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Moving Public Law Out of the Deference Trap in Regulated Industries

Jim Rossi

MOVING PUBLIC LAW OUT OF THE DEFERENCE TRAP IN REGULATED INDUSTRIES

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This Article argues that public law has fallen into what I call a "deference trap" in addressing conflicts in deregulated industries, such as telecommunications and electric power. The deference trap describes a judicial reluctance to intervene in disputes involving political institutions, such as regulatory agencies and state governments. By reassessing the deference trap across the legal doctrines that are affecting emerging telecommunications and electric power markets, public law can deliver much more for deregulated markets. The deference trap imposes a particular cost as markets are deregulated, one that may not have been present during previous regulatory eras in which public and private interests in regulatory bargaining were more likely to converge. In expanding the range and degree of potential divergence between public and private interests, deregulation challenges policymakers and courts to reevaluate many of the traditional public law doctrines that frame the process for defining and implementing the rules in competitive markets. This Article sets out to advance this project in the context of three vignettes. In so doing, I draw on a bargaining account of regulation, supplemented with a comparative institutional analysis. The approach 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 (and often competing) institutions, including courts, Congress and state legislatures, and state and federal regulators.

Part II illustrates that public law has fallen into a deference trap in the context of the filed tariff doctrine and suggests that, by focusing on bargaining conditions in tariffing, courts could minimize strategic forum shopping in regulatory enforcement.

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Part III warns against public law falling into a deference trap in the context of judicial review of state regulation under the dormant commerce clause and state action immunity to antitrust enforcement and suggests that courts correct for this by taking into account private firm incentives in the state lawmaking process. Part IV suggests that federal preemption, as currently construed, also invites a deference trap which can create regulatory commons problems and recommends that courts reformulate preemption principles to realign the incentive to facilitate regulatory coordination between the federal government and states. By isolating ex ante and ex post incentives and stressing the institutional context for institutional bargaining in the regulatory process, together these examples reveal weaknesses in traditional doctrines of regulatory law in deregulated markets and suggest ways courts might correct for them.

I. INTRODUCTION

Theories of economic regulation modulate between optimism—associated with those who view regulators as benignly pursuing the public interest or other civic-minded goals[1]—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.[2] These accounts of regulation focus mainly on regulation's substance rather than on 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.[3] Such a focus will have important implications for how we understand the role of courts, and especially public law, in deregulated industries.[4]

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1. *See* Steven P. Croley, *Public Interested Regulation*, 28 FLA. ST. U. L. REV. 7 (2000); Mark Seidenfeld, *A Civic Republican Justification for the Bureaucratic State*, 105 HARV. L. REV. 1511 (1992).

2. For a summary of public choice perspectives on public law, see DANIEL A. FARBER & PHILIP P. FRICKEY, LAW AND PUBLIC CHOICE: A CRITICAL INTRODUCTION (1991); JERRY L. MASHAW, GREED, CHAOS & GOVERNANCE: USING PUBLIC CHOICE TO IMPROVE PUBLIC LAW (1997).

3. George L. Priest, *The Origins of Utility Regulation and the "Theories of Regulation" Debate*, 36 J.L. & ECON. 289 (1993).

4. Joseph D. Kearney & Thomas W. Merrill, *The Great Transformation of*

Placing focus on "deregulatory takings" (constitutional and breach of contract challenges to deregulation policies), as many did in the 1990s, appropriately centers on the bargaining aspects of the regulatory process.[5] However, advocates of deregulatory takings envision courts as enforcers of rights and contractual bargains. This account of the judicial role has many critics,[6] but the strongest argument against deregulatory takings is that it envisions activist judicial review of the interactions between government and firms.[7] If courts are to award compensation for deregulatory policies, their primary role is to search for and sustain preexisting bargains between firms and the government—a role that does not fit with the longstanding tradition of judicial deference to regulatory bodies.

The fate of deference given deregulation is a much debated topic. More than two decades ago, a classic exchange between (now judge) Merrick Garland and Cass Sunstein debated the merits of courts engaging in "hard look" review of agency decisions to deregulate industries.[8] In the context of electric power deregulation, Richard Pierce has advocated judicial deference in certain contexts.[9] Judicial deference has an undeniably important place in public law generally, including in the law of economic regulation. Deference recognizes the costs of judicial review of complex and technical regulatory matters whose resolution courts are ill-equipped to reach

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Regulated Industries Law, 98 COLUM. L. REV. 1323, 1369 (1998) ("Although lacking the same policymaking authority as Congress and regulatory commissions, the courts affect the pace, extent, or manner of regulatory change each time they decide a case involving legislative or administrative regulatory policies—whether they ratify, overturn, or require the government to reconsider a particular policy.").

5. The leading treatment is J. GREGORY SIDAK & DANIEL F. SPULBER, DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT: THE COMPETITIVE TRANSFORMATION OF NETWORK INDUSTRIES IN THE UNITED STATES (1997) (arguing that deregulation without compensation for "stranded costs" constitutes an unconstitutional taking of private property).

6. *See generally* Jim Chen, *The Second Coming of* Smyth v. Ames, 77 TEX. L. REV. 1535 (1999); Herbert Hovenkamp, *The Takings Clause and Improvident Regulatory Bargains*, 108 YALE L.J. 801 (1999); Jim Rossi, *The Irony of Deregulatory Takings*, 77 TEX. L. REV. 297 (1998) (reviewing SIDAK & SPULBER, *supra* note 5).

7. *See, e.g.*, Chen, *supra* note 6; *see also* Susan Rose-Ackerman & Jim Rossi, *Disentangling Deregulatory Takings*, 86 VA. L. REV. 1435 (2000).

8. *See* Merrick B. Garland, *Deregulation and Judicial Review*, 98 HARV. L. REV. 505 (1985) (criticizing "hard look" review of agency decision making); Cass Sunstein, *Deregulation and the Hard-Look Doctrine*, 1983 SUP. CT. REV. 177 (advocating for the "hard look").

9. Richard J. Pierce, Jr., *The Unintended Effects of Judicial Review of Agency Rules: How Federal Courts Have Contributed to the Electricity Crisis of the 1990s*, 43 ADMIN. L. REV. 7 (1991).

on their own. 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. This convergence was certainly not perfect—a lot of regulation was counterproductive, as public choice theorists remind us—but it was stable for more than a few generations. Especially given the stability of this regulatory order, the deference approach was inviting to courts, as it allowed judges to avoid meddling in complex and highly technical matters which courts frequently lacked sufficient expertise and competence to resolve.

As attractive as deference may be, it also presents a pernicious trap for federal courts. By embracing deference too broadly courts create a strong presumption of no judicial intervention. However, where regulatory conditions change, this presumption may no longer be appropriate and can easily eviscerate important doctrines of public law for deregulated industries, leaving the judicial branch a mere bystander in many disputes about emerging market policies. This Article argues that public law has fallen into what I call a "deference trap" in addressing conflicts in deregulated industries and other regulated industries in transition, such as the telecommunications and electric power industries. The deference trap describes a judicial reluctance to intervene in disputes involving political institutions, such as federal regulatory and state governmental agencies. By reassessing the deference trap across the legal doctrines that are affecting emerging telecommunications and electric power markets, public law has the capacity to deliver much more for deregulated markets.

