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Greater Efficiency or Higher Consumer Rates? FCC Preemption of State Depreciation Methods for Telephone Companies in Virginia State Corporation Commission v. FCC

GREATER EFFICIENCY OR HIGHER CONSUMER RATES? FCC PREEMPTION OF STATE DEPRECIATION METHODS FOR TELEPHONE COMPANIES IN *VIRGINIA STATE CORPORATION COMMISSION v. FCC*

Through the Communications Act of 1934, Congress created the Federal Communications Commission (FCC)[1] to consolidate the federal government's regulatory control over telephone, telegraph, and wireless radio companies.[2] Congress provided the FCC with regulatory powers over interstate telephone service and reserved to state regulatory commissions powers over intrastate telephone service.[3] For nearly four decades, the FCC regarded accounting and depreciation practices[4] for intrastate telephone service as within the jurisdiction of state regulatory commissions.[5] The concept of depreciation

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1. Communications Act of 1934, Pub. L. No. 416, ch. 652, 48 Stat. 1064 (codified as amended at 47 U.S.C. §§151-609 1982). In the Communications Act of 1934, Congress stated that the Federal Communications Commission (FCC) should make available an efficient nationwide wire and radio communications service at reasonable cost to consumers. *Id.* at § 151. Congress stated that the Communications Act would consolidate and centralize authority over the nation's communications network within the FCC. *Id.* Congress specifically granted the FCC authority over interstate and foreign commerce in wire and radio communication. *Id.* Congress empowered the FCC to prescribe reasonable rates and charges for telephone and wire communication interstate service. *Id.* at § 205. The Communications Act also provided the FCC with the authority to control accounting and depreciation methods used by carriers providing interstate telephone service. *Id.* at § 220. *See generally* B. SCHWARTZ, THE ECONOMIC REGULATION OF BUSINESS AND INDUSTRY 2373 (1973) (describing legislative history of the Communications Act); T. BERRY, COMMUNICATIONS BY WIRE AND RADIO, THE COMMUNICATIONS ACT, 1-31 (1937) (reviewing statutory language of the Communications Act).

2. S. Doc. No. 144, 73rd Cong. 2d Sess. 1 (1934). President Franklin Roosevelt urged the adoption of the Communications Act to consolidate the authority split between the Federal Radio Commission and the Interstate Commerce Commission. *Id.* Roosevelt stated that for the sake of clarity, services known as utilities should be divided into three fields and governed by different federal agencies. *Id.* Roosevelt noted that the Interstate Commerce Commission had jurisdiction over transportation, and the Federal Power Commission had authority over the development and transmission of electric power. *Id.* Roosevelt stated that no single federal agency possessed broad authority to address uniformly communications needs and problems, and that the FCC would fill that void. *Id.* Roosevelt suggested that Congress provide the FCC with authority over all services utilizing or using wire, cables, or radio as a medium of transmission, and with full power to investigate and study the business of existing communications companies. *Id.*

3. *See* 47 U.S.C. § 220(h) (1982) (excepting state carriers subject to state regulation from FCC prescription of accounting and depreciation methods); 47 U.S.C. § 221(b) (forbidding FCC jurisdiction with respect to charges, classifications, practices, services or facilities for intrastate service regulated by state commissions); 47 U.S.C. § 152(b) (forbidding FCC from asserting jurisdiction with respect to carriers engaged in interstate service solely through physical connection with another independent carrier).

4. *See infra* note 6 (discussing depreciation purposes under Internal Revenue Code).

5. Memorandum Opinion and Order, 89 F.C.C.2d 1094, 1106 (April 15, 1982). The FCC

measures the loss of service value due to wear and tear or obsolesence of a capital asset over time.[6] Telephone companies or carriers apply a depreciation deduction for tax purposes to each individual year in which an asset is in service.[7] Through use of depreciation deductions, carriers recover capital expended on assets while the asset continues to serve the customers.[8] The FCC has stated that depreciation and accounting measures affect pricing and ratemaking decisions because carriers may consider depreciation deductions as an expense to be recouped from consumers through higher rates.[9]

Since 1983, the FCC has reversed its position on preemption of state-set depreciation rates and now requires that state regulatory commissions controlling intrastate telephone service follow the FCC's accounting and depreciation schedules.[10] The FCC currently requires state regulatory commissions to refrain from using accounting and depreciation methods inconsistent with

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stated in the 1982 Order that state regulatory commissions have a right to depart from FCC-recommended accounting and depreciation rules. *Id.* The FCC acknowledged that Congress did not intend to coerce any state commission into using ratemaking methods deemed unacceptable by the state commission. *Id.*

6. *See* I.R.C. § 167(a) (1984). Section 167(a) of the Internal Revenue Code allows as a depreciation deduction a reasonable amount for the exhaustion, wear and tear, and obsolescence of property used in business. *Id.*; United Rys. & Elec. Co. v. West, 280 U.S. 234, 262 (1930). In *United Railways*, the United States Supreme court described depreciation as an accounting device designed to serve three purposes. *Id.* at 264. First, depreciation preserves the integrity of the investment. *Id.* Secondly, depreciation equitably allocates over the course of asset service life the original investment cost less the estimated salvage value. *Id.* Third, depreciation provides a clearer picture of the actual financial status of a company during the year's operation, because depreciation reflects the decrease in value of assets. *Id. See generally* Lindheimer v. Illinois Bell Tel. Co., 292 U.S. 151, 167 (1934) (describing depreciation as decrease in value of an asset that is not restored by maintenance).

7. *See* I.R.C. § 167(m)(1) (1984). Section 167(m)(1) of the Internal Revenue Code allows a reasonable depreciation deduction for an asset in a given taxable year that reflects the anticipated useful life of an asset. *Id.*

8. *Id.* The reasonable allowance for depreciation under § 167(m)(1) of the Internal Revenue Code allows a carrier to recover the amount originally invested in an asset by deducting that amount during the period constituting the asset's service life. *See id.*

9. 83 F.C.C.2d 267, 272 (1980) (depreciation schedules determine how much depreciation reserve remains in rate base and how much must be paid as return on investment to investors); *see* C. WILCOX, PUBLIC POLICIES TOWARD BUSINESS 563 (1960). Depreciation deductions for tax purposes become depreciation expenses charged to consumers in order to provide funds for the replacement value of an asset. *Id.* The depreciation expense allows carriers to charge consumers for the replacement of assets as a cost of consumer service. *Id., see* E. BRIGHAM & J. PAPPAS, LIBERALIZED DEPRECIATION AND THE COST OF CAPITAL 26 (1970) (utility customers must pay rates to cover depreciation expenses included in operating costs); *see also infra* note 180 (describing relationship between depreciation practices and rate increases).

10. 92 F.C.C.2d 864, 869 (January 6, 1983). In the 1983 depreciation order, the FCC determined that § 220(b) of the Communications Act allows FCC preemption of state accounting and depreciation methods. *Id.* at 869. The FCC stated that § 220(b) of the Communications Act did not distinguish between interstate and intrastate property for purposes of depreciation, and that, consequently, Congress intended no such distinction. *Id.* The FCC further held that, even if § 220(b) does not preempt the authority of state commissions, the FCC may preempt in order to promote federal policies and objectives. *Id.* at 875. Section 220(b) states that the FCC

the FCC-prescribed methods.[11] In justifying its new position on depreciation, the FCC has stated that the statutory language and legislative history of the Communications Act of 1934 allow federal preemption of inconsistent state accounting and depreciation methods.[12] In the alternative, the FCC has argued that federal preemption is necessary to further the goals and policies of the FCC as outlined by Congress.[13] The goals and policies cited by the FCC include providing efficient and modern communications service at reasonable cost.[14]

A federal regulatory agency derives the authority to preempt state regulations from the supremacy clause of the United States Constitution[15] as

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shall define certain classes of property for depreciation purposes, and shall set the depreciation percentages for such charges. 47 U.S.C. § 220(b). Section 220(b) applies to carriers subject to FCC jurisdiction, or carriers engaged in interstate telephone service. *See* 47 U.S.C. § 220(a).

The FCC's 1983 order reversed another FCC order issued only nine months earlier which recognized state authority to set depreciation methods other than those recommended by the FCC. 89 F.C.C.2d 1094, 1107 (April 27, 1982). In the 1982 order, the FCC expressly recognized the right of state commissions to depart from FCC accounting and depreciation methods. *Id.* at 1107. The FCC Stated that § 220 of the Communications Act supports state commissions by precluding FCC jurisdiction over charges, practices, methods, or facilities of carriers providing intrastate telephone service regulated by state commissions. *Id.* at 1108; *see* 47 U.S.C. § 152(b) (prohibiting FCC jurisdiction over intrastate service). In the 1982 order, the FCC stated that the right of state commissioners to set depreciation and ratemaking methods had been recognized by the FCC for four decades. 89 F.C.C.2d at 1098, 1108. The FCC stated that Congress did not intend for the FCC to preempt state ratemaking methods unless those methods threatened important interests of national communications policy. *Id.* at 1108. The FCC concluded that requiring carriers to maintain additional records for intrastate ratemaking purposes would not threaten national communications policy interests. *Id.*

11. 92 F.C.C.2d at 870.

12. *Id.* In the 1983 depreciation order, the FCC construed the legislative history of § 220 of the Communications Act to allow state regulation of accounting and depreciation methods only so long as the FCC did not designate a conflicting method for determining depreciation. *Id.* at 873. The FCC stated that Congress did not intend to allow the states to prescribe depreciation rates different from those established at the federal level. *See id.* at 873. *But see infra* note 71 (discussing legislative history tending to show state authority over depreciation methods). Upon FCC designation of conflicting methods, the FCC determined that the Communications Act allows federal preemption of state accounting and depreciation methods. 92 F.C.C.2d 873; *see infra* note 38 (discussing FCC reasons for preemption of state depreciation methods).

13. *See* 92 F.C.C.2d at 876. In the 1983 depreciation order, the FCC stated that state depreciation rate schedules do not properly provide for capital recovery needed to promote competition, efficiency, and modernization. *Id.*; *see* 47 U.S.C. § 151 (stating that FCC must make available an efficient, nationwide communications system with adequate facilities at reasonable charges).

14. 92 F.C.C.2d at 875. In the January 6, 1983, order, which mandated FCC preemption of state depreciation regulations, the FCC stated that state depreciation methods do not provide for adequate capital recovery, and that such inadequate capital recovery frustrates the FCC policy of promoting efficient telephone service with adequate facilities. *Id.*

15. U.S. CONST., ART. VI, § 2. Article VI of the United States Constitution states that "This Constitution, and the Laws of the United States which shall be made in pursuance thereof...shall be the supreme law of the Land...." *Id., see* United States v. Smith, 393 F.2d

interpreted by the United States Supreme Court.[16] Federal law requires preemption of a state law or regulation when a federal statute expressly states or clearly implies preemption.[17] In *Virginia State Corporation Commission v. FCC*,[18] the United States Court of Appeals for the Fourth Circuit held that FCC regulations pertaining to accounting and depreciation practices preempt any state regulations concerning depreciation methods for intrastate telephone service prescribed by the Virginia State Corporation Commission (VSCC).[19]

The conflict in *VSCC v. FCC* arose from two FCC orders issued during 1980 and 1981.[20] In the 1980 order, the FCC determined that the equal life method[21] of depreciation should replace the vintage year method.[22] The 1980

318, 321 (5th Cir. 1968) (interpreting laws of United States to include federal regulations as well as federal statutes); *cf.* Messier v. Zeiller, 373 F. Supp. 1198, 1203 (D.N.H. 1974) (state statutes, if inconsistent with federal regulations, must conform to federal regulation under supremacy clause).

16. *See* Parker v. Brown, 317 U.S. 341 (1943). The United States Supreme court in *Parker v. Brown* stated that Congress could use its power provided by the Constitution to regulate interstate commerce by instituting federal legislation, the effect of which would be to preempt conflicting state action. *Id.* at 350.

17. *See* Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 153 (1982) (holding that federal preemption of state regulations may be either express or implied).

18. 737 F.2d 388 (4th Cir. 1984).

19. *Id.* at 396. The Fourth Circuit in *Virginia State Corporation Comm'n. (VSCC) v. FCC* stated that state depreciation policies slowed capital recovery and inhibited innovation by carriers. *Id.* at 395. Consequently, the Fourth Circuit held that FCC depreciation methods must preempt state methods because state methods thwarted the FCC goals of promoting efficiency and competition. *Id.* at 392; *see* 47 U.S.C. § 151 (describing the general policy goals of the FCC). The dissent in *VSCC* strongly objected to extending FCC jurisdiction over depreciation and accounting methods to intrastate telephone service. *Id.* at 396 (Widener, J., dissenting). The *VSCC* dissent noted that the impossibility of severing interstate jurisdiction from intrastate jurisdiction found in earlier cases did not exist in *VSCC*. *Id.* at 397-98 (Widener, J., dissenting); *cf.* North Carolina Utils. Comm'n. v. FCC (*NCUC I*), 537 F.2d 787, (4th Cir.) (separate FCC and state regulation of equipment used in both interstate and intrastate service could not coexist because of impossibility of dual regulation), *cert. denied*, 429 U.S. 1027 (1976); North Carolina Utils. Comm'n. v. FCC (*NCUC II*), 552 F.2d 1036 (4th Cir.) (separate FCC and state regulation of equipment used in both interstate and intrastate service could not exist because of impossibility of dual regulation), *cert denied*, 434 U.S. 874 (1977). Thus, the dissent in *VSCC* reasoned that the Fourth Circuit's decisions in *NCUC I* and *NCUC* II did not mandate preemption in *VSCC*. 737 F.2d at 398 (Widener, J., dissenting).

