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978-1-107-40255-3 - Regulatory Bargaining and Public Law

Jim Rossi

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Regulatory Bargaining and Public Law

In *Regulatory Bargaining and Public Law*, Professor Rossi explores the implications of a bargaining perspective for institutional governance and public law in deregulated industries such as electric power and telecommunications. Leading media accounts blame deregulated markets for failures in competitive restructuring policies. However, the author argues that governmental institutions, often influenced by private stakeholders, share blame for the defects in deregulated markets. The first part of the book explores the minimal role that judicial intervention played for much of the twentieth century in public utility industries and how deregulation presents new opportunities and challenges for public law. The second part of the book explores the role of public law in a deregulatory environment, focusing on the positive and negative incentives it creates for the behavior of private stakeholders and public institutions in a bargaining-focused political process. *Regulatory Bargaining and Public Law* presents a unified set of default rules to guide courts in the United States and elsewhere as they address the complex issues that will come before them in a deregulatory environment.

Jim Rossi is the Harry M. Walborsky Professor and Associate Dean for Research at Florida State University College of Law. He holds an LL.M. from Yale Law School, a J.D. from the University of Iowa College of Law, and a B.A. in economics from Arizona State University. He has served as a faculty member at the University of North Carolina School of Law, and he has been a visiting faculty member at the University of Texas Law School. A scholar in the fields of administrative and regulatory law, Professor Rossi's publications have appeared in *Virginia Law Review*, *Michigan Law Review*, *Duke Law Journal*, *Texas Law Review*, *Northwestern University Law Review*, *Vanderbilt Law Review*, and *Energy Law Journal*, among many other journals. He is co-author of the leading textbook on energy law, *Energy, Economics, and the Environment* (2000).

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[More information](#)

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Frontmatter

[More information](#)

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Frontmatter

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Contents

<i>Preface</i>	<i>page vii</i>
<i>Acknowledgments</i>	<i>xi</i>
1. The Scope of Regulatory Bargaining	1
PART I: EXTENDING INCOMPLETE BARGAINS FROM THE ECONOMICS OF THE FIRM TO PUBLIC GOVERNANCE	
2. Regulatory Bargaining and the Stability of Natural Monopoly Regulation	31
3. The Incompleteness of Regulatory Law: Moving Beyond the “Small World” of Natural Monopoly Regulation	51
4. Refin(anc)ing Retail Service Obligations for the Competitive Environment	71
PART II: INCOMPLETE REGULATORY BARGAINS, INSTITUTIONS, AND THE ROLE OF JUDICIAL REVIEW IN DEREGULATED INDUSTRIES	
5. Deregulatory Takings and Regulatory Bargaining	95
6. Incomplete Regulatory Tariffs and Judicial Enforcement	129
7. Bargaining in Decentralized Lawmaking	172
8. Overcoming Federal–State Bargaining Failures	206

Cambridge University Press
978-1-107-40255-3 - Regulatory Bargaining and Public Law
Jim Rossi
Frontmatter
[More information](#)

vi	<i>Contents</i>	
9.	Conclusion: Incomplete Regulatory Bargaining and the Lessons for Judicial Review	233
	<i>References</i>	241
	<i>Index of Primary Legal Authorities</i>	257
	<i>Subject Index</i>	263

Cambridge University Press

978-1-107-40255-3 - Regulatory Bargaining and Public Law

Jim Rossi

Frontmatter

[More information](#)

Preface

Theories of economic regulation modulate between optimism – associated with those who view regulators as benignly pursuing the public interest or other civic-minded goals – and pessimism – most commonly associated with the public choice school, which sees regulators as captured by the powerful private firms they are charged to regulate. These accounts of regulation focus mainly on regulation’s substance, rather than the process by which it is enacted and its ability to promote stability in government policy for the operation of markets and the decisions of investors. Yet, whatever account is best in the abstract, regulatory law has failed utterly to examine the evolution of regulation and how it interacts with changes in technology, economic conditions, and political preferences. Examining regulation and regulatory law through the lens of bargaining sheds light on the institutional role courts can play, particularly given the new issues that arise in deregulated, or competitively restructured, markets.

Under the regime of natural monopoly regulation, predominant in the twentieth century, public and private interests converged in ways that were often (to the extent the public interest account of regulation is correct), but certainly not always (as public choice reminds us), welfare enhancing. Natural monopoly regulation, which represents a contract of sorts, was plagued with its own problems; however, it provided a relatively stable legal system for more than 50 years. The stability of cost-of-service rate making largely limited renegotiation to the firm-specific rate-making process, working to minimize the incentives for regulated firms to attempt to influence government *ex ante* (i.e., prior to the formulation of a public decision) outside the regulatory agency. Against this backdrop, traditional doctrines of regulatory law purported to protect investors and consumers. In fact, for most of the twentieth century, courts played a modest role in regulated industries. Courts engaged in judicial review

of regulatory agency decisions, but by and large agency decisions were not upset by the judiciary, which routinely deferred to the expertise and political accountability of regulators. Regulators were largely seen as facilitating a convergence between private and public interests, particularly where they regulated only a handful of firms on an ongoing basis.