The deference trap poses a particular cost as markets are deregulated, one that may not have been present during previous regulatory eras in which public and private interests in regulatory bargaining were more likely to converge. 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.[10] For instance,

10. In this vein, this Article looks skeptically on the use of the term "deregulation"—a misnomer given that regulation of many "deregulated"

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 markets. This Article sets out to advance this project in the context of three vignettes. In doing so, I draw on a bargaining account of regulation, supplemented with a comparative institutional analysis. The approach 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 (and often competing) institutions, including courts, Congress and state legislatures, and state and federal regulators. One caveat is in order at the outset: The approach of this Article is not to embrace activist judicial review of preexisting bargains (as do advocates of deregulatory takings), but to focus more on the bargaining conditions that surround the lawmaking process. By focusing on the bargaining conditions under which regulation is formulated and enforced, I shall argue that public law has the capacity to improve the functioning of competitive markets, such as

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industries continues on in a new form. The use of "deregulation" in this Article is not intended to imply complete dismantling of regulation, but discarding certain features of traditional regulation, such as cost-of-service ratemaking. Frequently, partial regulation of industries such as electric power and telecommunications remains long after these industries are deregulated. Deregulation generally entails disentangling the network characteristics of these industries from their competitive sectors, and regulation of networks by federal, state, and local governments remains active, even in the most "deregulated" environments. As Alfred Kahn has stated, "The decision to regulate never represents a clean break with competition." II ALFRED E. KAHN, THE ECONOMICS OF REGULATION 113 (1988). So too, the decision to embrace competition in these industries never represents a clean break with regulation. *See* PAUL L. JOSKOW & RICHARD SCHMALENSEE, MARKETS FOR POWER: AN ANALYSIS OF ELECTRICAL UTILITY DEREGULATION 211-12 (1983) ("Our analysis leads us to conclude that any sensible deregulation scheme will require continuing economic regulation of some segments of the electric power industry."); LEAN-JACQUES LAFFONT & JEAN TIROLE, COMPETITION IN TELECOMMUNICATIONS 272 (2000) (discussing the regulatory approaches for deregulated telecommunications markets).

those evolving in telecommunications and electric power.[11]

Part II illustrates that public law has fallen into a deference trap in the context of the filed rate doctrine and suggests that, by focusing on bargaining conditions in tariffing, courts could minimize strategic forum shopping in regulatory enforcement. Part III warns against public law falling into a deference trap in the context of judicial review of state regulation under the dormant commerce clause and state action immunity to antitrust enforcement, suggesting that courts correct for this by taking into account private firm incentives in the state lawmaking process. Part IV suggests that federal preemption, as currently construed, also invites a deference trap which can create regulatory commons problems and recommends that courts reformulate preemption principles to realign incentives to facilitate regulatory coordination between the federal government and states. By isolating ex ante incentives and stressing the institutional context for the adoption and enforcement of regulation, together these examples reveal weaknesses in traditional doctrines of regulatory law in deregulated markets and suggest ways courts might correct for them.

II. USING PUBLIC LAW TO MITIGATE STRATEGIC FORUM SHOPPING IN REGULATORY ENFORCEMENT

The filed rate doctrine is a venerable doctrine of public utility regulation. When a court applies it—and courts frequently do—the doctrine serves as a litigation shield for regulated utilities. Federal courts invoking this shield frequently defer to regulators and refuse to exercise jurisdiction over an alleged antitrust violation or tort or contract claim whose resolution would require a departure from a utility's filed rate.[12] Like many venerable legal rules, the filed rate doctrine is rarely questioned. For over a century, it has served many important purposes. However, with deregulation of wholesale electric power markets at the federal level and various degrees of deregulation across the states, both the doctrine's continued applicability and usefulness are increasingly suspect.

Moreover, as recent examples in the industry suggest, presumptive application of the filed rate doctrine by both firms and

11. For further elaboration of this approach, see JIM ROSSI, REGULATORY BARGAINING AND PUBLIC LAW (2005). In this book, I address more fully how a bargaining account of regulatory systems can sustain a vision of public law for deregulated industries that strikes a balance between deference and judicial intervention.

12. For extensive discussion of the doctrine, see Jim Rossi, *Lowering the Filed Tariff Shield: Judicial Enforcement for a Deregulatory Era*, 56 VAND. L. REV. 1591, 1598-1601 (2003).

courts can cause affirmative harm for the development of energy markets and policy. For example, a recent U.S. District Court decision in Texas applied the filed rate doctrine in an astonishingly broad manner, precluding antitrust claims against energy suppliers in the deregulated Texas wholesale power market and leaving those harmed by market abuses without any legal or administrative remedy.[13] Examples such as this illustrate a serious need for reassessment of the doctrine by federal courts in the energy context. Both courts and litigators have at their disposal ways of lowering the filed tariff shield to allow more efficient energy markets to develop, furthering better the goals of energy policy.

A. *History and Context*

Historically, federal courts developed the filed rate doctrine to further the purpose of natural monopoly regulation—protecting consumers against discrimination in utility service rates. A utility with a filed tariff is prohibited from offering customers rebates and discounts that are at odds with the filed tariff, which historically reflected a regulator's careful evaluation and affirmative approval of costs and prices. In addition to the noneconomic goal of fairness, the nondiscrimination principle behind the filed rate doctrine also has an economic purpose. The general idea behind a regulator prohibiting price discrimination is to preclude a monopolist from using its market power to extend its monopoly into secondary markets.[14] For most of the twentieth century, cost-of-service regulation provided regulators a ready forum for ensuring that rates did not discriminate in ways that caused serious losses to social welfare. While nondiscrimination in rates is the primary purpose courts give for applying the filed rate doctrine, two other goals of the doctrine play an important role for historically regulated industries, such as electric power.

First, where a federal court is asked to apply substantive state law, as often occurs in a fraud or breach of contract claim, there is a federal preemption strand to the filed rate doctrine. For example, the Ninth Circuit invoked the filed rate doctrine to bar California's governor from commandeering expensive wholesale power contracts during the state's recent deregulation crisis.[15] The court's rationale for invoking the doctrine in that case was that the state's action would present a conflict with a tariff filed with the Federal Energy

13. Tex. Commercial Energy v. TXU Energy, Inc., No. C-03-249, 2004 U.S. Dist. LEXIS 13908, at *46-47 (S.D. Tex. June 24, 2004).

14. For discussion, see Rossi, *supra* note 12, at 1598-1601.

15. Duke Energy Trading & Mktg., L.L.C. v. Davis, 267 F.3d 1042, 1056-59 (9th Cir. 2001).

Regulatory Commission (FERC). While the court relied on the filed rate doctrine, at the bottom line it was making a legal determination that federal preemption precluded state regulatory action.