20. *See* 373 F.2d at 390. In *VSCC v. FCC*, the Fourth Circuit noted that in a 1980 order the FCC Determined that the equal life group should replace the vintage group method of depreciation because of the latter's inaccuracy. *Id.*; 83 F.C.C.2d 267 (1980). The Fourth Circuit also examined the FCC's 1981 decision that allowed carriers to charge individual consumers the cost of inside wiring in homes and businesses. 737 F.2d at 391; 85 F.C.C.2d 818 (1981).

21. *See* 83 F.C.C.2d at 281 (describing benefits of equal life method including promotion of new technology and innovation); *see also infra* text accompanying notes 146-147 (describing equal life depreciation method).

22. *See* 83 F.C.C.2d at 293 (stating that vintage year method of depreciation lacks accuracy to match asset cost recovery with asset service life); *see also infra* text accompanying notes 140-145 (describing vintage group method of depreciation).

order also replaced the whole life method[23] of depreciation with the remaining life method.[24] The FCC described the objectives of the 1980 order as ensuring that carriers recover the full cost of an asset in a reasonable manner over the asset's service life,[25] and promoting innovation and the introduction of new technology.[26] The FCC's 1981 order[27] specifically required that regulatory agencies charge the cost of inside wiring for telephone service in homes and businesses to current users, instead of requiring the carrier to treat the cost as a capital investment depreciable over time.[28] In the 1981 order, the FCC also sought to promote the goal of overall deregulation of customer-premises-equipment (CPE) such as inside wiring, the actual telephone unit, and answering machines.[29] The FCC concluded that deregulation of CPE would encourage competition between suppliers of CPE by allowing consumers to choose among different types of CPE provided by various competing suppliers.[30]

Shortly after the FCC issued its 1981 order, the National Association of Regulatory Utility Commissioners (NARUC) sought clarification of how the two FCC orders might affect state regulatory commission control over intrastate telephone service.[31] State regulatory commissions control intrastate

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23. 83 F.C.C.2d at 289; *see infra* notes 175-177 (describing whole life method of depreciation).

24. 83 F.C.C.2d at 288-89; *see infra* note 179 (describing remaining life method of depreciation).

25. 83 F.C.C.2d at 294. In the 1980 depreciation order, the FCC stated that to distribute the full cost of an asset over the asset's service life, the FCC must utilize the most accurate means of measuring an asset's useful service life. *Id.* The FCC concluded that the equal life method more accurately measures service life than the vintage group method. *Id.* at 293; *see infra* notes 145 and 146 (discussing ELG service life estimations).

26. 83 F.C.C.2d at 281. In the 1980 depreciation order, the FCC noted that technological change in the communications industry has proceeded at a rapid pace in recent years, and that the FCC should encourage the continued introduction of new technology. *Id.*

27. 85 F.C.C.2d 818 (1981).

28. *Id.* at 828. The FCC noted in the 1981 order that carriers had used a large amount of investment capital to cover the costs of inside wiring, and stated that consumers should bear the costs of inside wiring expense. *Id.*

29. 85 F.C.C.2d at 827. In the 1981 order, the FCC stated that deregulation would provide a carrier the same regulatory status in marketing customer-premises-equipment (CPE) as any other supplier of CPE because of the removal of any regulatory barriers to competition. *See id.* Consequently, under deregulation, carriers would not receive any undue advantage or disadvantage in entering the CPE market. *See id.*

30. *Id.* The FCC in the 1981 order stated that deregulation of inside wiring would increase installation choices for consumers and would create new business opportunities for competing suppliers of terminal equipment. *Id.*

31. 737 F.2d at 391. The *VSCC* court noted that the National Association of Railroad and Utilities Commissioners (NARUC) requested that the FCC issue a statement clarifying the FCC's 1981 order. *Id.* NARUC requested that the FCC issue a statement allowing state commissions to ignore the FCC's 1981 order regarding the prescription of depreciation methods and the deregulation of inside wiring used in intrastate communications. *Id.* The FCC then stated in a 1982 order that when state regulation is reconcilable with federal policies or rules, the FCC would not preempt state regulations. *Id.*; 89 F.C.C.2d at 1108.

service which include the equipment, procedures, and ratemaking process within the borders of a state.[32] In response to NARUC's request, the FCC stated in a separate 1982 order that when state accounting and depreciation regulations were reconcilable with federal rules or goals, the FCC would not preempt such state regulations.[33] The FCC also stated, however, that the FCC may preempt state regulatory action whenever state action frustrated the FCC's policies or rules regarding interstate or foreign communications.[34]

In response to the 1982 FCC order, the American Telephone and Telegraph Company (AT&T) requested that the FCC reconsider its 1982 order regarding state accounting and depreciation regulation.[35] Specifically, AT&T sought reversal of the FCC's 1982 order that would allow state commissions to set accounting and depreciation methods other than those recommended by the FCC.[36] Instead, AT&T requested that the FCC require state commissions to follow FCC prescribed accounting and depreciation methods across the board.[37] As a result, just nine months after upholding state authority to set depreciation methods, the FCC issued its January 6, 1983 order reversing the position taken in the 1982 order, and stating that depreciation methods prescribed by the FCC always will preempt depreciation methods set by state regulatory commissions.[38] In *VSCC v. FCC*, the Virginia

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32. *See* 47 U.S.C. § 221(b) (restricting FCC jurisdiction over intrastate service); *see also supra* note 3 (discussing areas of state commission jurisdiction and limits on FCC authority).

33. *See* 89 F.C.C.2d at 1108 (1982). The FCC stated in a 1982 order that the FCC did not seek to coerce any state regulatory commission into using ratemaking methods deemed unacceptable by the state commission. *Id.* at 1106.

34. 89 F.C.C.2d at 1108. The FCC stated in the 1982 order that the Communications Act does not prohibit the FCC from preempting state actions that frustrate policies or rules essential to efficient interstate communications. *Id.* However, the FCC noted that in regard to state depreciation methods, the FCC may not preempt state methods merely because carriers would have to pay the administrative costs of maintaining multiple sets of depreciation records. *Id.* The FCC concluded that state depreciation methods and any costs associated with the implementation of those methods did not frustrate any policies or rules essential to efficient interstate communication. *Id.* Nine months after the FCC issued its 1982 order, the FCC reversed its position and required federal preemption of state depreciation methods. *See* 92 F.C.C.2d 864 (1983); *see also supra* note 10 (comparing FCC's 1982 and 1983 orders).

35. 737 F.2d at 391. The Fourth Circuit in *VSCC* stated that the American Telephone and Telegraph Company's (AT&T) Petition for Reconsideration resulted in a reversal of FCC policy regarding the preemption of state depreciation policies. *Id.*; *see* 92 F.C.C.2d at 879-880 (requiring that FCC depreciation methods preempt state methods).

36. *See* 92 F.C.C.2d at 865.

37. *See id.* at 866-67. The Fourth Circuit noted that the FCC stated in its 1983 order that it had not adequately considered § 220(b) of the Communications Act in the FCC's 1982 order allowing state regulation of depreciation method. *Id.* In reversing the 1982 order, the FCC noted that § 220(b) of the Communications Act states that the FCC may set accounting and depreciation methods, but does not specify whether FCC authority extended to prescribing such methods for intrastate as well as interstate service. *Id.*; *see also* 47 U.S.C. § 220(b) (allowing FCC prescription of depreciation methods for interstate carriers).

38. *See* 92 F.C.C.2d at 879. In a 1983 order, the FCC reversed its 1982 ruling allowing independent state commissions to regulate depreciation methods. *Id.*; *see* 89 F.C.C.2d at 1108.

State Corporation Commission, supported by other state and local regulatory commissions, filed a petition for review of the FCC's January 6, 1983 Order, which preempted all state regulation of accounting and depreciation practices.[39] The VSCC claimed that the FCC incorrectly determined that the Communications Act preempted state prescription of depreciation rates and accounting methods for intrastate ratemaking purposes.[40] The VSCC also asserted that the FCC erred in determining that the differences in depreciation and accounting methods between interstate and intrastate jurisdictions would frustrate federal policies and justify preemption under the supremacy clause of the United States Constitution.[41]

In analyzing the VSCC's claim, the Fourth Circuit examined two similar Fourth Circuit cases brought by the North Carolina Utilities Commission against the FCC.[42] In *North Carolina Utilities Commission v. FCC (NCUC I)*,[43] the Fourth Circuit stated that the FCC has primary authority to preempt state control[44] over the interconnection of terminal equipment with the

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The FCC justified the reversal on the basis of § 220(b) of the Communications Act, which the FCC reinterpreted as allowing the FCC to preempt state regulations whenever such regulations encroach upon interstate service, or frustrate the goals and objectives of the FCC. 92 F.C.C.2d at 879. The FCC defined the goals served by preemption of state depreciation methods as the promotion of efficient, competitive interstate service. *Id.* at 876.

39. 737 F.2d at 392.

40. *Id.* In *VSCC*, the VSCC claimed that the FCC lacked authority to preempt state depreciation methods as a matter of law, since the Communications Act reserved authority over intrastate practices and methods to the states. *Id.*; *see* 47 U.S.C. § 221(b) (reserving jurisdiction over classifications, practices, and facilities used in intrastate service to states).

41. 737 F.2d at 392. In *VSCC*, the VSCC claimed that the FCC lacked authority to preempt state depreciation methods because the state could maintain separate depreciation methods for intrastate and interstate assets. *Id.*; *see infra* note 78 (discussing separability of depreciation methods for intrastate and interstate service). The VSCC stated that state-set depreciation methods would not frustrate federal policies of promoting greater efficiency and providing adequate capital recovery. *See* Brief for Petitioner Virginia State Corporation Commission at 34, VSCC v. FCC, 737 F.2d 388 (4th Cir. 1984). The VSCC stated that some states, including Arizona, California, and Florida, allowed more rapid depreciation than in the methods prescribed by the FCC. *Id.* at 35. The VSCC stated that FCC preemption would prevent states from responding to specific state needs regarding the application of depreciation methods. *Id.* The VSCC further claimed that FCC preemption of state depreciation methods would not necessarily lead to greater efficiency and innovation in communication networks. *Id.* at 38. The VSCC noted that historically consumers have contributed to innovation by paying increased rates which fund research and development. *Id.* The VSCC stated that no proof exists that state depreciation methods have frustrated efficiency or innovation in telephone service. *Id.*

42. *See* 737 F.2d at 392. The Fourth Circuit in *VSCC* examined two cases brought by the North Carolina Utilities Commission against the FCC in which the Fourth Circuit determined that the FCC regulations may preempt contrary state regulations that threaten interstate efficiency. *Id.* at 390; *see also infra* notes 44 and 52.

43. North Carolina Utils. Comm'n. v. FCC, 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976).

44. 537 F.2d at 793. The Fourth Circuit in *North Carolina Utils. Comm'n. v. FCC (NCUC I)* noted that, while the FCC may not preempt state regulatory authority over intrastate matters that do no substantially affect interstate communications, the Communications Act

national telephone network.[45] The Fourth Circuit in *NCUC I* stated that the FCC must remain free to determine the types of equipment that consumers may connect with interstate and intrastate communication networks.[46] The *NCUC I* court also stated that to allow state regulatory commissions to restrict the connection of equipment with the communication networks would frustrate the FCC's authority over interstate service.[47] Placing restrictions upon equipment used in intrastate service necessarily restricts the use of such equipment for interstate purposes because the same equipment is connected to both the intrastate and interstate communications network.[48] The *NCUC I* court recognized, however, that the FCC does not have authority over services that do not substantially affect the efficiency or safety of interstate telephone service.[49] In a subsequent suit, *North Carolina Utilities Commission*

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forbids state regulation if the state regulation substantially encroaches upon the statutory authority of the FCC to preserve the efficiency of the interstate system. *Id.* The *NCUC I* court stated that the FCC's intention of exercising primary authority over the interconnection of terminal equipment with the national telephone network is a proper and reasonable assertion of jurisdiction conferred by the Communications Act. *Id.* at 794.

