribe a unitary rate of return for all exchange telephone companies. *FCC Modifies Rate of Return Methodologies and Prescribes Telco Interstate Rates of Return*, FCC News Release (Aug. 7, 1986). Because the order of reconsideration was not released when this article was written, the analysis is limited to the initial order.

43. United States v. Western Elec. Co., 552 F. Supp. 131, 226-34 (D.D.C. 1982), *aff'd sub nom.* Maryland v. United States, 460 U.S. 1001 (1983).

44. Authorized Rates of Return For the Interstate Services of AT&T Communications and Exchange Telephone Companies, 49 Fed. Reg. 32,871-72 (1984) (notice of proposed rulemaking).

45. *Id.* at 32,872.

46. The Bell Operating Companies accounted for roughly 80% of the nation's access lines. *See supra* note 39. The intercity facilities of AT&T accounted for another large share of the enterprise's capital. *See* AT&T ANNUAL REPORT 1985, at 17.

47. *See* AT&T, Modification of Prescribed Rates of Return, 86 F.C.C.2d 221 (1981), *aff'd sub nom.* United States v. Federal Communications Comm'n, 707 F.2d 610 (D.C. Cir. 1983).

48. *Id.*

AT&T petitioned to raise the authorized rate of return.[49]

With the divestiture of the Bell Operating Companies from AT&T, the joint enterprise was broken up in several ways. Exchange carriers now file tariffs with the FCC for interstate access services.[50] Each large exchange carrier files tariffs based on its individual costs and its authorized rate of return; these tariffs cover all interstate services except for carrier common line service.[51] The carriers earn different returns from their individual tariffs but the same return from the carrier common line pool. However, the pool yields only about half of the carriers' interstate revenues, and this share will decline with the implementation of higher end-user common line charges.[52] Large carriers' earned returns from their interstate offerings have varied, which indicates that different risks attach to each carrier's interstate operations.[53]

Another change since divestiture is that the Bell Operating Companies have different capital structures, differents costs of embedded debt, and according to discounted cash flow analyses filed in the FCC proceeding, different costs of equity.[54] There is no longer a single cost of capital associated with a dominant share of interstate access services.

After the divestiture, the FCC continued to apply the rate of return authorized for AT&T in 1981 to AT&T and all exchange carriers.[55] However, recognizing that the changed conditions warranted reevaluation of how the FCC should authorize rates of re-

49. *Id.*; AT&T (Docket No. 20,376), 57 F.C.C.2d 960 (1976); AT&T (Docket No. 19,129), 38 F.C.C.2d 213 (1972), *aff'd sub nom.* Nader v. Federal Communications Comm'n, 520 F.2d 182 (D.C. Cir. 1975).

50. 47 C.F.R. § 69 (1985).

51. *See* Midyear Access Tariff Filings, CC 4867 (released May 30, 1986).

52. *See* Separate Statement of Commissioner Dawson in FCC Docket No. 84-800, Phase II, FCC News No. 2471 (released Feb. 6, 1986). The end-user common line charge for residential and single-line business customers increased from $1 to $2 per month on June 1, 1986, and the FCC has indicated that further increases in this charge would be economically desirable. WATS-Related and Other Amendments of Part 69 of the Commission's Rule, 51 Fed. Reg. 633, 638-39 (1986) (notice of proposed rulemaking), FCC 86-115 (released March 21, 1986) (to be codified at 47 C.F.R. pt. 69) (report and order). These charges reduce the costs covered by the carrier common line pool.

53. Quarterly W-P-C-4955 (Section 214 Application) Reports filed at the FCC by the Bell Regions showed the following interstate rates of return for the first three quarters of 1985 for the three regions reporting on a regional basis: NYNEX 11.43%, Bell Atlantic 11.90%, and Southwestern Bell 12.62%. Other regions reported operating company interstate results for this period varying from 10.24% for Indiana Bell to 15.87% for Pacific Northwest Bell. Though there are some differences in the methods used by the regions to calculate these results, these differences do not explain the wide variations.

54. *See, e.g.*, Reply Findings of Fact and Conclusions of the NYNEX Telephone Companies, CC Docket No. 84-800, Phase III (filed July 3, 1986).