Second, and especially relevant to judicial consideration of federal antitrust claims, there is an agency deference strand to the doctrine. Courts find the filed rate doctrine particularly inviting where a matter is highly complex and technical, as many energy disputes are. The leading case on this is *Keogh v. Chicago & Northwestern Railway Co.*,[16] decided by the Supreme Court in 1922. *Keogh* held that a private antitrust plaintiff is precluded from recovering treble damages against a carrier based on the claim that a tariff filed with the interstate commerce commission was allegedly monopolistic. Noting that section 8 of the Interstate Commerce Act gave shippers injured by illegal rates actual damages plus attorney's fees, Justice Brandeis reasoned that the rate issue is one best determined by the agency, not by a court.[17]

While federal courts have almost presumptively applied the filed rate doctrine to matters that have undergone a rate hearing, there are two recognized exceptions to the doctrine. First, courts generally do not apply it where the injured party is a competitor, rather than a consumer, as in this context a judicial remedy would not necessitate a departure from the filed rate.[18] Second, courts have been very reluctant to apply it to antitrust claims raising colorable price squeeze concerns, as in this context regulators lack jurisdiction to remedy allegedly illegal conduct.[19]

B. *The Implications of the Filed Rate Doctrine in Deregulated Markets*

In the deregulated electric power industry, the filed rate doctrine continues to play an important role in precluding judicial enforcement of antitrust, contract, and tort laws. For instance, the filed rate doctrine has been used to bar antitrust claims in the deregulated electric power industry. In *Town of Norwood v. New*

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16. 260 U.S. 156 (1922).

17. *Id.* at 162-64.

18. *See, e.g.*, Cost Mgmt. Servs. v. Wash. Natural Gas Co., 99 F.3d 937, 945-48 (9th Cir. 1996); Barnes v. Arden Mayfair, Inc., 759 F.2d 676, 679 (9th Cir. 1985).

19. *See, e.g.*, City of Kirkwood v. Union Elec. Co., 671 F.2d 1173, 1177-80 (8th Cir. 1982); City of Mishawaka v. Ind. & Mich. Elec. Co., 560 F.2d 1314, 1321-24 (7th Cir. 1977); *see also* John E. Lopatka, *The Electric Utility Price Squeeze as an Antitrust Cause of Action*, 31 UCLA L. REV. 563, 638-39 (1984) (explaining that price squeeze claims pose a special challenge to the extent a utility is able to manipulate the dual jurisdictional framework).

England Power Co.,[20] the First Circuit invoked the *Keogh* strand of the filed rate doctrine to bar a price squeeze claim against a utility—even where the tariff filed with FERC was a market-based tariff relying on competitively set prices.[21] The *Norwood* court reasoned, "[i]t is the *filing* of the tariffs, and not any affirmative approval or scrutiny by the agency, that triggers the filed rate doctrine."[22] However, the deference trap of automatic application of the filed rate doctrine to the partially deregulated electric power industry leads to harmful results.[23] The conventionally understood concern with the application of the filed rate doctrine in deregulated markets is that, by valuing regulatory over market price determinations, it stands in the way of competitive markets. Markets depend on price fluctuations, and, if taken to its extreme, the filed rate doctrine can freeze market prices in ways that impede rather than facilitate coordination of supply and demand.

Another concern with the filed rate doctrine arises due to the strategic actions of firms in the regulatory process. To the extent that cases such as *Norwood* allow the mere filing of tariffs to presumptively determine whether a court will exercise jurisdiction, the filed rate doctrine invites even more radical deregulation than either Congress or the regulatory agencies accepting tariffs would prefer—that is, markets absent antitrust and common law remedies. As the Ninth Circuit has observed, Congress did not intend this result in enacting either the Federal Power Act or subsequent energy legislation.[24]

Unlike other types of immunity from litigation, which often apply to firms across the board, the filed rate doctrine is a firm-specific defense. To the extent the filed rate doctrine is used by courts as a basis to decline jurisdiction, private firms might look to ex ante tariffing as a clever strategy to foreclose antitrust or common law litigation, thus reducing the possibility of ex post judicial enforcement. Allowing private conduct to determine the institutional forum for market enforcement leads to a serious bias against judicial enforcement. This bias in favor of regulatory agencies privileges private choice over public assessment of the effectiveness of dual enforcement.

Reliance on private forum selection for a regulatory

20. 202 F.3d 408 (1st Cir. 2000).

21. *Id.* at 418-21. The *Keogh* strand of the filed rate doctrine has its genesis in *Keogh v. Chicago & Northwest Railway Co.*, 260 U.S. 156 (1922). *See supra* notes 16-17 and accompanying text.

22. *Town of Norwood*, 202 F.3d at 419.

23. Rossi, *supra* note 12, at 1615-29.

24. California *ex rel.* Lockyer v. F.E.R.C., 383 F.3d 1006, 1016 (9th Cir. 2004).

enforcement mechanism poses a particularly costly problem as we move from cost-of-service based regulation to a different approach to regulating markets, focusing on inputs or the structure of access to important facilities for competition. For instance, a utility lacking market power can file an umbrella tariff with FERC; this, coupled with quarterly reports (including numerical details on actual sales prices), will satisfy the Federal Power Act's requirement that FERC find wholesale rates to be "just and reasonable."[25] FERC has a much-debated market power test,[26] but market based tariffs do not include a filed rate—only an offer to negotiate, which can have the odd effect of preventing enforcement of antitrust, tort, and contract laws. Similarly, transmission tariffs can raise filed rate issues, as firms may use these tariffs to maintain that the conduct of individual transmission-owning utilities, regional transmission organizations, or independent service operators are immune from antitrust enforcement and other legal protections against market misconduct.[27]

While courts do not have the same degree of expertise that agencies possess, courts do have some comparative institutional competence in implementing enforcement regimes that could benefit competitive markets. Unlike regulatory agencies, courts do not depend on budget allocations or legislative delegations of specific regulatory jurisdiction. Courts have wider remedial authority and discovery powers than do regulatory agencies as well as greater political independence. Thus, as we implement competition policy for electric power markets, judicial enforcement of remedies for market abuses based on violations of antitrust, tort, and contract law can play an important role in protecting public welfare. To the extent the filed rate doctrine privileges private choice over assessment of the public interest in choosing the mechanism for enforcement, courts should refuse to apply it automatically to preclude judicial enforcement.

C. *A Texas-Sized Regulatory Enforcement Gap*

In June 2004, the U.S. District Court for the Southern District of Texas, Corpus Christi Division, applied the filed rate doctrine to preclude antitrust claims for illegal conduct in deregulated wholesale power markets against numerous power supply

25. 16 U.S.C. § 824d(a) (2000).

26. *See* Duke Power, 109 F.E.R.C. ¶ 61,270, at 62,265 (2004) (describing and applying FERC's market power test).

27. For example, a federal bankruptcy court rejected PG&E's filed rate defense based on a transmission tariff filing with FERC. *In re* Pac. Gas & Elec. Co., 295 B.R. 635, 667 (Bankr. N.D. Cal. 2003).

companies and the Electric Reliability Council of Texas ("ERCOT").[28] The case provides a clear illustration of why federal courts need to revisit the filed rate doctrine in the deregulatory environment.