45. *Id.* at 791. The Fourth Circuit in *NCUC I* determined that since terminal equipment connected to a subscriber's intrastate station and line also connects to the interstate communications network, such terminal equipment serves both intrastate and interstate service. *Id.* Therefore, the *NCUC I* court held that the FCC may regulate the use and connection of such equipment. *Id.*; *see also* North Carolina Utils. Comm'n. v. FCC, 552 F.2d 1036, 1040 (4th Cir.), *cert. denied*, 434 U.S. 874 (1977). The Fourth Circuit in *North Carolina Utils. Comm'n. v. FCC (NCUC II)* defined "terminal equipment" as those devices attached to the national telecommunications network for either transmission or reception of communications. 552 F.2d at 1040. Such devices include residential telephones, answering machines, and computer terminals. *Id.*

46. 537 F.2d at 793. The Fourth Circuit in *NCUC I* stated that state restrictions or prohibitions on the attachment of equipment by consumers to the intrastate communications system interfered with the unrestricted connection of such equipment to the interstate system. *Id.* The Fourth Circuit stated that such state restrictions infringed on the FCC's authority to determine the types of equipment consumers may attach to the interstate communications system. *Id.*

47. *Id.* at 794; *see supra* note 46 (discussing FCC interest in controlling connection of equipment with interstate communications system).

48. 537 F.2d at 793.

49. *Id.* The Fourth Circuit in *NCUC I* stated that separation of the ratemaking process between intrastate and interstate service does not interfere with FCC authority over interstate communication. *Id.* at 793 n.6. The Fourth Circuit stated that while the Communications Act prohibited the FCC from exercising authority over those local services separable from interstate communications, the Communications Act allowed the FCC to exercise authority over intrastate matters that encroached substantially upon interstate service. *Id.*

In contrast, the *NCUC I* dissent asserted that Congress intended to establish a telephone regulatory system with divided jurisdiction between federal and state systems. *Id.* at 798 (Widener, J., dissenting). The dissent also stated that the literal meaning of § 221(b) of the Communications Act, read in conjunction with the FCC's interpretation of the statute over the past 40 years, allows state rather than federal regulation of attachments to intrastate facilities, even if such intrastate facilities are also connected to interstate service. *Id.* (Widener, J., dissenting); *see* Communications Act of 1934 (codified as amended at 47 U.S.C. §§ 151-609

v. FCC (NCUC II),[50] the Fourth Circuit stated that FCC regulations preempt contrary state regulations when the efficiency or safety of the interstate telephone system is at stake.[51] Without discussing any particular efficiency or safety considerations, the *NCUC II* court concluded that the FCC has full statutory authority to regulate facilities used both in intrastate and interstate service to ensure the safety of the national communications network.[52] Although the *NCUC II* court interpreted the Communications Act to support FCC preemption of state regulation over equipment used for both interstate and intrastate service,[53] the Fourth Circuit stated that state regulatory commissions nonetheless retain authority to set rates for all local services and facilities.[54] In *VSCC*, the Fourth Circuit applied the holdings of *NCUC I* and *NCUC II* and determined that all state depreciation methods

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(1982)); 47 U.S.C. § 152(b) (denying FCC authority over practices or facilities associated with intrastate service).

50. North Carolina Utils. Comm'n. v. FCC, 552 F.2d 1036 (4th Cir.), *cert. denied*, 434 U.S. 874 (1977).

51. 552 F.2d at 1046.

52. *Id.* at 1046-47. The Fourth Circuit in *NCUC II* acknowledged that FCC preemption of state regulation over equipment serving both interstate and intrastate service rests on the FCC's overriding authority to promote an efficient communications network. *Id.* at 1046. The Fourth Circuit conceded that the explicit language of § 221(b) of the Communications Act grants primary authority over facilities used in both interstate and intrastate service to the states. *Id.*; *see* 47 U.S.C. § 221(b). The FCC may not exercise jurisdiction over intrastate charges, classifications, practices, facilities, or regulations in connection with wire, mobile, or radio communication service, even if a portion of the intrastate service also constitutes interstate service. *Id.*

53. 552 F.2d at 1048.

54. *See id.* at 1048. In *NCUC II*, the Fourth Circuit stated that Congress had drafted the Communications Act with the intention of denying the FCC jurisdiction over the establishment of intrastate telephone rates. *Id.* at 1047. The Fourth Circuit in *NCUC II* stated that the FCC's objection to state restrictions on interconnection of terminal equipment in no way related to rate setting practices for intrastate service. *Id. See* Note, *Separating the Jurisdictional Authorities of State and Federal Administrators in the Regulation of the Physical Equipment Within the Nation's Telephone Network*, 8 TOLEDO L. REV. 733, 738-739 (1977) (examining the jurisdictional history of the FCC).

In drafting the Communications Act, Congress sought to deny to the FCC the ratemaking power given to the Interstate Commerce Commission (ICC) by the "Shreveport Doctrine" announced in the United States Supreme Court decision in *Houston, East & West Texas Ry. v. United States*. *See* Houston, East & West Texas Ry. v. United States, 234 U.S. 342 (1914). Under the Shreveport doctrine, the Supreme Court held that the ICC had the authority to preempt state control over intrastate rail shipment rates when local rates created unreasonable infringement on interstate commerce. *Id.* at 350-351; *see also* 78 Cong. Rec. 8823 (1934) (statement of Senator Dill, Chairman of Senate Interstate Commerce Committee). Senator Dill stated that Congress enacted the Communications Act to safeguard state regulation of intrastate telephone service from the Shreveport doctrine. *Id.* Senator Dill noted that the Shreveport doctrine had eroded the authority of state commissions to regulate intrastate railroad service. *Id.* Senator Dill further stated that the Communications Act protects the right of state commissions to regulate intrastate service, and does not extend FCC jurisdiction to matters regulated by state commissions. *Id.*

affect the efficiency of interstate telephone service because the depreciation methods are not separable from interstate communications.[55]

In analyzing the VSCC's request for review of the FCC's 1983 order, the Fourth Circuit in *VSCC* also reviewed cases from other federal circuits that involved FCC preemption of state regulatory control.[56] The Fourth Circuit found that in all but one case federal courts had allowed FCC preemption of state regulation.[57] Moreover, the Fourth Circuit found that all of the cases allowing federal preemption involved impossibility of dual federal and state regulation because dual federal and state regulation could not coexist.[58] For example, in *Computer and Communication Industry Association v. FCC*,[59] the United States Court of Appeals for the District of Columbia Circuit approved FCC preemption of state tariffs on customer-premises-equipment (CPE)[60] such as inside wiring and the telephone unit, because the court determined such tariffs impeded the federal policy of deregulating interconnection of CPE.[61] The District of Columbia Circuit, however, carefully distinguished between the FCC's authority over CPE used in interstate communications[62] and state authority over intrastate rates.[63] The

55. 737 F.2d at 395. The Fourth Circuit in *VSCC* stated that state depreciation methods would slow capital recovery and innovation because certain intrastate equipment subject to state depreciation methods also served interstate service. *Id.* However, the Fourth Circuit contradicted its finding that depreciation methods are not separable from interstate service by acknowledging that carriers could implement separate intrastate and interstate methods. *Id.* at 396. The Fourth Circuit stated that carriers could maintain accounts separating intrastate and interstate assets for depreciation purposes. *Id.*

56. 737 F.2d at 395-396.

57. *See id.* The Fourth Circuit in *VSCC* acknowledged that the United States District Court for Arkansas held that the FCC lacked jurisdiction to preempt state depreciation methods. *Id.* at 392 n.7; *see* Southwestern Bell Tel. Co. v. Arkansas Pub. Serv. Comm'n., 584 F. Supp. 1087 (E.D. Ark. W.D.), *rev'd*, 738 F.2d 901 (8th Cir. 1984).

58. *See* 737 F.2d at 396. The Fourth Circuit in *VSCC* noted that in many cases state regulation prohibiting consumers from connecting certain equipment to the interstate communications networks could not be harmonized with FCC regulation allowing connection of the equipment. *Id.* In addition, carriers cannot comply with conflicting state and FCC regulation concerning interconnection of communications equipment. *Id.* The Fourth Circuit stated, however, that carriers could apply conflicting depreciation methods separately to intrastate and interstate assets. *Id.*

59. 693 F.2d 198 (D.C. Cir. 1982), *cert. denied, sub nom.*, Louisiana Pub. Serv. Comm'n. v. FCC, 461 U.S. 938 (1983).

60. 693 F.2d at 204 nn.12 & 14. The United States Court of Appeals for the District of Columbia Circuit in *Computer and Communications Industry Ass'n v. FCC (Computer II)* described customer premises equipment (CPE) as including data processing equipment, telephones, answering machines, key systems, and interoffice switchboards. *Id.*

61. *Id.* at 216. The District of Columbia Circuit in *Computer II* stated that state tariffs on CPE provided by carriers would interfere with the consumer's ability to purchase CPE and would frustrate the federal policy of promoting competition and innovation by limiting the variety of competing suppliers. *Id.*

62. *Id.* In *Computer II*, the District of Columbia Circuit stated that the practice of using CPE jointly for interstate and intrastate communications allowed FCC preemption because when conflicting state policy encroaches on federal policy, federal policy prevails. *Id.*

63. *Id.* The D.C. Circuit in *Computer II* held that the FCC, in determining regulatory

District of Columbia Circuit acknowledged that state regulatory commissions and not the FCC had authority to set rates for intrastate service.[64] In a similar case, *New York Telephone Co. v. FCC*,[65] the United States Court of Appeals for the Second Circuit held that FCC regulation could preempt state tariffs on interstate telephone calls because such tariffs substantially affected the conduct or development of interstate communication.[66] Likewise, in *Puerto Rico Telephone Co. v. FCC*,[67] the United States Court of Appeals for the First Circuit stated that FCC jurisdiction over private branch equipment (PBX)[68] should preempt Puerto Rico's authority because PBX affects access to the interstate telephone system.[69] The First Circuit in *Puerto Rico Telephone* conceded that although the literal meaning of certain sections of the Communication Act would preclude the FCC from regulating intrastate matters,[70] the legislative history negates the literal meaning of the Communications Act.[71] The First Circuit stated that a provision in the Communications Act preventing FCC authority over charges, practices, or facilities

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treatment of CPE used for interstate communications, had not attempted to set rates for intrastate communications. *Id.*

64. *Id.* at 215-216. The District of Columbia Circuit in *Computer II* acknowledged that the Communications Act specifically protects state authority over intrastate rates. *Id.*; *see* 47 U.S.C. § 152 (restricting FCC jurisdiction over intrastate service).

65. 631 F.2d 1059 (2d Cir. 1980).

66. *Id.* at 1066. In *New York Telephone Co. v. FCC*, the United States Court of Appeals for the Second Circuit examined the differences between FCC authority and state commission authority over interstate and intrastate service, and considered whether the FCC could preempt state ratemaking authority. *Id.* The Second Circuit noted that New York Telephone Company charges on certain interstate consumers ranged up to 1600% higher than the comparable charge for intrastate consumers, and that such tariffs substantially affected the development of interstate communication and encroached upon FCC authority. *Id.* The Second Circuit noted that separability issues involving the intrastate and interstate ratemaking process did lessen the need for federal preemption because of the overriding concern that state regulation and tariffs not affect interstate telephone service. *Id.*

67. 553 F.2d 694 (1st Cir. 1977).

68. *Id.* at 696. In *Puerto Rico Tel. Co. v. FCC*, the United States Court of Appeals for the First Circuit defined private branch equipment (PBX) as including intra-office and intra-hotel telephone systems and switchboards that provide the link between a private system and the local telephone service. *Id.* PBX serves both intrastate and interstate service, and consequently, the First Circuit determined that the FCC may preempt state regulations affecting PBX that hamper access to the interstate communication system. *Id.*

69. *Id.* at 700. In *Puerto Rico Telephone*, the First Circuit determined that state regulation of PBX equipment amounted to state control of access to the interstate telephone system. *Id.* The First Circuit further stated that the FCC may ensure uniform standards of accessibility to the interstate system, and thus may preempt conflicting state regulation. *Id.*

70. *Id.* at 698. In *Puerto Rico Telephone*, the First Circuit stated that the language of §§ 152(b) and 221(b) of the Communications Act when read literally precludes federal jurisdiction over intrastate facilities, charges, services, classifications, or regulation. *Id.*

71. 553 F.2d at 698; *see* Communications Act of 1934 (codified as amended at 47 U.S.C. § 151). The First Circuit in *Puerto Rico Telephone* interpreted § 221(b) of the Communications Act as exempting from FCC regulation telephone exchange services in metropolitan areas overlapping state lines. *See* 553 F.2d at 698 (quoting S. REP. No. 781, 73d Cong., 2d Sess. 5 (1934)). The First Circuit stated that the legislative history in favor of federal preemption is

used in intrastate service applies only to attempted FCC regulation of local service in a multistate area, such as where a metropolitan area extends across state lines.[72] As a result, the First Circuit determined that, while the Communications Act deprives the FCC of authority over local services and facilities that are separable from and do not substantially affect interstate communication, the Communications Act does not prevent the FCC from preempting state regulation of intrastate matters that encroach upon access to the interstate telephone system.[73] The First Circuit stated that FCC jurisdiction extends to interstate service from the inception of such service to completion.[74] The First Circuit concluded that the Communications Act deprives the FCC of authority over intrastate services and facilities that are separable from interstate service, but allows FCC preemption of state regulation that substantially encroaches upon FCC authority over interstate service.[75] Consequently, the central issue in cases cited by the Fourth Circuit in *VSCC v. FCC* concerns whether state regulation affects or encroaches upon interstate service and FCC authority.[76]

"unequivocal." 553 F.2d at 698. However, the legislative history of the Communications Act indicates that Congress heeded the requests of state commissions to protect state regulatory authority over intrastate communication service. *See Hearings on H.R. 8301 Before the House Committee on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 136-44 (April 10, 1934). For example, the general solicitor of the National Association of Railroad and Utility Commissions (NARUC), Mr. J. Benton, stated that § 220 of the Communications Act takes account of local conditions and consequently acknowledges the powers of state commissions regarding regulation of depreciation and accounting. *Id.* Benton also stated that § 220 provides that the control of intrastate telephone service exercised by the states will continue to be exercised by the states without interference by the FCC. *Id.*; *see* 78 CONG. REC. S8822 (May 15, 1934). In the Senate hearing on the Communications Act, Senator Dill, sponsor of the Act, stated that Congress attempted to safeguard state regulation so that when state commissions regulate existing intrastate telephone service, the provisions of the Communications Act allowing federal preemption will not apply. *Id.* Senator Dill stated that Congress wanted to protect the right of state commissions to regulate intrastate service by preventing the FCC from usurping state authority. *See* 78 CONG. REC. H3285 (June 2, 1934). Congressman Sam Rayburn stated that § 221(b) of the Communications Act leaves regulation of local telephone service to state or local commissions even when a portion of such local service extends across state boundaries. *Id.*

72. 553 F.2d at 698-699. The First Circuit in *Puerto Rico Telephone* stated that the restrictions on FCC authority provided by the Communications Act sweep less broadly than the statutory language would indicate. *Id.* at 698; *see supra* note 71 (discussing legislative history of §§ 220 and 221 of Communications Act).