Deregulation has many benefits. It is often touted for its propensity to allow private and public interests to converge through price mechanisms. At the same time, many criticize deregulation for falling short of this goal. In an electric power market with price competition, for instance, firms may face strong pressures to abandon their traditional service obligations in favor of higher-paying (and hence, more profitable) customers, leading to a divergence between public and private interests in market decisions.

Less examined is how deregulation may present new tensions between public and private interests in the regulatory process and for public law. With deregulation, the firm-specific rate hearing is no longer the norm for the adoption and implementation of deregulatory policies, inviting a much less focused and less predictable type of private influence on the regulatory process. As regulators look to alternative mechanisms for the implementation of deregulatory policies, such as general legislation, rulemaking, and standard tariffs, government potentially shares some blame with private firms for any welfare-reducing divergence between private interests and the public interest. Just as the traditional regulatory process may have responded disproportionately to the strongest interest groups, the process by which deregulatory policies are formulated and implemented may invite policy makers to respond disproportionately to new interest groups, possibly leading to the enactment of economic policies that thwart, rather than enhance, the overall welfare effects of competition. For instance, given the dual-jurisdictional system for regulating electric power in the United States, firms have strategic ways to escape the jurisdiction of state or federal regulators, taking advantage of gaps or jurisdictional overlaps in regulatory enforcement. In contrast, cost-of-service regulation provided ways of coordinating these gaps between regulatory authorities and evaluated firm-specific conduct more carefully – backing this up with enforcement in the setting of the firm's rates – thus minimizing (but certainly not eliminating) the divergence between private and public interests.

In expanding the range and degree of potential divergence between public and private interests, deregulation challenges policy makers and courts to reevaluate many of the traditional public law doctrines that frame the process for defining and implementing the rules in competitive

Cambridge University Press

978-1-107-40255-3 - Regulatory Bargaining and Public Law

Jim Rossi

Frontmatter

[More information](#)*Preface*

ix

markets. This book sets out to advance this project. In contrast to the predominant accounts of public choice theory and public-interested regulation, the book draws on government relations bargaining as a mechanism for assessing regulatory law. Contract-based approaches to regulation analogize to a legalistic (judicially enforced) contract, drawing primarily on judicial authority to compensate or deter renegotiation by a regulatory agency. In contrast, this book embraces a broader understanding of the regulatory contract as a starting point for its method. Drawing on the literature from the law and economics of corporate governance and contracts, an “incomplete contracts” approach is presented in the institutional setting of economic regulation. This approach isolates incentives and welfare states associated with contract renegotiation. In contrast to legalistic contracts, which emphasize judicial enforcement of contracts, the government relations bargaining approach highlights the insurance implications of regulation and its renegotiation. This approach is supplemented with a comparative institutional analysis, which evaluates the institutional setting for governance of deregulated markets; it does not limit its analysis to the decisions of a single regulator but pays attention to alternative institutions, including courts, the legislature, and state versus federal regulation.

Using a case study of electric power deregulation to draw general lessons, the framework is applied to traditional doctrines of regulatory law, including customer service obligations, the takings clause as a constraint on regulators, the filed tariff doctrine as a mechanism for limiting ex post judicial enforcement, the dormant commerce clause and state action immunity from antitrust enforcement, and regulatory federalism. By isolating ex ante and ex post incentives and stressing the institutional context for renegotiation, the framework reveals weaknesses these traditional doctrines of regulatory law present in a deregulatory era and suggests ways courts might correct for them.

The title of the book – *Regulatory Bargaining and Public Law* – might seem oxymoronic. A bargaining approach implies that government regulation will be replaced with market-based ordering, especially as industries are deregulated, leaving public law irrelevant to the bargaining process. As is well known, though, deregulation is an extreme and somewhat idealized concept. In this sense, “deregulation” is a term that can be criticized on the same grounds as other commonly referenced media terms, such as “serious comic,” or loaded political terms, such as “peace-keeping force.” Yet, there is a point to simultaneously invoking bargaining in a deregulatory environment and regulatory concepts and theories. As even

Cambridge University Press

978-1-107-40255-3 - Regulatory Bargaining and Public Law

Jim Rossi

Frontmatter

[More information](#)

the most extreme market proponents are aware, deregulated markets rely heavily on regulation for implementation and oversight, especially where network facilities, such as electric power transmission lines, provide the primary means for market access for suppliers and customers. Further, as the book argues, regulatory bargaining entails much more than the negotiation of firm-specific regulation. Contractual relations abound in public law even where private firms are not an immediate party to anything approaching a legal contract. The government relations bargaining approach includes within its scope these relations, as well as more traditional regulatory contracts between the firm and the state. Public law retains relevance in framing these bargaining relations, even when markets are deregulated. Its role in this environment is the primary topic of inquiry within this book.