The claim, brought by Texas Commercial Energy ("TCE"), alleged that twenty-four defendants, including TXU Energy, Inc., American Electric Power, Inc., and other energy marketers within ERCOT engaged in anticompetitive market abuses in violation of federal and state antitrust laws as well as fraud, negligent misrepresentation, breach of contract, defamation, business disparagement, civil conspiracy, and malicious and willful/flagrant conduct under state law.[29] TCE alleged that these wrongful acts caused prices in the Balancing Energy Service Market ("BES market")–a bid-based market for short-term power–to rise drastically, forcing TCE to pay higher prices in the BES market and forcing it to withdraw credit-based collateral from its bilateral partners.[30]

As is typical in most cases involving the filed rate doctrine, the U.S. District Court in Texas dismissed TCE's lawsuit without addressing the substantive merits of the market abuse claims.[31] Although FERC possesses no authority over the Texas electricity market, the court reasoned that the doctrine is intended to allow markets to operate under rules approved by state regulators.[32] In declining to consider the merits of the federal antitrust claim, the court reasoned that the agency charged by the state legislature with overseeing the Texas electricity market, the Public Utility Commission of Texas ("PUCT"), possesses the "institutional competence to address rate-making issues in the BES market, one of the principles underlying the filed rate doctrine."[33] The court observed that PUCT is required by statute to ensure "safe, reliable, and reasonably priced electricity," including in BES markets.[34] The court noted, for example, that in August 2001 the Market Oversight Division of PUCT ordered market participants to return $30 million in illicit profits due to abusive and improper scheduling practices in the BES market.[35] In addition, rates in the BES market were

28. Tex. Commercial Energy v. TXU Energy, Inc., No. C-03-249, 2004 WL 1777597, at *13-14 (S.D. Tex. June 24, 2004).

29. *Id.* at *1.

30. *Id.*

31. *Id.* at *14.

32. *Id.* at *9-10.

33. *Id.* at *10 (citing Sun City Taxpayers' Ass'n v. Citizens Util. Co., 45 F.3d 58, 62 (2d Cir. 1995).

34. TEX. UTIL. CODE. ANN. § 39.101(a)(1) (Vernon Supp. 2004).

35. *TCE*, 2004 WL 1777597, at *10.

capped at $1,000 per megawatt hour.[36] After finding that the filed rate doctrine barred federal and state antitrust claims, the court went on to determine that it also barred breach of contract and other claims based on federal law.[37] While the court's decision echoed the approach of many other federal courts, which often presumptively apply the filed rate doctrine to refuse consideration of a market abuse claim, it also exposed substantial flaws with the doctrine in the deregulatory environment.

To begin, the court's premise that PUCT's "institutional competence" precluded consideration of the claim failed entirely to confront the predicate issue of the agency's authority to remedy harms. A regulator can only possess institutional competence if it also has the authority to act. However, Texas has no express or implied private right of action for injured purchasers and PUCT also lacks authority to order refunds and damages. While the district court referred to a previous $30 million settlement in Texas as evidence of PUCT's power,[38] the settlement depended entirely on PUCT voluntarily assuming the role of brokering the agreement and persuading the companies to disgorge some of their wrongfully obtained profits. While PUCT may have the political power to broker a deal, PUCT affords customers no formal complaint and restitution process where they are injured in the BES market.

Even to the extent there is a complaint and adjudication process for restitution, the filed rate doctrine precludes antitrust claims in which treble damages are available to serve a more meaningful deterrent function. Treble damages may not be necessary if agency regulators enforce one hundred percent of market abuses (since one of the main policy reasons behind treble damages is that the likelihood of being sued is so low that meaningful penalities must be high), but regulators lack the authority or resources to guarantee restitution for every market abuse. The absence of restitution coupled with the laçk of meaningful penalties means that a Texas-sized enforcement gap will exist in ERCOT's deregulated wholesale market.

Moreover, in discussing the filed rate doctrine the district court in *TCE* completely confused federal and state law. The *Keogh* case, on which the court relied extensively, involved the application of the filed rate doctrine as a matter of federal law to suspend application of federal antitrust laws to activities regulated by a federal agency. Here, no federal agency had regulatory authority—only a Texas state agency had any claim to regulatory authority. To the extent

36. *Id.* at *12.
37. *Id.* at *15-19.
38. *Id.* at *10.

the doctrine involves state regulation, the tariff should be treated as a matter of state law or, as is suggested below, under state action immunity—the appropriate federalism defense to the antitrust laws. The district court, however, did not reference a single Texas case involving the filed rate doctrine, and failed completely to evaluate whether state regulation of the BES market gives rise to state action immunity.

D. A More Direct Solution: How Other Legal Doctrines Further the Legitimate Goals of the Filed Rate Doctrine

A plea for more careful application of the filed rate doctrine by federal courts is not intended to suggest that the doctrine is without purpose in every case. It is, however, a request that courts not consider the filed rate doctrine automatic or presumptive, even in cases involving complex regulatory filings. Such an approach is consistent with *Otter Tail Power Co. v. United States*,[39] in which the U.S. Supreme Court refused to apply the tariff antitrust claims filed by competitors because the court perceived only "a potential conflict" with the Federal Power Commission's authority over transmission.[40] More recently, in *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*,[41] the Court held that courts clearly have the authority to apply general antitrust principles to regulated firms, although the 1996 Telecommunication Act's extensive provisions for access make it unnecessary for courts to apply an essential facilities doctrine under the antitrust laws to regulated firms.[42]

As a defense in cases involving energy markets, the filed rate doctrine continues to serve an important purpose where three conditions are present: where nondiscrimination remains an important regulatory goal; where regulators possess the authority and in fact do evaluate costs and prices; and where regulators possess an adequate remedy for nondiscrimination. While cost-of-service regulation may have justified a presumption against the exercise of judicial authority in most cases, in a deregulated environment it must be presumed that the agency has not engaged in an extensive firm-specific evaluation of nondiscrimination.

Before resorting to the filed rate doctrine to decline consideration of the merits of a dispute involving allegations of market wrongs, a court first needs to evaluate whether an agency

39. 410 U.S. 366 (1973).
40. *Id.* at 377.
41. 540 U.S. 398 (2004).
42. *Id.* at 406, 410-11 (2004) (considering an essential facilities claim, refusal to deal, and monopoly leveraging, but rejecting these claims on the merits).

accepting a tariff possesses the authority to protect against nondiscrimination and uses it in ways that would present a conflict with courts or make judicial enforcement unnecessary. In many contexts, it is not at all clear that agency regulators possess the authority to evaluate tariffs for nondiscrimination or to remedy discrimination and other market abuses. In other contexts, as in FERC's market-based tariffs, it is not at all clear that regulators routinely evaluate and exercise authority to protect against nondiscrimination.

For example, the Ninth Circuit recently rejected the presumption that the filed rate doctrine applies to market-based rates. *California ex rel. Lockyer v. FERC* held that the filed rate doctrine could apply to FERC's market-based rates, but only if FERC did something more than make a cursory finding of no market power in accepting a rate filing.[43] FERC also needed to exercise remedial authority to more actively monitor market-based rates for market abuses. If FERC does not do this, the Ninth Circuit panel suggested, "the purpose of the filed rate doctrine is undermined" and "the tariff runs afoul of . . . the FPA."[44] Otherwise, an enforcement gap—as in Texas—will exist.

Nondiscrimination is a questionable regulatory goal in today's regulatory environment, in which markets, not regulators, are increasingly determining prices. It should no longer give rise to a presumptive filed rate defense. In addition, federal courts have at their disposal commonly used doctrines that better promote the other purposes of the filed rate doctrine—federal preemption and deference. There is no reason to give a filed tariff an independent legal effect in order to further these goals.