73. 553 F.2d at 700. In *Puerto Rico Telephone*, the First Circuit stated that even though PBX is used mainly for intrastate service, PBX also is used for interstate service. *Id.* The First Circuit stated that just because PBX serves mainly intrastate service does not outweigh the need to assure uniform and reasonable access to the interstate communications network. *Id.* Carriers could not apply both federal regulations allowing unrestrained connection of PBX to the interstate system and commonwealth regulation restricting the connection of PBX to the intrastate system simultaneously, and consequently the First Circuit held that FCC regulations must preempt conflicting state regulations. *Id.*

74. *Id.* at 699.

75. 553 F.2d at 699-700.

76. 737 F.2d at 392-393; *see supra* notes 62, 66, & 69 (discussing recent federal circuit courts of appeals decisions regarding FCC preemption of state regulation).

The Fourth Circuit's decision in *VSCC* also recognized that the impossibility of compliance with dual regulation in the cases decided by other federal circuit courts of appeals[77] prevented carriers from applying both federal and state regulations.[78] The Fourth Circuit acknowledged, however, that the *VSCC* case raised no question of impossibility of complying with dual regulation.[79] In contrast, the Fourth Circuit noted that state depreciation and accounting methods applied separately to intrastate service would not hinder the FCC's ability to set depreciation and accounting methods for facilities within the FCC's interstate jurisdiction.[80] The Fourth Circuit also stated that carriers may maintain separate accounts for the depreciation of intrastate and interstate assets to comply with dual regulation.[81] Consequently, the Fourth Circuit did not determine whether the language of the Communications Act required preemption, but held only that the FCC's affirmative regulatory action in the interest of protecting efficient interstate service allowed preemption of state depreciation methods.[82]

In examining the statutory intent of the Communications Act, the Fourth Circuit in *VSCC* conceded that the plain statutory language of the Communications Act reserves to the states the authority to prescribe rates for intrastate telephone service.[83] Moreover, the Fourth Circuit failed to cite

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77. 737 F.2d at 392-393.

78. *See id.* at 396. In *VSCC*, the Fourth Circuit stated that unlike cases in which conflicting FCC and state regulations could not exist simultaneously, carriers could keep separate accounts for depreciation of intrastate and interstate assets and could comply with both FCC and state depreciation methods. *Id.* The Fourth Circuit held, however, that even if carriers could comply with both federal and state depreciation regulations, the FCC may preempt state regulations to promote the development of interstate facilities. *Id.*; *cf.* NCUC I, 537 F.2d at 793 n.6 (4th Cir. 1976). The Fourth Circuit in *NCUC I* stated that the ratemaking process may be divided between interstate and intrastate systems in such a manner that state regulation would not interfere with federal regulation. *Id.* at 793 n.6.

79. *See* 737 F.2d at 396.

80. *Id.*; *see* Smith v. Illinois Bell Tel. Co., 282 U.S. 133, 148 (1930). In *Smith v. Illinois Bell Tel. Co.* the United States Supreme Court stressed the importance and necessity of separating intrastate and interstate property in order to properly distinguish between state and federal control. *Id.* The Supreme Court stated that under § 20(5) of the Interstate Commerce Act, the ICC could prescribe the classes of property for which depreciation charges may properly be included in operating expenses, and the percentages of depreciation to be charged with respect to each class of property. *Id.* at 149. When portions of the Interstate Commerce Act became part of the Communications Act of 1934, the new statutory language acknowledged separation of FCC and state authority over interstate and intrastate rates. *See id.*; *see supra* notes 54 and 68 (discussing legislative history of Communications Act).

81. 737 F.2d at 396; *see supra* note 73 (discussing dual state and federal regulation of depreciation methods).

82. *See* 737 F.2d at 392. The Fourth Circuit in *VSCC* held that any FCC action taken to promote efficiency and innovation was sufficient to preempt inconsistent state action. *Id.* The Fourth Circuit consequently declined to determine whether as a matter of law the statutory language of the Communications Act required preemption. *Id.*

83. *See id.*

legislative history that would support a contrary reading of the Communications Act.[84] Instead, the Fourth Circuit held that the state's frustration of federal objectives through depreciation methods that allegedly affect interstate communications justified preemption in *VSCC v. FCC*.[85] According to the Fourth Circuit, the federal objectives that justify FCC preemption are the rapid development of interstate facilities and the maintenance of an efficient, viable interstate telecommunications network.[86] The Fourth Circuit failed to determine, however, how state prescription of accounting and depreciation rules for intrastate telephone service frustrate federal objectives.[87] In explaining its holding, the Fourth Circuit in *VSCC* stated that although state regulation of accounting and depreciation rules did not hinder federal objectives during the years of carrier monopoly power,[88] state regu-

84. *See id.* at 390; *see* Federal Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. at 157. *Federal Sav. & Loan Ass'n v. de la Cuesta* did not involve an FCC regulation but rather concerned preemption by the Federal Home Loan Bank Board of state limitations on certain practices by federal savings and loan associations. *Id.* at 167. However, the Fourth Circuit in *VSCC* relied on *de la Cuesta* to apply the United States Supreme Court's test for federal preemption of state regulation. 737 F.2d at 393. The *de la Cuesta* Court ruled that in determining whether federal preemption of state law is proper, the focus on the intent of Congress is not the sole means of inquiry. 458 U.S. at 157. The Court stated that the federal regulation must not be unreasonable, unauthorized, or inconsistent with the underlying statute. *Id.*; *see* Ridgway v. Ridgway, 454 U.S. 46, 57 (1981). The *de la Cuesta* Court further stated that federal regulations should not be disturbed unless the statute or legislative history indicates that Congress would not have sanctioned such a regulation. 458 U.S. at 154 (quoting United States v. Shimer, 367 U.S. 374, 381-382 (1961)). *See generally* Memorandum Opinion and Order, 89 F.C.C.2d at 1106 (1982). The FCC stated in its 1982 order that the legislative history of the Communications Act is at best uncertain as to whether state accounting and depreciation rules can be preempted by the FCC, although an inference may be drawn that Congress did not intend to preempt inconsistent state commission accounting practices. *Id.* The FCC reversed this finding nine months later in a 1983 order. *See* 92 F.C.C.2d at 869; *see also supra* note 71 (discussing legislative history of Communications Act of 1934).

85. 737 F.2d at 396. The Fourth Circuit in *VSCC* stated that the federal objective of developing and modernizing the communications systems would suffer if Virginia continued to use the state depreciation methods, which slowed capital recovery. *Id.* at 395.

86. *Id.* at 390.

87. *Id.* at 394. In *VSCC*, the Fourth Circuit stated that improper recovery of capital invested by carriers in particular communications equipment posed a threat to innovation in a competitive market. *Id.* The *VSCC* court, however, failed to explain the relationship of depreciation rules to capital recovery and innovation. *Id. See generally* W. BOLTER & D. IRWIN, DEPRECIATION REFORM, A CRUCIAL STEP IN TRANSFORMING TELECOMMUNICATIONS TO A FREE MARKET 9-12 (1980) (describing relationship between depreciation policies and modernization).

88. 737 F.2d at 394. In *VSCC*, the Fourth Circuit noted that state commissions had tended to follow FCC directives during the years before the breakup of the nationwide Bell System. *Id.* The Fourth Circuit stated, however, that the current competitive marketplace requires proper capital recovery. *Id.* However, competitive markets do not necessarily exist in the area of providing local telephone services. *See* United States v. American Tel. & Tel. Co., 552 F. Supp. 131, (D.D.C. 1982), *aff'd sub nom.*, Illinois v. United States, 460 U.S. 1001 (1983). In *United States v. American Tel. & Tel. Co. (AT&T)*, the District Court for the District of Columbia recognized the monopoly characteristics of local telephone service provided by intrastate carriers, and stated that a state may continue to require that a regulated monopoly provide local telephone service. *Id.* at 159 n.117, 224.

lation now poses a threat to competition.[89] The Fourth Circuit further stated that flexibility in depreciation practice may result in improper capital recovery for carriers, and that such improper recovery could hinder competition.[90] The Fourth Circuit did not explain what competitive markets are threatened by state regulation of intrastate telephone service.[91]

In analyzing the ability of the FCC to preempt state regulatory commissions, the Fourth Circuit also examined preemption as defined by the United States Supreme Court in *Fidelity Federal Savings & Loan Co. v. de la Cuesta*.[92] The *de la Cuesta* Court stated that when federal law and state law conflict, federal law nullifies state law.[93] The Supreme court further stated that such a conflict occurs when state law obstructs Congressional directives or objectives.[94] The *de la Cuesta Court* described the guidelines for determining federal preemption in the form of a two-prong test.[95] First, courts must consider whether the regulatory agency meant for the federal regulation to preempt state law.[96] Second, courts must decide whether the action taken by the agency fell within the agency's delegated authority.[97] The *de la Cuesta* Court further stated that federal agency regulations meant to preempt state law should not be disturbed unless the language of the federal statue or the legislative history indicates that Congress did not intend such preemption.[98]

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89. 737 F.2d at 394. In *VSCC*, the Fourth Circuit noted that 75% of all carrier investment in new equipment falls within the intrastate service category. *Id.* at 395. The FCC stated that if a large percentage of equipment investment should fail to receive adequate depreciation allowance, interstate service would suffer due to delayed innovation because certain intrastate equipment such as switchboards and connecting units also serves interstate service. *Id.*

90. *Id.* at 394.

91. *See id.* In *VSCC*, the Fourth Circuit discussed the threat of state depreciation methods to competitive markets. *Id.* The Fourth Circuit did not, however, identify any particular competitive markets, or indicate how competition should be considered in weighing factors related to federal preemption. *See id.*

92. 737 F.2d at 393; Fidelity Fed. Sav. & Loan Ass'n. v. de la Cuesta, 458 U.S. 141, 153 (1982). The United States Supreme Court held in *de la Cuesta* that federal regulation may preempt state regulation even without express directives from Congress when the overall effect of federal regulation infers preemption. *Id.*

93. 458 U.S. at 153.

94. *Id.* The United States Supreme Court in *de la Cuesta* defined the boundaries of state law compliance with congressional objectives by stating that such state regulations must not be unreasonable, unauthorized, or inconsistent with the underlying statute. *Id.* at 154 (quoting Free v. Bland, 369 U.S. 663, 666 (1962)).

95. *Id.*

96. *Id.* The United States Supreme Court in *de la Cuesta* stated that when an administrator of an agency promulgates regulations intended to preempt state law, the federal regulation should not be disturbed by a court unless the underlying statute or its legislative history indicates that Congress would not have sanctioned the federal regulation. *Id.*

97. *Id.* The United States Supreme Court in *de la Cuesta* stated that a court must determine the scope of an agency's delegated authority by examining the underlying statute or legislative history to see if Congress would have sanctioned preemption. *Id.*

98. *Id.* (quoting United States v. Shimer, 267 U.S. 374, 381-382 (1961)).

The Court further indicated that an analysis of legislative history may be crucial in determining the scope of an agency's preemption authority.[99]

Based on its reasoning in *VSCC v. FCC*, the Fourth Circuit did not satisfy the test for federal preemption as defined by the Supreme Court in *de la Cuesta*.[100] The Fourth Circuit correctly determined that the FCC satisfied the first prong of the *de la Cuesta* test by intending to preempt inconsistent state regulation.[101] However, concerning the second prong of the *de la Cuesta* test, the Fourth Circuit in VSCC specifically acknowledged that the Communications Act reserves to the states the authority to prescribe rates for intrastate telephone service, and prevents the FCC from assuming jurisdiction with respect to intrastate telephone service.[102] The Fourth Circuit also did not contend that the overall intent of the Communications Act implied preemption or that the Communications Act leaves no room for

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99. *Id.*; *cf.* Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 570 (1982) (courts may infer legislative intent through statutory language); Bread Political Action Comm. v. Fed. Elections Comm'n., 455 U.S. 577, 584 (1982) (best evidence of what Congress intended is found in language of statute itself, absent clearly contrary legislative intent).