55. Authorized Rates of Return for the Interstate Services of AT&T Communica-

turn for these carriers, the FCC began a rulemaking proceeding in August 1984.[56] The FCC attempted in this proceeding to establish a methodology which would lessen the administrative burden of represcriptions by specifying, for example, preferred indicators of equity costs, treatment of flotation costs, streamlined evidentiary procedures, and timing of represcriptions.[57]

B. Options

A key component of any such methodology is the grouping of exchange carriers for represcriptions. The FCC's primary reasons for prescribing a single authorized rate of return for all exchange carriers were the desire to reduce administrative burdens and the belief that these carriers face very similar risks in providing interstate services.[58] For exceptional circumstances, the FCC granted an opportunity for relief through a waiver process.[59]

The FCC took the short-cut of group treatment without laying the necessary empirical foundations by showing administrative burdens as well as typicality of the group average.[60] The FCC cited various Supreme Court decisions for the principle that the agency "has unquestioned authority and wide discretion to prescribe multi-carrier rates of return for geographic or other logical groups in a regulatory environment in which prescription of individual carrier rates of return threatens a complete breakdown of the administrative process."[61]But the Court's endorsement of the discretion derived from administrative inconvenience was based on the particular facts from which the cases arose.[62] The situation

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tions and Exchange Telephone Company, CC Docket No. 84-800, Phase I, FCC 85-527, at 3 (released Sept. 30, 1985).

56. Authorized Rates of Return for the Interstate Services of AT&T Communications and Exchange Telephone Carriers, 49 Fed. Reg. 32,871 (1984) (notice of proposed rulemaking), 50 Fed. Reg. 33,786 (1985) (supplemental notice of proposed rulemaking), 51 Fed. Reg. 1,795 (1986) (report and order). The Federal Energy Regulatory Commission undertook a similar rulemaking. Generic Determination of Rate of Return on Common Equity for Electric Utilities, 49 Fed. Reg. 29,946 (1984), 49 Fed. Reg. 29,967 (1984), 50 Fed. Reg. 21,802 (1985) (to be codified at 18 C.F.R. pt. 37) [hereinafter cited as Generic Determination].

57. Authorized Rates of Return, *supra* note 37, 51 Fed. Reg. at 1796.

58. *Id.* at 1798-99. The FCC decided to prescribe a separate rate of return for AT&T. *Id.* at 1796.

59. *Id.* at 1797, 1799.

60. *See infra* notes 62 and 68.

61. Authorized Rates of Return, *supra* note 37, 51 Fed. Reg. at 1798.

62. In New England Divs. Case, 261 U.S. 184, 197, 199 (1923), over 600 railroads were respondents to an Interstate Commerce Commission ("ICC") proceeding. Many of these railroads were financially weak and required immediate relief. Moreover, the ICC had failed in a five-month attempt to have the parties adjust their divisional arrangements

described by the Court was not present in this proceeding. The FCC did not attempt to show that the alternative groupings and methodologies supported by most parties threatened "a complete breakdown of the administrative process." How much longer would it have taken for the FCC to prescribe individual authorized rates of return for the eight large holding companies? The approach adopted by the FCC involves individualized analyses of the Bell Regions in reaching a group prescription.[63] Therefore, the additional time (if any) required to use the alternative grouping is probably just a matter of a few hours or days, and certainly not a matter of years or even months.

While the FCC pointed to problems with individual prescriptions,[64] this approach falls far short of demonstrating that the resulting individual rates would be less reasonable or manageable than the unitary group rate.[65] The difficulties and delays involved in some individual prescriptions do not justify sacrificing accuracy

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individually. The ICC's order adjusted millions of joint rates. The Supreme Court held that the premise of group proceedings is that evidence pertaining to the group is typical of its individual members. *See also* United States v. Louisiana, 290 U.S. 70, 75-77 (1933).

In Chicago v. N.W. Ry. v. Atchison, Topeka and Sante Fe Ry., 387 U.S. 326, 342-43 (1967), 360 carriers *voluntarily* aligned themselves into groups, and presented evidence, and tried the case on a group basis. Moreover, they asked the ICC to prescribe new divisions on a group basis. There were no requests for individual treatment made during the hearings or during the presentation of evidence. The ICC took almost ten years to complete these proceedings. On appeal the Supreme Court upheld the group approach.

In Permian Basin Area Rate Cases, 390 U.S. 747, 755 n.4, 757, 772 (1968), the Federal Power Commission decided to set maximum rates for producers in an area where rates were filed by 3371 independent producers and the Commission had a backlog that would have taken over 82 years to clear, even if the Commission had tripled its staff. The Court referred to area regulation as "experimental." *See also* Meeks & Landeck, *Area Rate Regulation of the Natural Gas Industry*, 1970 DUKE L.J. 653.

63. Authorized Rates of Return, *supra* note 37, 51 Fed. Reg. at 1801-03.

> The principal proposed method used composite or average of RHC [Bell Regional Holding Company] firm returns that were based upon the actual capital structure of an RHC, the firm's embedded cost of debt and a firm cost of equity that is determined by use of a Discounted Cash Flow or DCF method. A substantial number of the comments advocated the use of that method without the "compositing" step.

Id. at 1801.