Courts, for example, routinely find that national regulatory programs preempt state law remedies for breach of contract and tort. Such determinations, however, are not automatic. Instead, courts carefully evaluate the scope of the regulatory scheme and the extent to which it presents a conflict with state remedies. By contrast, courts applying the filed rate doctrine as in *Norwood* often use the mere existence of a filed tariff to imply federal preemption, with little or no analysis of whether a regulatory conflict in fact exists. Borrowing from federal preemption analysis, courts should generally apply a presumption against preemption in this context.

In addition, the doctrine of primary jurisdiction—widely used in federal judicial proceedings involving agency regulation—makes it unnecessary for courts to apply the filed tariff doctrine in order to further the goal of agency deference. While the filed tariff doctrine

43. 383 F.3d 1006, 1016-17 (9th Cir. 2004).

44. *Id.* at 1016.

bars both present and future claims, primary jurisdiction does not confer complete immunity to the allegedly anticompetitive conduct. Instead, in applying the doctrine, courts temporarily stay any judicial enforcement pending agency regulation of the conduct at issue. As Professor Louis Jaffe recognized long ago, the application of the doctrine of primary jurisdiction emphasizes that referral of a matter from a court to an agency is not based solely on agency expertise, but on the entire statutory scheme.[45] Thus, its inquiry is more suited to the problem federal courts routinely address in asserting or declining jurisdiction over a matter within a federal agency's jurisdiction: whether an exercise of judicial power unduly trespasses onto agency expertise and decision-making authority in enforcing regulatory goals. Primary jurisdiction provides a less blunt tool for courts to apply agency deference in a dual jurisdiction enforcement context involving both federal agencies and courts, as frequently arises under the antitrust laws.

Finally, in antitrust cases, such as TCE's complaint against TXU Energy and other suppliers potentially regulated by a state agency, the filed rate doctrine is a completely inappropriate—and astonishingly overbroad—defense to the claim. Apart from this case, it seems that the filed rate doctrine has never been extended to such a context, particularly since an alternative doctrine is available to deal with deference to the state regulator. State action immunity is an important federal defense to the application of the antitrust laws. This judicially created antitrust defense originated when the Supreme Court rejected a Sherman Act challenge to a California marketing program brought by a grower because the program derived "its authority and its efficacy from the legislative command of the state."[46] As modern courts apply the doctrine, "[f]irst, the challenged restraint must be 'one clearly articulated and affirmatively expressed as state policy'; second, the policy must be 'actively supervised' by the State itself."[47]

The Texas federal district court that dismissed TCE's complaint failed to make any effort to determine whether the supplier's alleged misdeeds were immune under the federal antitrust laws given state regulatory action. Indeed, since Texas affirmatively adopted the BES as a competitive market model but did not give PUCT plenary

45. Louis L. Jaffe, *Primary Jurisdiction*, 77 HARV. L. REV. 1037, 1057 (1964) (observing that "[a] special problem arises where the administrative agency is not given jurisdiction to award reparations," specifically mentioning the FPC, FERC's predecessor).

46. Parker v. Brown, 317 U.S. 341, 350 (1943).

47. Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 105 (1980) (citing City of Lafayette v. La. Power & Light Co., 435 U.S. 389, 410 (1978) (Brennan, J., plurality opinion)).

enforcement authority over suppliers, a claim of state action immunity in this case would have been unlikely to succeed.

These alternative legal doctrines are much more precise and effective means of promoting the goals of federal preemption and agency deference than the filed rate doctrine. Unlike the filed rate doctrine, they are not triggered by firm-specific actions but focus on the agency regulator's authority and actions. In this sense, they provide a more complete picture of the public interest in ensuring some enforcement of legal standards against market abuses in energy markets than would overbroad resort to the filed rate doctrine. To the extent the filed rate doctrine is purely a matter of state law, courts should apply it with similar enforcement concerns in mind. As a matter of federal law, in most instances involving energy regulation today, the filed rate doctrine's goals could readily be served if lawyers and courts were to look to other legal rules.

As a recent trade press article suggests, applying the filed rate doctrine in deregulated wholesale markets is akin to pounding "a square peg into a round hole."[48] Ultimately, if competitive markets are to succeed, Congress must explicitly detariff electric power, in a manner similar to the deregulation of telecommunications markets. Indeed, H.R. 6, the proposed "Energy Policy Act of 2003,"[49] would have moved the basic authority to set rates from FERC to the Commodity Futures Trading Commission, making the death of the filed tariff shield a fait accompli in the electric power and natural gas settings.[50] Even if FERC were to move in this direction on its own—regulating markets over prices—the question of injury to those losing money due to market manipulation will likely be resolved by courts.[51] In the meantime, courts would best serve the development of competitive energy markets by looking to alternative legal doctrines to serve the purposes of the filed rate doctrine. Rate and tariff filings in the deregulated energy context should be of no less legal consequence than other regulatory instruments. But they also should not be of any more legal consequence.

III. USING PUBLIC LAW TO MITIGATE PRIVATE MANIPULATION OF STATE AND LOCAL MONOPOLY REGULATION

The deference trap of public law may also have implications for the formulation of state regulation in deregulated industries. If

48. Richard Stavros, *Lost in Translation: Critics Say FERC's Filed Rate Doctrine Is Wrong for the Times*, PUB. UTIL. FORT., July 2004, at 4.

49. H.R. 6, 108th Cong. (2003).

50. H.R. REP. NO. 108-375, at 297 (2003); *see also* Robert C. McDiarmid, *Trading Spaces? Will the CFTC Move into FERC's House?*, PUB. UTIL. FORT., Jan. 2004, at 40.

51. McDiarmid, *supra* note 50, at 42.

courts are too deferential to state and local regulators, deregulated markets may result in more—not less—use of the political process to engage in socially harmful rent seeking. The political and economic consequences of rent seeking are well chronicled by public choice theorists,[52] but in the legal realm these concerns play out in the context of the dormant commerce clause of the U.S. Constitution and state action immunity to antitrust enforcement.

The "dormant" commerce clause, derived from the Commerce Clause of the U.S. Constitution,[53] limits the power of a state to enact barriers to interstate commerce that blatantly discriminate against out-of-state businesses or which have the effect of bringing about such discrimination.[54] At the core of dormant commerce clause jurisprudence is a norm of barrier-free interstate markets except in very limited circumstances, such as where a state itself is a market participant.[55] The doctrine can be conceptualized as responding to a type of contractual incompleteness—due to transaction costs, states may find it difficult to bargain with each other to ensure that trade barriers are not harmful to overall social welfare. An individual state's approach to monopoly regulation may impose spillover costs for other jurisdictions. By striking state legislation that does so, rather than deferring to state political processes, the dormant commerce clause works to internalize these costs.

While the dormant commerce clause is pro-competitive (and hence anti-protectionist) in spirit—indeed, it is anti-regulation in spirit to the extent it protects competition in the external market—state action immunity from antitrust enforcement is seemingly pro-regulation, presenting an interesting apparent contrast in goal and approach. State action immunity suspends federal antitrust

52. *See supra* note 2.