100. *See* 737 F.2d at 394. In *VSCC*, the Fourth Circuit held that the FCC could preempt any state regulation that impaired efficient interstate telephone service. *Id.* The Fourth Circuit based its holding on § 151 of the Communications Act, which stated that the FCC should make available an efficient, nationwide communications system with adequate facilities at reasonable charges. *Id.* at 390; *see* 47 U.S.C. § 151. The Fourth Circuit stated that state depreciation methods threaten the efficient operation of the communications industry in a competitive market, but failed to show how state depreciation methods result in inefficient or inadequate facilities, or in unreasonable charges. *See* 737 F.2d at 393-95. Further, the Fourth Circuit chose not to follow a provision of the Communications Act which states that the FCC must not construe the Act to give the FCC jurisdiction with respect to intrastate service. *See id.* at 392; 47 U.S.C. § 152(b). In addition, the Fourth Circuit did not choose to follow the more specific statutory language of a provision of the Communications Act which forbids FCC jurisdiction over any intrastate service regulated by a state commission even if a portion of the intrastate service constitutes interstate or foreign communication. 737 F.2d at 392; 47 U.S.C. § 221(b). The Fourth Circuit instead stated that the FCC intended to preempt state regulation, thereby satisfying the first prong of the *de la Cuesta* test. 737 F.2d at 393. The Fourth Circuit stated that the FCC also satisfied the second prong of the *de la Cuesta* test because the preemption of intrastate depreciation methods fell within the delegated authority of the FCC by virtue of the FCC's interest in promoting efficiency. 737 F.2d at 393-94. The dissent in *VSCC* stated that the Fourth Circuit's holding had effectively written out of the Communications Act §§ 152(b) and 221(b) which prohibit FCC jurisdiction over intrastate practices, methods, and facilities. *Id.* at 398 (Widener, J., dissenting). The dissent stated that the FCC consequently could usurp all state regulatory authority over intrastate matters by asserting that federal preemption will in some way foster competition in a market that the FCC need not specify. *Id.*

101. 737 F.2d at 393. The Fourth Circuit in *VSCC* stated that the FCC clearly meant to preempt inconsistent state regulation. *Id.* The Fourth Circuit quoted the FCC's 1983 depreciation order, which demonstrated that the FCC specifically stated an intention to preempt inconsistent state depreciation methods. *Id.* at 393-94; *see* 92 F.C.C.2d at 879-80 (preempting state depreciation methods).

102. 737 F.2d at 392. The Fourth Circuit in *VSCC* stated that the Communications Act reserves to the states the power to set rates for intrastate service as long as such authority does not hinder efficient interstate service. *Id.*

supplementary action by the states.[103] On the contrary, the Fourth Circuit acknowledged the role of state regulatory authority as outlined in the statutory language of the Communications Act.[104] Furthermore, while the Fourth Circuit emphasized the goal of promoting efficiency, the Fourth Circuit failed to show that the use of state depreciation methods during the last forty years resulted in inefficiency or in any tangible way hampered the interstate telephone system.[105] Thus, while the Fourth Circuit determined that the FCC intended that federal regulation of depreciation and accounting methods would preempt state law, the Fourth Circuit failed to show that the action taken by the FCC fell within the agency's delegated authority.[106]

The Fourth Circuit's decision in *VSCC v. FCC* expands the doctrine of federal preemption.[107] The Fourth Circuit specifically extended the parameters of federal preemption to include not only cases in which state and federal regulations inescapably conflict, but also cases in which federal and state

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103. *Id.* at 396. The Fourth Circuit did not reach the question of whether the language of the Communications Act requires preemption. *See id.* at 392. Instead, the Fourth Circuit stated that the affirmative regulatory action taken by the FCC to promote efficiency allowed preemption. *Id.* The Fourth Circuit failed to show, however, that the structure and and purpose of the Communications Act eliminates state regulation, and in fact the Fourth Circuit acknowledged that the Act grants state authority in some instances. *See id.* at 390. The Fourth Circuit acknowledged that the Communications Act provides for state regulation of charges, classifications, practices, services, and facilities for intrastate telephone service. *Id.* at 390; *see* 458 U.S. 141, 153; *see also* 47 U.S.C. §§ 152(b), 221(b) The language of the Communications Act specifically carves out areas for state regulation, including ratemaking. *Id.* The Supreme Court in *de la Cuesta* stated that preemption of state law may occur when state law conflicts with federal law. 458 U.S. at 153. In *Jones v. Rath Packing Co.*, the Supreme Court allowed federal preemption when explicitly provided for by Congress in statutory language, or when explicitly provided for by Congress in the structure and purpose of a statute. Jones v. Rath Packing Co., 430 U.S. 519, 525 (1977). In *Florida Lime & Avocado Growers, Inc. v. Paul*, the Supreme Court defined a conflict between state and federal regulation as requiring federal preemption when compliance with both federal and state regulations is an impossibility. Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-143 (1963). The Fourth Circuit acknowledged that the *VSCC* case raised no question of impossibility that Virginia carriers could comply with both federal and state regulation. 737 F.2d at 396.

104. *See* 737 F.2d at 392 (discussing state authority to prescribe rates for intrastate service).

105. *See id.* at 395-396. The Fourth Circuit in *VSCC* stated that state depreciation methods would provide capital recovery for carriers at a slower rate than the methods proposed by the FCC. *Id.* at 395. However, the Fourth Circuit did not find that the rate of capital recovery under various state depreciation methods was insufficient to provide for an efficient communications system at reasonable cost. *See id.* at 395-96.

106. 737 F.2d at 396. The Fourth Circuit in *VSCC* stated that preemption of inconsistent state regulation is justified when state regulation hinders the development of interstate facilities. *Id.* The Fourth Circuit did not indicate, however, whether 40 years of state depreciation methods had hindered the development of adequate and efficient interstate facilities. *See id.* If state depreciation methods provide adequate and efficient facilities and service, then the FCC acted beyond its scope of delegated authority in preempting such state depreciation methods. *See* Brief for Petitioner *VSCC* at 41, VSCC v. FCC, 737 F.2d 388 (4th Cir. 1984); *see also supra* note 100 (discussing FCC's goal of promoting efficiency as basis for preemption).

107. *See* 737 F.2d at 396. The Fourth Circuit in *VSCC* specifically stated that the existence of a physical impossibility of compliance with dual federal and state regulation is not the only basis for federal preemption of state regulation. *Id.* The Fourth Circuit held that frustration of

regulations may coexist.[108] In *VSCC*, the Fourth Circuit recognized the ability of carriers to comply with both interstate and intrastate regulations for accounting and depreciation.[109] The Fourth Circuit, nonetheless, upheld the federal preemption of state regulation even when regulation of intrastate service could be harmonized with differing federal regulation of interstate service.[110]

FCC jurisdiction over interstate service was effectively limited, however, by the decision of the United States District Court for the District of Columbia in *United States v. American Telephone & Telegraph Co. (AT&T)*.[111] In *AT&T*, the district court recognized the separability of local or intrastate telephone service from interstate service.[112] The *AT&T* court further recognized the authority of the states to regulate intrastate telephone service,[113]

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federal objectives also provides a valid basis for preemption. *Id.* For example, in *Hines v. Davidowitz*, the United States Supreme court allowed federal preemption of state law when state regulation obstructed the accomplishment and execution of purposes and objectives of Congress. 312 U.S. 52, 67 (1941); *cf.* Goldstein v. California, 412 U.S. 546 (1973). In contrast to the *Hines* decision, the United States Supreme Court in *Goldstein v. California* later upheld state law differing with federal law when differences in the law's objectives were reconcilable. 412 U.S. at 554-555. Similarly, the United States Court of Appeals for the Second Circuit in *New York Tel. Co. v. New York State Dep't of Labor* upheld state regulation of unemployment compensation for employees involved in a strike even though the state regulation conflicted with the broad federal policy of free collective bargaining under the National Labor Relations Act. *See* 566 F.2d 388, 395 (2d Cir. 1977), *aff'd* 440 U.S. 519 (1979). The Second Circuit stated that Congress had shown a willingness to tolerate such a conflict to give deference to state authority. *Id.* In *VSCC*, the Fourth Circuit acknowledged that conflicting state depreciation methods could coexist with FCC methods. 737 F.2d at 396. In creating the Communications Act, Congress indicated a willingness to protect and preserve state regulation over intrastate telephone service from FCC preemption. *See supra* note 71 (discussing the legislative history of the Communications Act).

108. 737 F.2d at 396.

109. *Id.*

110. *Id.* The Fourth Circuit in *VSCC* stated that a state law's frustration of federal objectives often provides a valid basis for federal preemption even if the carriers could comply with differing state and federal depreciation methods. *Id.* The Fourth Circuit did not explain why the federal objective of promoting efficiency should preempt intrastate depreciation methods set by state commissions. *See id.*; *see also supra* notes 105-06 (discussing Fourth Circuit's failure to show that state depreciation methods frustrate efficiency).

111. United States v. American Tel. & Tel. Co., 552 F. Supp. 131 (D.D.C. 1982), *aff'd*, 460 U.S. 1001 (1983). In *United States v. American Tel. & Tel. Co. (AT&T)*, the United States District Court for the District of Columbia entered an antitrust decree ordering the divestiture by AT&T of twenty-two local operating companies, or any companies that provided essentially intrastate service. *Id.* at 141.

112. 552 F. Supp. at 141. The *AT&T* court held that the Bell System could no longer supply local telephone service. *Id.* The *AT&T* court determined that local service would be supplied by independent operating companies that would serve a certain exchange area. *Id.* The exchange area would be limited to the territory of one state unless specifically approved by the court. *Id.* The district court further provided that the operating companies would provide local telephone service within the same exchange area and would provide access to calls from other exchange areas. *Id.* The *AT&T* court specifically prohibited the local operating companies from providing interexchange service, or service from one exchange area to another. *Id.* at 142.

113. *Id.* at 169. The *AT&T* court acknowledged the dual authority of state and federal

and acknowledged the division of state and federal authority between intrastate and interstate service.[114] The *AT&T* court required the American Telephone & Telegraph Company to sever relations with subsidiary telephone companies that supply local telephone service.[115] The *AT&T* court then directed the subsidiary companies to supply local telephone service within a given "exchange area," which usually constitutes a local or intrastate area.[116] The district court in *AT&T* determined that the interexchange[117] or interstate portion of calls would be carried by AT&T and other interstate carriers.[118] The FCC has ruled that local carriers engaged in interstate communication solely through physical connection with the facilities of an interstate carrier such as AT&T are exempt from FCC jurisdiction.[119] Inasmuch as the *AT&T* court had expressly forbidden local carriers that provided intrastate service from providing interstate service, the sole link between the local carriers regulated by state commissions and interstate carriers regulated by the FCC lies in a physical connection.[120] The *AT&T* court recognized that state

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regulatory agencies to set rates and tariffs. *Id.* For example, the *AT&T* court defined the division of state and federal regulatory control by requiring state regulators to set rates for intraexchange service, and requiring the FCC to set rates for interexchange or interstate service. *Id.* at 169 n.161.

114. *Id.* at 169. The *AT&T* court separated state and federal authority into two distinct categories by noting that state regulators set access charges for intrastate long distance service while the FCC sets access charges for interstate long distance service. *Id.* The *AT&T* court stated that local telephone companies possess a monopoly over local telephone service, and may not engage in providing long distance interstate service. *Id.* at 224. Consequently, the *AT&T* court acknowledged that state regulatory commissions have authority over local telephone companies, since such companies may not provide interstate service which is subject to FCC regulation. *See id.*

115. *Id.* at 141.

116. *Id.* The *AT&T* court defined an exchange area as a standard metropolitan area or the territory of one state. *Id.* The *AT&T* court further stated that before a state may regulate service in a territory extending beyond its boundaries, the state must obtain approval from the United States Department of Justice. *Id.* at 141 n.36.

117. *Id.* at 141 n.39. The *AT&T* court defined interexchange service as long distance service. *Id.*

118. *Id.* at 141.

119. *See* The Communications Act, 47 U.S.C. § 152(b)(2). Section 152(b)(2) states that the FCC shall not have jurisdiction over any intrastate carrier involved in interstate or foreign communication solely through physical connection with the facilities of another carrier. *Id.*, *see* Classification of Telephone Companies, 3 F.C.C. 37 (1935). In *Classification of Telephone Companies*, the FCC ruled that carriers engaged in interstate or foreign communication solely through physical connection with the facilities of another carrier are exempt from FCC jurisdiction, except under limited exceptions. *Id.*, 47 U.S.C. §§ 201-205. For example, § 201 of the Communications Act grants the FCC the authority to regulate telephone company charges for interstate service. 47 U.S.C. § 201. Section 202 allows the FCC to punish telephone companies for discriminatory practices. *Id.* § 202. Section 203 requires the filing of certain tariffs. *Id.* § 203. Section 204 provides for a hearing to evaluate proposed rate changes. *Id.* § 204. Section 205 grants the FCC authority to vary rates in accordance with § 201. *Id.* § 205. The FCC further stated that even FCC jurisdiction under §§ 201-205 of the Communications Act may be subject to valid state regulation. 3 F.C.C. 37 (1935).