64. Authorized Rates of Return, *supra* note 37, 51 Fed. Reg. at 1797-99.

65. To reach a group prescription, the FCC required the Bell Regions to identify and analyze "comparable firms" by developing and applying complex screens. *Id.* at 1803-04. These indicators of reasonable returns were designed to supplement readily available indicators derived from applying discounted cash flow analysis to the Bell Regions and from returns authorized by state commissions. The indicators based on comparable firms probably contribute little to accurately determining costs of capital, but impose heavy burdens on carriers to produce the studies and on the FCC to review them. The administrative burdens related to these supplemental indicators probably exceed those of performing individual prescriptions for large carriers. Moreover, the contribution to

in setting these rates.[66] Although administrative burdens might outweigh any benefits derived from individualized prescriptions for small carriers, this may not be true for large carriers.[67]

The Supreme Court has held that group treatment may not be used by an agency unless the agency finds that the group average is typical of the individual carriers.[68] The FCC did not make this finding regarding the costs of capital of exchange carriers. While the FCC did find that these carriers face similar risks in providing interstate services,[69] this finding only goes to the costs of equity. The FCC did not compare group averages against variations in carriers' costs of embedded debt and capital structures. In fact, the record showed that these variations produce substantially different returns on equity for exchange carriers under a uniform prescribed rate of return.[70] Thus, the FCC's approach undercuts its basic premise of authorizing the same return for identical risks.

Other regulatory practices are in sharp contrast to the FCC's approach. Most regulatory agencies frequently establish new authorized rates of return. Each year, a typical state commission sets

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reasonable rates of these supplemental indicators is probably less than that of individual prescriptions for large carriers.

66. *See* Farmers Union Cent. Exch. v. Federal Energy Regulatory Comm'n, 734 F.2d 1486, 1522, 1530 (D.C. Cir.) (court rejected departures from cost-based rates and a rate-of-return methodology which failed to reflect the pipelines' actual cost of capital), *cert. denied*, 105 S. Ct. 507 (1984); Alabama Elec. Coop. v. Federal Energy Regulatory Comm'n, 684 F.2d 20, 27-30 (D.C. Cir. 1982) ("[T]he difficulties and delays encountered in attempts to arrive at an acceptable rate scheme offer no justification for FERC to perform any less than its full regulatory responsibility under the Federal Power Act.").

67. The FCC could choose among a variety of ways to delineate which companies would qualify for individualized prescriptions without having to request waivers, and which would receive an averaged prescription unless they requested and received waivers. Interstate revenues may be used to draw this line; there is a sharp drop in interstate revenues after the eight largest holding companies of exchange carriers. UNITED STATES TELEPHONE ASSOCIATION, TELEPHONE STATISTICS 1985, at 8 (1985). Another possible basis for line drawing is the availability of securities analysts' forecasts of a carrier's dividend growth for purposes of discounted cash flow analysis.

68. New England Divs. Case, 261 U.S. 184, 197, 199 (1923). In Baltimore & Ohio R.R. v. Aberdeen & Rockfish R.R., 393 U.S. 87 (1968), the Court remanded an ICC prescription based on territorial average costs because the ICC failed to make findings on the nature and volume of the traffic, and because there was no substantial evidence that the average costs were typical of this traffic. The Court found that without reasoned findings regarding typicality, administrative expertise would "be on its way to becoming a monster which rules with no practical limits on its discretion." *Id.* at 92-93.

69. Authorized Rates of Return, *supra* note 37, 51 Fed. Reg. at 1797. Even this finding was disputed by many parties to the proceeding. *Id.* at 1796; *see* Separate Statement of Commissioner Dawson in CC Docket No. 84-800, Phase II, FCC News No. 2471, at 1 (released Feb. 6, 1986).

70. *See* Comments of Southwestern Bell Telephone Co., CC Docket No. 84-800, Phase II, at 12a (filed Sept. 25, 1985).

individual rates of return for several telephone companies as well as other regulated carriers. Similarly, the Federal Energy Regulatory Commission has established a procedure by which it sets a benchmark rate of return on common equity, adjusts the benchmark for individual cases, and then employs this rate together with individual carriers' costs of embedded debt and capital structures to determine reasonable individual rates of return.[71] The FCC's own individual treatment of large exchange carriers in prescribing depreciation rates and reviewing access tariffs suggests that individual rate-of-return prescriptions for large carriers are not excessively burdensome.[72]

Finally, the FCC's waiver process does not cure the defects of its group treatment. Citing the potential for administrative paralysis caused by multiple individual rate-of-return determinations, the FCC established stringent criteria for granting waivers.[73] The FCC's rules allow an individual prescription only when a carrier demonstrates that the group rates to be prescribed by the FCC later that year and two years thereafter *both* will constitute *confiscation* (not merely unreasonableness) for that carrier.[74] Moreover, a carrier must also demonstrate exceptional facts and circumstances; the carrier must do this before it knows what the group rates will be, and even before the evidence required by the FCC's rules has been filed.[75] Again, the FCC did not analyze the administrative burdens that would accompany alternative, less stringent waiver criteria.