53. The Commerce Clause provides that "[t]he Congress shall have Power . . . [t]o regulate Commerce . . . among the several States . . . ." U.S. Const. art. I, § 8, cl. 3. The "dormant" commerce clause, often referred to as the "negative" commerce clause, embodies the notion that the grant of authority to Congress to regulate interstate commerce carries with it implied restrictions on the ability of states to initiate regulations affecting interstate commerce.

54. The evolution of the dormant commerce clause can be traced back to *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1 (1824). Examples of the doctrine being used to strike down offending state programs abound. *See, e.g.*, Kassel v. Consol. Freightways Corp., 450 U.S. 662 (1981); Hunt v. Wash. State Apple Adver. Comm'n, 432 U.S. 333 (1977); Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520 (1959); Dean Milk Co. v. City of Madison, 340 U.S. 349 (1951); S. Pac. Co. v. Arizona *ex rel.* Sullivan, 325 U.S. 761 (1945); Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511 (1935); Di Santo v. Pennsylvania, 273 U.S. 34 (1927); Buck v. Kuykendall, 267 U.S. 307 (1925).

55. On the market-participant exception, see *infra* note 75 and accompanying text.

enforcement under the Sherman and Clayton Acts[56]—statutes designed to enhance competition and free trade norms—where a state actively supervises the private activity.[57] For example, price-regulated public utilities, including electric and telecommunications monopolies, have long escaped the scrutiny of antitrust enforcement for their regulated activities. Rate proceedings have served to police concerns with the exercise of market power. With deregulation, however, there is widespread recognition that antitrust laws may play an increasingly important role in deregulated industries, such as telecommunications, electric power, and natural gas.[58] To the extent state regulation is more likely to be incomplete in a deregulated environment, immunity from antitrust enforcement must be approached with extreme caution. State action immunity—once widely taken for granted by firms in the electric power and telecommunications industries—should no longer automatically bar antitrust suits in utility industries any more than does the filed tariff doctrine. The erosion of immunity will greatly increase the uncertainty that historically regulated monopolies face in deregulated markets, yet courts have not taken a principled approach to deciding when to suspend state action immunity for

56. *See, e.g.*, FTC v. Ticor Title Ins. Co., 504 U.S. 621 (1992); City of Columbia v. Omni Outdoor Adver., Inc., 499 U.S. 365 (1991); S. Motor Carriers Rate Conference, Inc. v. United States, 471 U.S. 48 (1985); Town of Hallie v. City of Eau Claire, 471 U.S. 34 (1985); Hoover v. Ronwin, 466 U.S. 558 (1984); New Motor Vehicle Bd. v. Orrin W. Fox Co., 439 U.S. 96 (1978); Bates v. State Bar of Ariz., 433 U.S. 350 (1977); Parker v. Brown, 317 U.S. 341 (1943).

57. *See* Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 105-06 (1980) (refusing to grant state action immunity where the program at issue was not actively supervised by the state).

58. *See, e.g.*, Ray S. Bolze et al., *Antitrust Law Regulation: A New Focus for a Competitive Energy Industry*, 21 ENERGY L.J. 79 (2000); Jade Alice Eaton, *Recent United States Department of Justice Actions in the Electric Utility Industry*, 9 CONN. J. INT'L L. 857 (1994); Craig A. Glazer & M. Bryan Little, *The Roles of Antitrust Law and Regulatory Oversight in the Restructured Electricity Industry*, ELECTRICITY J., May 1999, at 21; William J. Kolasky, *Network Effects: A Contrarian View*, 7 GEO. MASON L. REV. 577 (1999); John Burrit McArthur, *Anti-Trust in the New [De]Regulated Natural Gas Industry*, 18 ENERGY L.J. 1 (1997); Thomas A. Piraino, Jr., *A Proposed Antitrust Analysis of Telecommunications Joint Ventures*, 1997 WISC. L. REV. 639; William J. Baer, FTC Perspectives on Competition Policy and Enforcement Initiatives in Electric Power, Address Before the Conference on the New Rules of the Game for Electric Power: Antitrust and Anticompetitive Behavior (Dec. 4, 1997), *available at* http://www.ftc.gov/speeches/other/elec1204.htm; Robert Pitofsky, Competition Policy in Communications Industries: New Antitrust Approaches, Remarks Before the Glasser LegalWorks Seminar on Competitive Policy in Communications Industries: New Antitrust Approaches (Mar. 10, 1997), *available at* http://www.ftc.gov/speeches/pitofsky/newcomm.htm.

utility industries.

Just as deference should have no place in the context of the dormant commerce clause, a deference approach to state action immunity can be harmful in deregulated markets. A principled approach to state action immunity in the context of economic regulation would not accept state regulation at face value as providing for immunity from antitrust enforcement. As a starting point, it must be recognized that other legal doctrines, such as the dormant commerce clause, play an important role in limiting state-assisted monopoly and the scope of state regulation. On the conventional understanding, the dormant commerce clause and state action immunity from antitrust enforcement seem inconsistent, even contradictory, in their overall objectives. One doctrine is designed to protect against state regulation that rises to protectionist levels and impedes external markets, while the other allows state regulation to trump federal competition policies. Put another way, one doctrine is oriented towards free trade, while the other favors—and may even encourage—state-sanctioned monopoly. At their core, however, both doctrines deal with the permissible boundaries of monopoly, a fundamental organizational form for many regulated and deregulated firms. Unless carefully approached, these doctrines can present a tension for the law of regulated industries.

A focus on the harms associated with judicial deference illustrates how these two doctrines have much more common ground than either judicial doctrine, or most commentators, recognize. Both doctrines facilitate cooperation in the public governance process in order to sustain background norms of competition—the dormant commerce clause concerns itself with the external market, while state action immunity concerns itself primarily with the internal market. But the doctrinal convergence is not limited to mere pro-competitive policies that promote commercial exchange. Examining how these doctrines might encourage a type of deference to state and local regulation highlights their unified purpose—limiting the negative impact of interest group capture of the state regulatory process without completely prohibiting rent-seeking behavior. At their core, the fundamental goal of both doctrines is to protect a political process that facilitates regulatory contracts by tempering self-interested interference that degrades cooperative norms between the states, including a norm of free exchange of commerce between states.[59] A bargaining perspective on regulation advances

59. For further elaboration of this argument, see Jim Rossi, *Political Bargaining and Judicial Intervention in Constitutional and Antitrust Federalism*, 83 WASH. U.L.Q. (forthcoming 2005).

the case for viewing the two doctrines as close cousins, if not siblings, in a family of legal doctrines that provides background norms, not only for the operation of American capitalism, but also for its governance. This has particularly important implications for the role of courts in considering antitrust cases in a deregulated environment. Particularly, it suggests that the standard of review applied by federal courts in the context of economic regulation should go beyond mere deference to state politics in both constitutional and antitrust federalism contexts. Public law, and in particular judicial review, should police strategic manipulation of state regulators in considering dormant commerce clause challenges to state regulation, as well as in the context of gatekeeping for antitrust enforcement pursuant to the application of state action immunity.