120. *See* 552 F. Supp. at 169. The *AT&T* court noted that operating companies that are

commissions and not the FCC would regulate local carriers, even though local carriers are linked to the interstate telephone system.[121] Consequently, the *AT&T* court, by preventing local carriers from providing interstate service, effectively denied the FCC the authority to regulate local carriers because the Communications Act limits FCC jurisdiction to interstate matters.[122]

Consistent with the Fourth Circuit's *VSCC* decision upholding FCC preemption of depreciation and accounting methods,[123] decisions prior to *VSCC* usually enforced the FCC's 1983 depreciation order.[124] For example, six federal district courts had enjoined state regulatory commission from disobeying the FCC's 1983 order concerning depreciation methods.[125] In contrast, the United States District Court for the Eastern District of Arkansas

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restricted to providing local telephone service will have facilities to connect with other carriers providing interstate service. *Id.*

121. *See* 552 F. Supp. at 169, *see also supra* note 119 (discussing limits on FCC regulation of intrastate service).

122. *See* 552 F. Supp. at 141; *see also supra* notes 112 (defining the restricted service area of intrastate carriers) and 119 (discussing limits on FCC regulation of intrastate service).

123. *See infra* note 78 (discussing FCC preemption of state depreciation methods).

124. *See infra* note 125 (describing federal district court cases upholding FCC's 1983 preemption order).

125. *See* Mountain States Tel. & Tel. Co. v. Dep't of Public Serv. Regulation, 588 F. Supp. 5 (D. Mont. 1983). The district court in *Mountain States Tel. & Tel. Co. v. Dep't of Pub. Serv. Reg.* granted the Mountain States Company a preliminary injunction requiring the state public utilities commission to follow FCC depreciation methods. *Id.* at 9. The *Mountain States* court stated that it did not have jurisdiction to reverse an FCC order, and that public utilities commissions must follow the FCC's 1983 order until reversed by a federal court of appeals. *Id.* at 7; *see* Southwestern Bell Tel. Co. v. Arkansas Pub. Serv. Comm'n, 584 F. Supp. 1087 (D.E. Ark. 1984) (upholding FCC's 1983 depreciation order); *infra* note 128 and accompanying text (discussing district court's upholding of FCC preemption in Southwestern Bell Tel. Co. v. Arkansas Pub. Serv. Comm.), *see also* South Central Bell Tel. Co. v. Louisiana Pub. Serv. Comm., 570 F. Supp. 227 (M.D. La. 1983). The district court in *South Central Bell Tel. Co. v. Louisiana Pub. Serv. Comm.* granted South Central Bell a preliminary injunction preventing the public service commission from using depreciation methods other than those required by the FCC. *Id.* at 238. The *South Central* court stated that orders of administrative agencies carry the full force of federal law and possess the same preemptive effect. *Id.* at 232; *see* Chesapeake & Potomac Tel. Co. v. Pub. Serv. Comm'n, 560 F. Supp. 844 (D. Md. 1983). The district court in *Chesapeake & Potomac Tel. Co. v. Pub. Serv. Comm'n* ordered the public service commission to adhere to the FCC's 1983 preemption order. *Id.* at 849. The Chesapeake court also stipulated that the Chesapeake & Potomac Tel. Co. return any excess monies collected from consumers if the United States Court of Appeals for the Fourth Circuit reversed the validity of the FCC order in *VSCC v. FCC*. *Id.* at 849; *see* New England Tel. & Tel. Co. v. Pub. Util. Comm'n of Maine, 570 F. Supp. 1558 (D. Me. 1983). The district court in *New England Tel. & Tel. Co. v. Pub. Util. Comm. of Maine* stated that the Communications Act provides that the federal district court shall enforce duly made FCC orders. *Id.* at 1574; *see* 47 U.S.C. § 401(b). The *New England Tel.* court granted a preliminary injunction requiring that the public utilities commission obey the FCC's 1983 preemption order. 570 F. Supp. at 1582; *see* Pacific N.W. Bell Tel. Co. v. Washington Util. & Transp. Comm., 565 F. Supp. 17 (W.D. Wash. 1983). The district court in *Pacific N.W. Bell Tel. Co. v. Washington Util. & Transp. Comm'n* noted that it did not have jurisdiction over the question of whether the FCC had the

refused to enforce an FCC preemption order.[126] In *Southwestern Bell Telephone Company v. Arkansas Public Service Commission*,[127] the Arkansas district court determined that the preemption order sought by the FCC would require express congressional approval and characterized the FCC order as ultra vires, or beyond the scope of FCC authority.[128] The United States Court of Appeals for the Eighth Circuit, however, reversed the district court's decision.[129] The Eighth Circuit directed the district court to enjoin the Arkansas Commission from disobeying the FCC order because federal law grants federal courts of appeal exclusive jurisdiction to enjoin, set aside, or determine the validity of FCC orders.[130] Generally, federal district courts have upheld the FCC's 1983 order that mandated federal preemption of state regulations. Moreover, federal circuit courts of appeal also have upheld the 1983 FCC order and have reversed contrary district court decisions.[131]

The Fourth Circuit's decision in *VSCC* requiring state regulatory commissions to follow FCC prescribed depreciation methods will have a significant impact on the rate setting practices of state commission.[132] Depreciation

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statutory authority to preempt state depreciation charges. *Id.* at 21. However, the *Pacific N.W.* court granted Pacific N.W. Bell a preliminary injunction requiring the utility commission to obey the FCC's 1983 order preempting state depreciation methods. *Id.* at 21-22.

126. Southwestern Bell Tel. Co. v. Arkansas Pub. Serv. Comm'n, 584 F. Supp. 1087, 1092 (E.D. Ark.) *rev'd*, 738 F.2d 901 (8th Cir. 1984).

127. *Id.*

128. *Id.* at 1090. The district court in *Southwestern Bell Telephone Co. v. Arkansas Public Service Comm.* characterized the FCC's 1983 depreciation order as ultra vires because the FCC lacked the statutory power to preempt inconsistent state depreciation and accounting methods. *Id.* at 1089. The district court noted that if the FCC wanted the authority to preempt, the FCC should seek express Congressional approval. *Id.* at 1090.

129. Southwestern Bell Telephone Co. v. Arkansas Public Service Commission, 738 F.2d 901, 905 (8th Cir. 1984).

130. *Id.* The United States Court of Appeals for the Eighth Circuit in *Southwestern Bell Tel. Co. v. Arkansas Pub. Serv. Comm'n* noted that federal law grants federal courts of appeal exclusive jurisdiction to enjoin, set aside or determine the validity of FCC orders. *Id.*; *see* 28 U.S.C. § 2342(1) (1982). The Eighth Circuit held that the exclusive grant of jurisdiction to federal courts of appeal for review of FCC orders precludes district courts from exercising such authority. *Id.* at 906. The Eighth Circuit did not examine whether the FCC acted beyond its authority in preempting state depreciation methods, but rather held that district courts should enforce the FCC preemption order unless a federal court of appeals overrules the FCC's order. *Id.*

131. *See supra* notes 125 & 130 (discussing court rulings upholding the FCC's 1983 preemption order).

132. *See* 737 F.2d at 394; *see* A. KAHN, THE ECONOMICS OF REGULATION 32-35 (1970). The depreciation methods required by the FCC allow a carrier to increase depreciation expenses, and the increased depreciation expenses are included in a carrier's operating costs. *See id.* at 35. The cost of carrier service determines consumer rates. *See id.*; *see* C. PHILLIPS, JR., THE ECONOMICS OF REGULATION 194-206 (1969). Depreciation deductions reimburse carriers for the cost of an asset and for the capital required to make the original purchase, and carriers also may include such costs in the rates charged to consumers. *See id.* at 194-195; *see also* Lindheimer v. Illinois Bell Tel. Co., 292 U.S. 151, 167 (1934). The United States Supreme Court in *Lindheimer v. Illinois Bell Tel. Co.* stated that in determining consumer rates, carriers may

charges are included in carrier operating costs[133] and operating costs serve as a guide for setting consumer rates.[134] The method of determining the depreciable life[135] of an asset affects consumer rates because a shorter depreciation life allows a higher depreciation charge, which increases annual capital costs.[136] If a carrier incurs higher annual capital costs, the carrier will require a higher consumer rate increase to cover operating costs.[137]

Prior to the FCC's 1983 preemption order,[138] carriers could determine depreciation life through the vintage group and whole life methods of depreciation.[139] The vintage group method (VG) of determining depreciation calculates the average service life of a particular group of equipment to provide the basis for depreciation of a class or subclass of depreciable equipment.[140] The average life of all items in the group constitutes the depreciable life for the group even if the group contains equipment with

include in operating costs an allowance for consumption of capital. 292 U.S. at 167; *see American Telephone and Telegraph Company Divestiture Effects, September 25, 1984: Hearings Before the House Committee on Small Business*, 98th Cong., 2d Sess. (1984) (statement of Bruce Hagen, Vice Chairman of Committee on Communications, National Association of Railroad and Utility Commissioners). Hagen stated that the Fourth Circuit's *VSCC* decision will put pressure on local companies to raise telephone rates. *Id.* Hagen said that higher telephone rates for consumers will occur because of additional regulatory costs arising from the change in accounting methods and the implementation of accelerated depreciation. *Id.* at 9. *See also* infra note 183 (discussing rate increases for consumers due to implementation of FCC-prescribed depreciation method).

133. *See* J. SUELFLOW, PUBLIC UTILITY ACCOUNTING: THEORY AND APPLICATION 57-58 (1973). Operating expenses represent the carrier's cost of doing business including property acquisition, maintenance, wages, taxes, and depreciation. *Id.*

134. *See* PHILIPPS, *supra* note 132 at 129-130. Operating costs constitute the largest portion of a carrier's revenue requirement. *Id.* at 129. State commissions set rates to allow a carrier to cover operating costs, and to earn a reasonable rate of return on business property. *Id.* As a carrier's operating expense increases, the expected amount of consumer contribution or rates also increases. *Id.*

135. *See* W. BOLTER & D. IRWIN, DEPRECIATION REFORM, A CRUCIAL STEP IN TRANSFORMING TELECOMMUNICATIONS TO A FREE MARKET 13-17 (1980). The depreciable life of an asset corresponds to the period during which a carrier recovers the original value or cost of the asset. *Id.*

136. *See* E. BRIGHAM & J. PAPPAS, LIBERALIZED DEPRECIATION AND THE COST OF CAPITAL 30 (1970). The length of an asset's life determines the yearly amount of depreciation expense because the amount of depreciation is divided by the number of years of an asset's life. *Id.* A longer asset life results in a lower annual depreciation charge, whereas a shorter asset life requires a higher depreciation charge. *Id.* For example, a transformer costing $100 with a service life of 20 years results in a depreciation charge to consumers of $5 per year for 20 years. If the same transformer has an estimated service life of 5 years, the depreciation expense for consumers is $20 per year for 5 years.

137. *See supra* note 136 (describing the relationship between service life an depreciation expense).

138. Memorandum Opinion and Order, 92 F.C.C.2d 864 (1983).

139. *See* Memorandum Opinion and Order, 89 F.C.C.2d 1094, 1106-1107 (1982) (state regulatory commissions may employ accounting and depreciation rules of their own choosing).

140. *See* Memorandum Opinion and Order, 83 F.C.C.2d 267, 268 (1980). The FCC stated that the vintage group method of calculating depreciation is a form of straight line depreciation.

varying life expectancies.[141] VG depreciation is calculated on a straight line basis.[142] The FCC determined that VG does not match capital recovery with the rate of capital consumption when a carrier retires equipment before an age equal to the vintage group average.[143] The FCC decided, therefore, that state regulatory commissions should not use the VG method of calculating depreciation.[144]

Instead, the FCC now requires the use of the equal life group (ELG) depreciation method.[145] ELG actually breaks down a group of carrier assets under VG into smaller subgroups to allow greater accuracy in measuring depreciable life.[146] ELG is a form of accelerated deprecia-

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Id.; *see infra* note 142 (describing straight line depreciation). The vintage group method of depreciation categorizes all similar types of equipment purchased in a particular year into vintage groups. *See* Brief for Respondent FCC at 11, VSCC v. FCC, 737 F.2d 388 (4th Cir. 1984). Carriers depreciate all equipment in a vintage group according to the average useful life of the entire group of equipment, even though some items within the group have shorter or longer lives than the group average. *Id.* at 11-12.

141. *See supra* note 140 (describing vintage group depreciation method).

142. 83 F.C.C.2d at 275; 47 C.F.R. § 31-013(gg). The FCC defines straight line depreciation as when the value of an asset is charged to operating expenses and then credited to a depreciation reserve account through equal annual charges that correspond as closely as possible to the asset's service life. *Id.* For example, if a particular transformer costs $100 with an estimated useful life of 10 years, the straight line method of depreciation would allow the carrier to assign $10 per year as a depreciation expense. Carriers may recover depreciation expense annually through increases in telephone rates charged to the consumer.