In conclusion, the FCC relied heavily on vague invocations of

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71. Generic Determination, *supra* note 56.

72. *See, e.g.*, Prescription of Revised Percentages of Depreciation, 103 F.C.C.2d 185, 187 (1985) (since the late 1940's, the FCC has annually reviewed and prescribed the depreciation rates for approximately one-third of the telephone carriers subject to its jurisdiction; hundreds of new rates were prescribed for fourteen carriers through this procedure in 1985); Prescription of Revised Percentages of Depreciation, 103 F.C.C.2d 380, 381 (1985) (FCC allows annual updates of depreciation rates by streamlined procedures); Annual 1985 Access Tariff Filings, Mimeo No. 7401 (released Sept. 30, 1985) (reviewing 85 revised annual interstate access tariffs filed by local exchange carriers).

73. Authorized Rates of Return, *supra* note 37, 51 Fed. Reg. at 1799-1800.

74. *Id.* at 1808-09; 47 C.F.R. § 65.101 (1985).

75. The methodology adopted by the Federal Energy Regulatory Commission provides that the industry average return on equity will not be binding in an individual case when a company files an initial or changed rate schedule if "the Commission determines that the risk of the operations under the rate schedule is significantly different from average or the Commission determines that a different rate of return be allowed." Generic Determination, *supra* note 56, 49 Fed. Reg. at 29,946. This standard allows for more individualized treatment and more realistic showings than the FCC's rule for waivers. *See also* Schuck, *When the Exception Becomes the Rule: Regulatory Equity and the Formulation of Energy Policy Through an Exceptions Process*, 1984 DUKE L.J. 163.

administrative inconvenience in establishing an aberrational approach to rate-of-return prescriptions. The agency performed little analysis of the additional resources necessary to pursue alternative methodologies, or of the costs and benefits of those alternatives. An appellate court should take a hard look at the record in this proceeding on the issue of group treatment of exchange carriers. Without more evidence of administrative burdens and little variation in carriers' costs, the unitary prescription may appear arbitrary and capricious.[76]

IV. LIMITS OF ADMINISTRATIVE INCONVENIENCE

Invocations of administrative inconvenience can affect not only the reasonableness of decisions concerning carriers and consumers, but also the legitimacy and credibility of the agency making the decision.[77] Both of the decisions analyzed in this article involved substantial departures from the FCC's requirement that each carrier's rates be based on careful studies of its costs and usage. There are, however, at least two danger signals of unjustified reliance on administrative inconvenience present in the rate-of-return grouping that did not exist in the surcharge prescription.

First, the record in the rate-of-return proceeding included comments from many parties explaining how the FCC could develop individual prescriptions for the large exchange carriers and why these approaches would be superior to a unitary prescription.[78] Though the FCC criticized these approaches, it did not show that they would be too burdensome or that they would not yield more reasonable prescriptions. In contrast, the record in the surcharge proceeding did not contain an alternative approach to estimating the interstate switched traffic from special access lines. While longer, more costly administrative efforts in the surcharge proceeding might have produced more reasonable estimates, the prescription based on the agency's general expertise did not fly in the face of reasonable alternatives in the record.

Second, the feasibility of individualized treatment of carriers'

76. It is possible that the FCC chose the unitary approach in order to alter the resulting prescription. That is, the FCC's unitary prescription may differ from the average of what would have been its individual prescriptions. Moreover, the record developed under the unitary approach may be inadequate to reveal any such difference to an appellate court, or to show an appellate court that such difference means that the unitary prescription is unreasonable.

77. *See* Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1669 (1975).

78. *See supra* notes 40-42 and accompanying text.

rates of return is well-established by state and other federal commissions. Moreover, the FCC treats large exchange carriers individually in depreciation prescriptions and reviews of access tariffs. The rate-of-return proceeding, therefore, was a departure from established agency practice. On the other hand, with respect to the surcharge proceeding, no regulatory agency had previously addressed the discrimination arising from the absence of additional charges on switched traffic from special access lines. Prior practice indicated that any estimate of this traffic would be rough, and that an agency should not be pressed to undertake a long, costly proceeding to establish such an estimate.

V. CONCLUSION

Generalizing from these two FCC proceedings, almost every major agency decision involves consideration of the delays, costs and benefits which would accompany additional administrative proceedings. However, agencies should not be able to pursue an aberrant approach by invoking administrative inconvenience without establishing in some detail the burdens avoided by the short-cut and the reasonableness of the result. In particular, agencies should compare the burdens and results under the aberrant approach against alternatives set forth in the record of the proceeding. Also, agencies should explain why, when they were previously able to undertake more extensive proceedings on certain matters, they presently do not believe that they have the resources, or the reason to use them, for other matters of apparently similar importance and complexity.