A. *The Dormant Commerce Clause: Monitoring Acceptable Levels of Regulation*

Although it is not an express mandate of the text of the U.S. Constitution's Commerce Clause, the dormant commerce clause doctrine limits the power of state governments to impair free trade. As Oliver Wendell Holmes once remarked:

> I do not think the United States would come to an end if we lost our power to declare an Act of Congress void. I do think the Union would be imperiled if we could not make that declaration as to the laws of the several States. For one in my place sees how often a local policy prevails with those who are not trained to national views and how often action is taken that embodies what the Commerce Clause was meant to end.[60]

Among recent judicial skeptics, such as Justices Scalia and Thomas, the doctrine is referred to as the "negative" commerce clause, indicating its lack of textual basis in the Constitution.[61] Notwithstanding the lack of textual support for the doctrine in the

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60. Oliver Wendell Holmes, *Law and the Court*, *in* COLLECTED LEGAL PAPERS 295-96 (1921).

61. Skeptics believe that the purposes of the dormant commerce clause can readily be served by other more textually explicit constitutional doctrines, such as the Import-Export Clause of Article I, Section 10 or the Privileges and Immunities Clause of Article IV, Section 2. These alternatives are not without their own critics. *See, e.g.*, Brannon P. Denning, *Justice Thomas, The Import-Export Clause, and* Camps Newfound/Owatonna v. Harrison, 70 U. COLO. L. REV. 155 (1999); Brannon P. Denning, *Why the Privileges and Immunities Clause of Article IV Cannot Replace the Dormant Commerce Clause Doctrine*, 88 MINN. L. REV. 384 (2003). However, for purposes of this Article, let it suffice it to emphasize that the alternatives would make protections against interstate regulatory barriers much narrower.

Constitution, the jurisprudence of the dormant commerce clause has a long-standing basis in American constitutional jurisprudence. As Justice Cardozo famously remarked, the Commerce Clause prohibits any state law that burdens interstate commerce "when the avowed purpose of the [law], as well as its necessary tendency, is to suppress or mitigate the consequences of competition between the states."[62] This general principle was invoked to strike a New York regulatory scheme that had been used to deny a license to an out-of-state milk processing facility.[63] Since the licensing provision had been enacted "solely [for] protection of local economic interests, such as supply for local consumption and limitation of competition," it was found to be unconstitutional.[64]

Since the 1980s, when deregulation began to take hold in a variety of industries, the Supreme Court has addressed dormant commerce jurisprudence on several occasions. One of its cases on the topic, *General Motors Corp. v. Tracy*,[65] evaluated Ohio's differential tax burdens for in-state and out-of-state natural gas suppliers but refused to find a violation of the dormant commerce clause on the particular facts that had been raised. General Motors, which mounted a legal challenge to Ohio's differential tax, was a large enough customer to purchase its gas from the open market (rendered competitive by national regulators) rather than bundled from a state-regulated local distribution company ("LDC").[66] However, absent competition between the LDC and the open market serving General Motors, the Court reasoned, "there can be no local preference, whether by express discrimination against interstate commerce or undue burden upon it, to which the dormant Commerce Clause may apply."[67] The case illustrates how intrastate regulation, which may reject competition (as where, for example, state regulators retain jurisdiction over retail rates), poses a potential tension under the dormant commerce clause, which protects interstate competition where national regulators have made a policy decision favoring competitive markets. FERC clearly has made such a decision in the context of the wholesale power market, bringing the dormant commerce clause into relevance.

Other recent cases extend the dormant commerce clause beyond merely protecting the external (interstate) market. In *C&A*

62. Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 522 (1935) (striking down a New York Law that set minimum prices that all milk dealers were required to pay New York milk producers).

63. *Id.* at 520, 527.

64. H.P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 531 (1949).

65. 519 U.S. 278 (1997).

66. *Id.* at 285.

67. *Id.* at 300.

Carbone, Inc. v. Town of Clarkstown,[68] the Supreme Court invalidated a municipally-imposed monopoly over nonrecyclable solid waste collected for processing and transfer.[69] To guarantee a minimum stream of revenues for the project, the town of Clarkstown, New York, adopted a flow control ordinance, allowing the private operator of a transfer station to collect a fee of $81 per ton—in excess of the disposal cost of solid waste in the private market.[70] C&A Carbone, Inc., processed solid waste and operated a recycling center, as it was permitted to do under the Clarkstown flow control ordinance.[71] The flow control ordinance required companies like Carbone to bring nonrecylable waste to the locally franchised transfer station and to pay a fee, while prohibiting them from shipping the waste themselves.[72] "[A] financing measure," the flow control ordinance ensured that "the town-sponsored facility will be profitable, so that the local contractor can build it and Clarkstown can buy it back at nominal cost in five years."[73] The Court reasoned that the local law violated the dormant commerce clause because in "practical effect and design" it barred out-of-state sanitary landfill operators from participating in the local market for solid waste disposal.[74] In so reasoning, the majority drew from a 1925 case, written by Justice Brandeis, in which the court held that a "statute prohibit[ing] common carriers from using state highways over certain routes without a certificate of public convenience" and necessity was unconstitutional.[75]

If a municipal government itself were to create and own the facility, this would bring the monopoly within an exemption to the dormant commerce clause known as the market-participant exemption.[76] In creating monopolies, however, local governments

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68. 511 U.S. 383 (1994).
69. *Id.* at 389.
70. *Id.* at 387.
71. *Id.* at 387-88.
72. *Id.* at 388.
73. *Id.* at 393.
74. *Id.* at 389, 394.
75. *Id.* at 394 (citing Buck v. Kuykendall, 267 U.S. 307, 312-13 (1925)). Justice Brandeis wrote for the Court:

> [The statute's] primary purpose is not regulation with a view to safety or to conservation of the highways, but the prohibition of competition. It determines, not the manner of use, but the persons by whom the highways may be used. It prohibits such use to some persons while permitting it to others for the very same purpose and in the same manner.

Buck, 267 U.S. at 315-16.

76. *See, e.g.*, Reeves, Inc. v. Stake, 447 U.S. 429, 435-36 (1980); Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 806-09 (1976). While many have criticized this exemption to dormant commerce clause jurisprudence, it is

frequently work with private firms, using the advantages of the state—subsidies, below-market interest rates from non-taxable bonds, and the ability to bypass state or local restrictions on use of municipal tax powers, for example—to assist firms and create incentives for them to provide service. Since municipal governments often help to pay for privately operated infrastructure, such as waste disposal facilities, through the issuance of bonds, it is understandable that a local government may want to create a monopoly in order to ensure that the facility maintains sufficient revenues to cover its costs and to avoid jeopardizing the government's bond rating. Such facilities are allowed to collect charges, which serve the same basic function as a tax. If the government itself were to build, own, and operate a facility, the political process would impose a general tax, but with private operations subsidized by a state or locally enforced monopoly, the tax implications of such projects are obscured. The town of Clarkstown, New York, for example, guaranteed revenue for its solid waste transfer station—it promised a minimum of 120,000 tons of waste per year, allowing a private firm to make more than $9.7 million in annual revenue—and, after a period of five years, the town agreed to buy it for one dollar.[77] One way of understanding the Court's rejection of the Clarkstown flow control ordinance is to view it as based on the Court's concerns with impermissible government-assisted monopolies against the backdrop of interstate competition.