143. 83 F.C.C.2d at 290. The FCC stated that the vintage group method does not allow for proper investment recovery in a competitive environment where estimated asset service lives may shorten dramatically due to obsolescence. *Id.*; *see* KAHN, *supra* note 132, at 146-148 (stating that traditional depreciation rates have been rendered obsolete by technological progress).

144. 83 F.C.C.2d at 293. In the 1980 depreciation order, the FCC did not forbid the use of the vintage group method, but recommended that the equal life group method replace the vintage group method whenever possible. *Id.*

145. *See* 92 F.C.C.2d 864 (1983). *See also* Brief of Intervenors Supporting Respondents at 10 n.1, 737 F.2d 388 (4th Cir. 1984). The brief of the intervening telephone companies supporting the FCC in the *VSCC* case provided the following comparison of the vintage year and equal life methods:

> For purposes of illustration, assume that a group of six telephone poles installed at the same time has an average estimated life of two years, yielding a depreciation rate of 50% a year under the vintage method. If the average actually comprises three subgroups of two poles each, estimated to last one, two and three years respectively, then a more accurate depreciation schedule would depreciate two poles at 100% for one year, two poles at 50% a year for two years, and two poles at 33 1/3% for three years; and this is what ELG does. In effect, ELG creates subgroups having estimated equal lives of useful service, and a more precise measure of depreciation in each year is produced.

Id.

146. *See* 83 F.C.C.2d at 279. In the 1980 depreciation order, the FCC did not specify how the accuracy of the ELG method would differ from the VG method, except that the ELG method would require more data in setting estimated asset service lives. *Id.* State regulatory commissions argued that the use of the ELG method of depreciation does not provide a more

tion[147] that allows carriers to charge higher depreciation expenses in the early years of an asset's depreciable life and lower expenses in later years.[148] Consequently, greater depreciation allowance in the early years of asset service results in lower federal income tax payments by the carriers.[149] The lower tax payments are offset by increased tax payments in later years as depreciation allowances are reduced.[150] The FCC stated that ELG provides a better match of capital consumption with capital recovery than the VG method of depreciation.[151] The FCC stated that ELG provides increased capital for carriers in the form of deferred tax payments, and depending on how carriers choose to use the increased capital, ELG may encourage modernization of the communications network and competition.[152] The FCC stated that since ELG increases a carrier's internally generated funds, carriers may use the funds for investment or modernization.[153] If carriers use such funds for modernization, ELG would not result in simply excess profit for carriers, but would facilitate technological evolution in the communications

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accurate matching of capital consumption with capital recovery. *Id.* Instead, the state commissions asserted that the adoption of ELG amounts simply to granting carriers a rate increase because of increased administrative costs. *Id.*

147. *See* PHILLIPS, *supra* note 132 at 201. Accelerated depreciation in calculating taxable income allows a carrier to charge higher depreciation charges in the early years of an asset's service life and lower depreciation charges in the waning years of asset service life. *Id.*; *see also* KAHN, *supra* note 132 at 32-33. In effect, accelerated depreciation provides a carrier with an interest-free loan during the initial period of tax deferral because a carrier receives higher rates and more revenue than necessary to cover operating costs. *Id.* The real rate of return on investment increases if a carrier keeps an increased percentage of profits for any period of time before having to pay taxes to the government. *Id.* Consequently, carriers earn a higher rate of return when allowed to retain an interest-free loan in the form of higher depreciation charges. *See id.*; *see also supra* note 132 (discussing relationship between depreciation charges and consumer rates).

148. *See supra* note 147 (describing tax deferral effect of accelerated depreciation).

149. *See* PHILLIPS, *supra* note 132 at 202; *see also* KAHN, *supra* note 132 at 33. As long as total carrier assets increase, taxes paid by carriers under accelerated depreciation will always be lower than under straight line depreciation. *See* KAHN, *supra* note 132 at 33. When a carrier continues to make investments, the tax savings on new investments often will exceed the amount of taxes due on prior investments. *Id.* Thus, accelerated depreciation can result in permanent tax deferral for carriers at consumer expense due to higher rates to support new investments. *See id.*

150. *See supra* note 147 (discussing timing of tax payments under accelerated depreciation).

151. 83 F.C.C.2d at 279. The FCC in its 1980 depreciation order did not explain how ELG provides a better match of capital consumption with capital recovery than VG, but stated that ELG would hinder the ability of carriers to provide efficient telephone service. *Id.* However, the FCC acknowledged that use of the ELG method would result in an increase in consumer rates. *Id.* The FCC also noted that the ELG method would result in an increased regulatory burden and require an increase in staff. *Id.* The FCC speculated that ELG would encourage modernization, but knew absolutely that ELG would increase rates and regulatory costs. *See id.* Consequently, the FCC placed a greater emphasis on promoting the speculative goal of modernization, and did not adequately consider the equally important goal of preserving reasonable rates. *See id.*; *see also infra* note 194 (discussing FCC goals of providing efficient service at reasonable cost).

153. *See* 83 F.C.C.2d at 279.

industry.[154] Technological evolution in turn may result in greater efficiency and in the utilization of equipment that increases productivity.[155] Therefore, an excess in revenue generated by ELG may encourage carriers to invest in new technology that promotes efficiency and productivity.[156]

While consumers may benefit from savings on interest because of carrier self-financing through ELG-generated funds, consumers also may pay higher rates than necessary because ELG provides a carrier with capital in excess of actual operating expenses.[157] An excess of carrier revenue occurs when a state regulatory commission includes as an operating expense higher federal income taxes than a carrier actually is paying.[158] State regulatory commissions consider federal taxes for a carrier as an operating expense, and calculate that expense as if the carrier paid the federal income tax on a straight line basis.[159] In reality, the carrier pays federal taxes according to an accelerated depreciation rate, and consequently receives inflated operating expense credit for paying more federal taxes than the carrier actually has paid.[160] Inflated operating expenses result in rate increases that provide carriers with more capital than necessary to meet actual operating expenses.[161] The excess capital

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154. *See* W. BOLTER & D. IRWIN, *supra* note 135 at 34. Depreciation reform such as use of accelerated depreciation methods allows carriers to utilize excess revenue for the purpose of new investment and modernization. *Id.* Modernization may enhance the competitive marketplace through the retirement of obsolete equipment and the employment of new, more efficient equipment. *Id.*

155. *See* W. BOLTER & D. IRWIN, *supra* note 135 at 34. New products and innovation often lower the cost of services by providing greater efficiency. *Id.* Depreciation rates can provide rewards and incentives to encourage carriers to invest in more productive technology. *Id.*

156. *Id.*; *see supra* note 154 (describing relationship between excess revenue, modernization, and efficiency).

157. *See* 83 F.C.C.2d at 284. The FCC recognized that the adoption of the ELG method would increase consumer rates and carrier cash flow over and above that needed under the vintage group method. *Id.*; *see supra* note 147 (describing relationship of ELG and increased carrier cash flow).

158. *See* KAHN, *supra* note 132 at 32-33. Tax deferral does not reduce the total amount of taxes paid, but defers the payment of taxes until a later time. *Id.* Tax deferral for a carrier allows the carrier to keep more profits during the deferral period and in effect acts as an interest-free loan. *Id.* at 33.

159. *See* PHILLIPS, *supra* note 132 at 201. When state commissions include as operating costs the higher income taxes carriers would pay under a straight line method, the carriers receive the equivalent of an interest-free loan in the form of the difference between taxes actually paid under accelerated depreciation, and taxes credited to operating expenses under the straight line method. *Id.* at 201-202.

160. *See supra* notes 147 & 153 (describing excess funds that accrue to carriers under accelerated depreciation).

161. *See* C. WILCOX, PUBLIC POLICIES TOWARD BUSINESS 560-562 (1960). Regulated companies do not necessarily gain an economic advantage by keeping operating expenses down. *Id.* at 560. Inflated expenses can lead to higher profits and thus may result in higher salaries and bonuses for carrier executives. *See id.* The consumer pays for inflated expenses through higher rates. *Id.*

generated by the difference between a carrier's federal tax payment calculated according to straight line depreciation for ratemaking purposes, and the actual tax payments calculated according to accelerated depreciation, accrues to a tax reserve account.[162] Carriers may use the capital accrued to a tax reserve account for payment of future taxes, investment, or other carrier expenses.[163] The tax reserve account increases as long as a carrier continues to invest in new equipment and tax deferrals for the new year exceed payments on previous tax deferrals.[164] Carriers also may use the tax reserve account as internally generated interest-free financing capital for further investment.[165] However, excess capital accrued to the tax reserve account often results from inflated operating expense estimations, and consequently requires that consumers pay higher rates than necessary to provide carriers with interest-free financing capital.[166]

State regulatory commissions unanimously opposed the adoption of the ELG method of depreciation.[167] The FCC acknowledged that the use of ELG would result in increased regulatory burden and consequently in the need for increased regulatory staff.[168] The FCC also acknowledged that the use of

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162. *See* J. SUELFLOW, *supra* note 133 at 105-106. The tax reserve account is not required in many states, but represents the accumulated depreciation earnings that a carrier may segregate for use in later tax payments or may reinvest in other utility property. *Id.* Some states require by statute that carriers maintain a separate depreciation account. *Id.* Carriers may use the accumulated funds for depreciation expenses and for investment in new extensions or additions to utility property. *Id.* at 106.

163. *See supra* note 162 (describing tax reserve account and its use).

164. *See supra* note 149 (discussing accelerated depreciation as resulting in permanent tax deferral).

165. *See supra* notes 147 and 159 (discussing investment capital generated by accelerated depreciation).

166. *See supra* note 147 (describing relationship between accelerated depreciation and higher consumer rates); *see also supra* note 159 (describing relationship between inflated operating expenses, and "interest-free financing" for carriers).

167. 83 F.C.C.2d at 278. Before making its 1983 depreciation ruling, the FCC received comments from seven state regulatory commissions regarding ELG (California Public Utilities Commission (PUC), Colorado PUC, Florida Public Service Commission (PSC), Kentucky PSC, Maryland PSC, New York PSC, and Wisconsin PSC) and comments from the National Association of Railroad and Utilities Commissioners (NARUC) subcommittee of staff experts on accounting, the Southeastern Association of Regulatory Utility Commissioners (SEARUC), and the Department of Defense. *Id.* All opposed the adoption of ELG. *Id.* The state commissions stated that ELG would increase operating expenses and rates for consumers. *Id.* The NARUC subcommittee stated that ELG, if adopted, should be mandatory only for large telephone companies and should be elective for all other carriers. *Id.* at 279. The state commissions, NARUC, SEARUC, and the Department of Defense also argued that the FCC had not demonstrated the carriers' need for increased cash flow that ELG would provide. *Id.*

168. 83 F.C.C.2d at 279. The FCC in its 1980 depreciation order cited a study by the accounting firm of Ernst & Ernst, Inc. *Id.* The FCC quoted the study as saying that the use of the ELG method of depreciation would result in rate increases for consumers, more work for regulators, and would require expansion of staff. *See id.*

ELG would require state regulatory commissions to pay greater attention to estimating an asset's depreciable life.[169] Consequently, the increased regulatory burden would result in hardship for smaller carriers because such carriers often lack the necessary means and data to implement the more detailed ELG method.[170]

The ELG method of depreciation sets accelerated depreciation schedules for assets according to specific groupings of assets at the beginning of an asset's life.[171] The FCC noted that a problem results when the estimation of asset life exceeds actual service life.[172] The FCC has stated that the primary goal of the depreciation process is to distribute the entire cost of an asset in a reasonable manner over an asset's service life.[173] The FCC previously used the whole life method[174] as a final step in depreciation calculation to try to avoid inaccurate estimations of depreciable life.[175] Inaccurate estimations of depreciable life often result in equipment retirement before carriers receive full depreciation recovery of the original capital investment.[176] The FCC

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169. 83 F.C.C.2d at 284. Although the FCC admitted that the adoption of the ELG method of depreciation would impose a greater burden on regulatory commissions and agencies, the FCC noted that a greater precision in depreciation life estimation would result. *Id.*

170. *Id.* at 284-285. In evaluating the effect of the ELG method of depreciation on smaller carriers, the FCC acknowledged that smaller carriers may lack the resources necessary to comply with the implementation of the ELG method. *Id.* Thus, in 1982 the FCC stated that not all carriers would be required by the FCC to follow the ELG method. *Id.* In 1983, however, the FCC reversed this position and required all carriers to use either the ELG or remaining life methods of depreciation. 92 F.C.C.2d 864 (1983).

171. *See supra* text accompanying notes 145-156 (discussing ELG method of depreciation).

172. *See* 83 F.C.C.2d at 288. In its 1980 order, the FCC described the problem created when the estimation of asset life exceeds actual service life as a capital recovery problem for carriers. *Id.* The FCC stated that when obsolescence shortens the life of an asset, a carrier fails to recover the full capital investment in the asset. *Id.* The FCC concluded that less than full capital recovery could stifle innovation and modernization because carriers would have less available capital to invest. *See id.*

173. *Id.* at 294.