Cambridge University Press

978-1-107-40255-3 - Regulatory Bargaining and Public Law

Jim Rossi

Frontmatter

[More information](#)

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As a young energy attorney in Washington, D.C., in the early 1990s, I was fortunate to work with a number of lawyers who understood

Cambridge University Press

978-1-107-40255-3 - Regulatory Bargaining and Public Law

Jim Rossi

Frontmatter

[More information](#)

the significance of the changes facing public utility industries. Earle O'Donnell and Robert O'Neil deserve particular mention for educating me about energy issues, as well as the practice of regulatory law. I may have gone into academia thinking I would escape the highly specialized world of energy law, but that was impossible. For the past decade, the American Bar Association Section on Administrative Law and Regulatory Practice has served as my main professional bridge to regulatory law practice and governmental agencies. Although my involvement with the Section has focused primarily on administrative law issues, many individuals from the Section have given me advice about this project, and my scholarship more generally.

I would not have been able to complete this book without the institutional support of Florida State University College of Law. Dean Don Weidner has always provided generous support for faculty research, even against precarious and declining state-based support for it. The institutional environment within the law school at Florida State University has also been more nurturing and supportive than any young scholar could expect. My on-site colleagues have tested my analysis, making the concepts, applications, and writing in the manuscript better over many discussions. My students patiently endured some discussion of the ideas in this book. Greg Goelzhauser provided diligent and thorough research assistance as I was preparing chapters.

To all of these people, thank you.

My inquiry into bargaining and regulation began with a series of law review essays and articles on public utility law and deregulation. Chapter 4 draws from an article on the duty to serve originally published in *Vanderbilt Law Review* in 1998.¹ Chapter 5 takes seed from a book review published in *Texas Law Review* in 1998.² It also draws from an article on deregulatory takings published in *Virginia Law Review* in 2000 (co-authored with Susan Rose-Ackerman),³ which was invited by the World Bank for a 1999 conference on infrastructure and investment in Rome, Italy. Chapter 6 owes much of its analysis to an article on the filed tariff doctrine published in *Vanderbilt Law Review* in 2003.⁴ Portions of this

¹ Jim Rossi, *The Common Law "Duty to Serve" and Protection of Consumers in an Age of Competitive Retail Public Utility Restructuring*, 51 *VANDERBILT LAW REVIEW* 1233 (1998).

² Jim Rossi, *The Irony of Deregulatory Takings*, 77 *TEXAS LAW REVIEW* 297 (1998).

³ Susan Rose-Ackerman & Jim Rossi, *Disentangling Deregulatory Takings*, 86 *VIRGINIA LAW REVIEW* 1435 (2000).

⁴ Jim Rossi, *Lowering the Filed Tariff Shield: Judicial Enforcement for a Deregulatory Era*, 56 *VANDERBILT LAW REVIEW* 1591 (2003).

Cambridge University Press

978-1-107-40255-3 - Regulatory Bargaining and Public Law

Jim Rossi

Frontmatter

[More information](#)*Acknowledgments*

xiii

article were submitted as expert testimony on behalf of California public power interests in the PG&E bankruptcy, but this article was prepared in advance of my involvement in those proceedings. The framework idea and California example in Chapter 1 were laid out in a book review published in *Michigan Law Review* in 2002, and this review also inspired me to address the issues raised in Chapter 7 (although I also reject some of my earlier analysis in Chapter 8).⁵ I am grateful to these journals for allowing me to test drive the ideas I more fully elaborate on in this book. Although these chapters draw on some of my earlier works and extend them in new directions, particularly within a bargaining framework, much of the chapters – as well as the rest of the book – consist of entirely new material.

Tallahassee, Florida (December 2004)

⁵ Jim Rossi, *The Electric Power Deregulation Fiasco: Looking to Regulatory Federalism to Promote a Balance Between Markets and the Provision of Public Goods*, 100 MICHIGAN LAW REVIEW 1768 (2002).

Cambridge University Press

978-1-107-40255-3 - Regulatory Bargaining and Public Law

Jim Rossi

Frontmatter

[More information](#)