174. *Id.* at 289.

175. *Id.* at 288-89. In its 1980 depreciation order, the FCC noted that the whole life method of depreciation charges consumers according to the pro rata share of the diminished value of an asset. *Id.* at 289. The pro rata share is a straight line calculation and constitutes a depreciation charge based upon actual service and not on a preference for full capital recovery. *See id.* Under the whole life method of depreciation, consumers pay the portion of asset depreciation expense that corresponds to the yearly loss of asset value as originally estimated. *See id.* Consequently, consumers do not pay costs incurred by carriers in the past to make up for carrier miscalculation of service lives, nor are consumers charged for projected future costs through higher than necessary depreciation charges. *See id.* Therefore, under the whole life method of depreciation consumers pay depreciation rates that reflect the present cost of service. *See id.*

176. *See infra* note 177 (discussing less than full recovery of capital due to inaccurate service life estimation).

determined that the whole life method lacked the flexibility to adjust to changing asset lives that might result from the introduction of new technology.[177] To counter the problem of less than full capital recovery through the whole life method, the FCC proposed the use of the "remaining life" method.[178]

When the depreciable life of an asset is shortened because of obsolesence or other factors, the remaining life method allows a company to recover the full amount of undepreciated investment during the remaining useful life of an asset.[179] In essence, the remaining life method allows carriers to recover the entire amount of depreciation value of an asset over a shorter period of time than originally estimated.[180] Shortening the time frame for recovery of

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177. 83 F.C.C.2d at 289-90. In a 1980 depreciation order, the FCC stated that the whole life method of depreciation did not allow for full investment recovery because technological developments of the 1970s shortened the estimated depreciable lives of newly obsolete assets. *Id.* Because of asset obsolescence the FCC determined that the whole life method of depreciation could result in underrecovery by carriers in their original asset investments. *Id.* For example, a telephone pole installed in 1970 might have an estimated life of 20 years, depreciating at 5% per year. In 1975, after one-fourth of the estimated life for the asset had elapsed, the new revised total life estimate for the telephone pole might be 10 years. Under the whole life method, the new depreciation rate would be set according to the new life estimate of 10 years, depreciating at 10% per year, and applied for the last five years. When the telephone pole is retired at the end of 1979, the depreciation recovery falls short of the cost of the asset. The total depreciation at retirement equals 75% of the original cost, representing a 5% per year depreciation charge from 1970 through 1974, and a 10% per year depreciation charge form 1975 through 1979. While carriers would receive less than full capital recovery under the whole life method of depreciation, depreciation charges would remain constant and would not increase rates. *See id.*; *see also infra* note 180 (discussing whether carrier or consumer should bear risk of failing to properly set depreciable life estimates).

178. 83 F.C.C.2d at 288-289; *see infra* note 179 (describing differences between remaining life and whole life methods of depreciation).

179. 83 F.C.C.2d at 289. In describing the differences between the whole life and remaining life depreciation rate calculations, the FCC in a 1980 depreciation order stated that the whole life method attempts to set an annual charge that corresponds to the yearly diminishing of asset value based on the carrier's original prediction of the asset's whole service life. *Id.* In contrast, the remaining life method distributes asset cost over the current prediction of future asset life, not the original whole service life estimate. *Id.* For example, a telephone pole installed in 1970 has an estimated life of 20 years, depreciating at five percent per year. In 1975, after one-fourth of the estimated telephone pole life had elapsed, the new revised total life estimate changes from 20 to 10 years. Under the remaining life method, a carrier increases the annual depreciation charges of 5% per year to a depreciation charge of 15% per year form 1975 through 1979 in order to recoup the remaining 75% of the original carrier investment. *Cf. supra* note 183 (explaining whole life depreciation method).

180. *See* 83 F.C.C.2d at 289. The FCC in its 1980 order stated that the remaining life method of depreciation would allow carriers to accelerate capital recovery and consequently increase depreciation charges in order to achieve full capital recovery. *Id.* Thus, if a carrier shortened an asset's estimated service life, depreciation charges for the remaining years of the asset's new estimated life would increase by whatever percentage necessary to provide the carrier with full recovery of original capital investment. *See id.* The FCC anticipated sharp rate increases resulting from the remaining life method because the FCC required that carriers monitor the difference in rate increases under the remaining life method compared to the whole

depreciation results in higher depreciation charges, which increase operating expenses and consequently increase consumer rates.[181] Thus, the remaining life method results in full capital recovery for carriers, and increased rates for consumers.[182]

The FCC has stated that application of the remaining life method of depreciation may result in sharp increases in revenue requirements and consumer rates.[183] Operating expenses and rates increase because the use of the remaining life method results in higher depreciation charges in the waning years of an asset's life when the estimated service life of the asset has been shortened by a carrier.[184] The increase in revenue requirements and rates results when carriers at their discretion shorten the depreciable life of an asset and add increased depreciation charges to the revenue requirement to recover the full capital investment within a shorter period of time.[185] In addition, the remaining life method may result in higher costs for future customers because depreciation charges may increase dramatically when the estimated life of an asset is shortened.[186] The increase in depreciation charges

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life method. *Id.* at 290. The FCC stated that carriers should advise the FCC when an increase in annual charges to the consumer of 115% or more result from the use of the remaining life method, as compared to the whole life method. *Id.* Thus, the FCC conceded that application of the remaining life method could result in sharp increases in consumer rates. *See id.*

181. *See supra* note 180 (discussing relationship between higher rates and remaining life depreciation method).

182. *See supra* note 179 (describing how remaining life method of depreciation results in full capital recovery); *see also supra* note 180 (discussing relationship between higher rates and remaining life depreciation method).

183. 83 F.C.C.2d at 290 (1980); *see supra* note 180 (discussing relationship between higher rates and remaining life depreciation method). The VSCC agreed, and estimated that as of January 1, 1983, annual depreciation expenses charged to Chesapeake & Potomac Telephone company of Virginia customers under the remaining life method of depreciation would amount to $110.73, compared to $87.90 under the whole life depreciation method. *See* Letter form William Irby, Manager for Engineering, Depreciation and Network Planning for the Virginia State Corporation Commission, Communications Division, to Donald E. Williams, Jr. (September 27, 1984) (discussing cost estimates for implementing remaining life method of depreciation) (on file at *Washingtion and Lee Law Review*). The VSCC also estimated that for the same period, annual depreciation expenses charged to customers of Continental Telephone Company under remaining life would amount to $125.01, compared to $84.41 under the whole life method. *Id.*

184. 83 F.C.C.2d at 290; *see supra* note 180 (discussing relationship between higher rates and remaining life depreciation method).

185. *See supra* note 179 (describing how remaining life method results in full capital recovery for carriers); *see also supra* note 180 (discussing relationship between higher rates and remaining life method).

186. *See* Fox, *The Remaining Life Depreciation Concept: A Regulator's View*, 102 Pub. Util. Fort. 19 (July 6, 1978). The remaining life method allows for substantial increases in depreciation charges in order to compensate for shortened depreciable service lives. *Id.* at 20. The increased depreciation charge reflects an expense that should have been distributed by carriers in prior billing periods. *Id.* Consequently, future customers will bear the expense of a carrier's failure to adequately estimate the service life of an asset. *Id.* At least one commentator has stated that the risk of a depreciation recovery shortfall should fall on the carriers and

increases operating expenses, which results in increased consumer rates.[187] The burden of paying for such depreciation expense then falls on customers who pay a larger depreciation expense than previous customers for the same asset.[188]

The FCC-prescribed methods of depreciation, ELG and remaining life, are binding upon state regulatory commissions in the Fourth Circuit as a result of the *VSCC* decision.[189] In *VSCC*, the Fourth Circuit sought to promote a uniform system of depreciation that would provide efficient telephone service.[190] In examining ELG and the remaining life methods of depreciation, the Fourth Circuit failed to note the drawbacks of the two methods.[191] While the newly prescribed depreciation methods do not assure greater efficiency, both the VSCC and the FCC acknowledge that higher rates for the consumer will result.[192] In considering the *VSCC v. FCC* case, the Fourth Circuit weighed policy considerations such as FCC promotion of an efficient, competitive communications system,[193] but the court failed to weigh the impact of the new depreciation methods on the important policy consideration of maintaining reasonable consumer rates.[194]

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shareholders, rather than on consumers. *Id.* at 21. Consumers do not devise service life estimates, and therefore should not have to bear the burden of inaccurate estimates. *Id.* Conversely, other commentators have stated that because the allowable rate of return for public utilities is regulated and typically kept low for the benefit of consumers, consumers should share in the risk of diminished capital recovery through depreciation if depreciation recovery shortfall occurs. *See* KAHN, *supra* note 132 at 120.

187. *See supra* note 132 (describing relationship between depreciation, operating expenses, and higher rates for consumers); *see also supra* note 134 (describing impact of higher operating costs on increase in consumer rates).

188. *See supra* note 186 (discussing effect of remaining life method on future consumers).

189. *See* 737 F.2d 388 (4th Cir. 1984) (requiring state commissions to follow FCC prescribed depreciation methods); *see also supra* note 123 (discussing authority of federal courts of appeal to determine validity of FCC orders).

190. *See* 737 F.2d at 390.

191. *Id.* at 392; *see* Fox, *The Depreciation Scapegoat: A Regulator's View*, 108 PUB. UTIL. FORT. 48-49 (July 16, 1981). In evaluating the remaining life method of depreciation, one commentator has stated that depreciable life estimates may suffer from speculation and bias. *Id.* at 49. The same commentator noted that the ELG and remaining life methods of depreciation may encourage carriers to make unwise or unnecessary investments in new equipment that may harm cost effective management of telephone service. *Id.*

192. *See* 737 F.2d at 394 (4th Cir. 1984) (noting that VSCC regarded FCC preemption action as resulting in rate hike); *see also* 83 F.C.C.2d at 290 (FCC acknowledged new depreciation methods would result in consumer rate hikes).

193. 737 F.2d at 394. The Fourth Circuit in *VSCC* stated that the FCC had a reasonable basis for deciding to preempt state depreciation methods in order to promote the goals of efficiency and competition through faster capital recovery. *Id.* Providing carriers with faster capital recovery would encourage innovation through investment in new equipment, according to the FCC. *Id.*

194. *See id.* at 392. The Fourth Circuit in *VSCC* quoted the Communications Act as providing for the FCC the overriding goal of promoting a rapid, efficient communications service. *Id.*; *see also* 47 U.S.C. § 151 (outlining general FCC policy goals). In its discussion in

In failing to examine adequately the effect of FCC preemption of state accounting and depreciation methods on the authority of state regulatory commissions and consumer rates, the Fourth Circuit's *VSCC* decision conflicts with the statutory language of the Communications Act of 1934[195] and with the legislative history of the Act.[196] The *VSCC* decision encourages but does not guarantee plant modernization.[197] In contrast, the Fourth Circuit's decision ensures an increase in consumer rates.[198] The *VSCC* decision results in the denial of state regulatory commissions' authority over accounting and depreciation methods,[199] deprives state commissions of ratemaking authority,[200] and effectively reaches a result contrary to the intent of Congress.

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VSCC, the Fourth Circuit failed to note that the same provision in the Communications Act also states that the FCC should provide a communications system with adequate facilities at reasonable charges. *See* 737 F.2d at 392; *see also* 47 U.S.C. § 151. Unlike the speculative nature of the Fourth Circuit's assertion that state depreciation methods may inhibit innovation, both parties agreed in *VSCC v. FCC* that consumer rates will increase because of the implementation of FCC-prescribed depreciation methods. *See* 737 F.2d at 394. The FCC admits that its depreciation methods may result in sharp increases in rates for consumers. *See* 83 F.C.C.2d at 290. The Fourth Circuit, however, failed to consider the effect of FCC depreciation methods on consumer rates and consequently ignored an overriding FCC policy concern that supports the continued regulation of depreciation methods by state commissions. *See id.* at 290.

195. *See supra* notes 3 and 119 (discussing statutory provisions in Communications Act that support state regulation of depreciation methods).

196. *See supra* note 71 (discussing legislative history of Communications Act that support state regulation of depreciation methods).

197. *See* WILCOX, *supra* note 161 at 560-561. When managers of regulated companies have excess capital, as would usually result under FCC depreciation methods, investment in new and more efficient equipment or increases in salaries for carrier employees could result. *See id. See also* Petition for Rehearing by Petitioners VSCC at 9, VSCC v. FCC, 737 F.2d 388 (4th Cir. 1984). Carriers with additional capital provided by the FCC's depreciation methods could use the money for lobbying or for increased dividends to shareholders, which would not further the FCC's goals of promoting efficiency or competition. *See id.*

198. *See* 737 F.2d at 394 (discussing FCC depreciation methods and VSCC opposition because of resulting rate hikes); *see also* 83 F.C.C.2d at 290 (FCC acknowledged new depreciation methods would result in rate hikes); *see also supra* note 132 (describing relationship between depreciation methods and higher rates for consumers).

199. *See* 737 F.2d at 392.

200. *See id.* at 399 (Widener, J., dissenting); *see also supra* note 132 (describing relationship between depreciation methods and higher rates for consumers).