The basic animating principle of recent commerce clause cases has frequently been described as the protection against "discriminat[ion] between in-state and out-of-state competitors."[78] If these decisions are taken at face value, the Supreme Court's dormant commerce clause jurisprudence might be said to embrace a pro-competition stance, consistent with the ideology and goals of a neoclassical economics framework of federalism. In *Tracy*, for example, Justice Souter, writing for the Court, stated, "[t]he dormant Commerce Clause protects markets and participants in

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defended as a pragmatic balance between competing federalism concerns. Dan T. Coenen, *Untangling the Market-Participant Exemption to the Dormant Commerce Clause*, 88 MICH. L. REV. 395, 398 (1989). The exemption is limited and is not automatically available where the state could expand into the market; to avail itself of the exemption the state must establish that it is a market participant and may not use mere contractual privity to immunize downstream regulatory conduct in a market in which it is not a direct participant. *See* South-Central Timber Dev., Inc. v. Wunnicke, 467 U.S. 82, 89 (1984).

77. *C&A Carbone, Inc.*, 511 U.S. at 387.

78. Paul E. McGreal, *The Flawed Economics of the Dormant Commerce Clause*, 39 WM. & MARY L. REV. 1191, 1223 (1998).

markets, not taxpayers as such."[79] He bolstered this vision of the dormant commerce clause by referencing the famous words of Justice Jackson:

> Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his export, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any. Such was the vision of the Founders; such has been the doctrine of this Court which has given it reality.[80]

This neoclassical view of the dormant commerce clause sees the role of federal courts as protecting states from interfering with the economic exchange of a free market economy.[81] Under this view, the primary purpose of the dormant commerce clause is to guard against balkanization by protecting free trade from state government interference in the external market.

It would be a mistake, however, to read the dormant commerce clause as a constitutional mandate for competition, let alone deregulation. As dormant commerce clause jurisprudence itself recognizes, there are exceptions to the dormant commerce clause where the state itself takes on the role of market participant. Further, the dormant commerce clause allows substantial state government intervention in the setting of prices, subsidies, and taxes, so long as a state does not engage in differential treatment in the same market in ways that burden interstate competition. Moreover, since the dormant commerce clause is not derived from the express language of the U.S. Constitution, Congress can override it by adopting a national policy that preempts, or overrides, the competitive market between individual states. *General Motors Corp. v. Tracy*, for example, seems to carve out a safe harbor for state regulation of natural gas distribution. Under the Commerce Clause, Congress has the express authority to establish an agency such as the Interstate Commerce Commission ("ICC"), giving it jurisdiction to regulate railroad rates previously left to individual

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79. Gen. Motors Corp. v. Tracy, 519 U.S. 278, 300 (1997).

80. *Id.* at 299-300 (quoting H.P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 539 (1949)).

81. *See* Julian N. Eule, *Laying the Dormant Commerce Clause to Rest*, 91 YALE L.J. 425, 428 (1982); Steven Gey, *The Political Economy of the Dormant Commerce Clause*, 17 N.Y.U. REV. L. & SOC. CHANGE 1, 4-5 (1989-90); McGreal, *supra* note 78, at 1222-23.

states. "Our Constitution," the late Julian Eule wrote, "did not attempt to solve economic parochialism by an express prohibition against interference with free trade. Instead, it shifted legislative power over economic matters that affect more than one state to a single national body."[82]

To take a more modern example than the now-defunct ICC railroad regulation regime, Congress has since created FERC, which has made a major policy choice to implement regional competitive wholesale power markets. Congress has the power to override FERC's decision to implement regional competitive wholesale markets, but no one has seriously proposed this. Alternatively, Congress might expand FERC's jurisdiction, taking some or all regulatory authority over retail markets away from state regulators. If it were to do so, by occupying the lawmaking field, Congress might preclude states from enacting some laws that discriminate against out-of-state suppliers in deregulated wholesale markets; again, however, Congress has not done so. Congress's inaction, however, does not mean that preemption plays no role in this context. Congress's acquiescence in FERC's competitive policies serves as the legal source for a type of federal preemption of individual states acting in ways that impair commerce between the states. Absent a change in federal policy, state efforts to curtail competition in wholesale electric power markets could be suspect under the dormant commerce clause to the extent they undermine the interstate markets created by FERC. While a federal preemption argument for interstate market norms is based on a positive legal source of congressional or federal agency enactments which preclude contrary state laws, the dormant commerce clause also arguably finds some source in the cooperative behavior between two or more states that have adopted a competitive norm of exchange in which Congress acquiesces.[83]

Many have suggested that the neoclassical account of the dormant commerce clause—as a legal source of free trade policies between the states—is flawed.[84] An alternative view understands the dormant commerce clause not as inherently protecting competition itself, let alone free markets, but as protecting a political process that makes markets possible. For instance, in *West Lynn Creamery, Inc. v. Healy*,[85] the Supreme Court struck down a Massachusetts tax and rebate scheme for milk, even where the tax

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82. Eule, *supra* note 81, at 430.

83. *See* Jim Chen, *A Vision Softly Creeping: Congressional Acquiescence and the Dormant Commerce Clause*, 88 MINN. L. REV. 1764 (2004).

84. *See* sources cited *supra* note 81.

85. 512 U.S. 186 (1994).

operated neutrally without regard to the milk's place of origin, but where tax revenues went into a subsidy fund and were distributed solely to Massachusetts milk producers.[86] In writing for the majority, Justice Stevens embraced a political process account of the dormant commerce clause, in which its role is seen as representative-enforcing in a manner similar to *Carolene Product*'s famous footnote four.[87] As Justice Stevens remarked in striking down the tax and subsidy regime in *West Lynn Creamery*:

> Nondiscriminatory measures, like the evenhanded tax at issue here, are generally upheld, in spite of any adverse effects on interstate commerce, in part because "[t]he existence of major in-state interests adversely affected . . . is a powerful safeguard against legislative abuse." However, when a nondiscriminatory tax is coupled with a subsidy to one of the groups hurt by the tax, a State's political processes can no longer be relied upon to prevent legislative abuse, because one of the in-state interests which would otherwise lobby against the tax has been mollified by the subsidy.[88]

Rather than inherently protecting competition and free markets, the purpose of the dormant commerce clause doctrine can be understood within the framework of Madisonian democracy as well as efficiency—specifically, limiting welfare reducing interest group rent seeking in the state regulatory process.[89]

Unlike the traditional public choice critique, which condemns all state and local rent seeking, the political process account of the dormant commerce clause targets only those rent seeking laws that restrain commerce pursuant to implicit or explicit contracts between other states. The state political process allows states, like the U.S. Congress, to adopt rent-seeking legislation in the form of regulation, subsidies, and taxes. However, an individual state cannot enact a law that undermines a desirable pro-commerce regime that has been put into place through the implicit or explicit cooperation of states, any more than it can undermine a pro-commerce regime adopted formally by Congress or a federal agency (under the preemption clause).

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86. *Id.* at 191-92.

87. United States v. Carolene Products Co., 304 U.S. 144, 152 n.4 (1938). John Hart Ely has applied the representation-reinforcing role of *Carolene Products* to equal protection jurisprudence. JOHN HART ELY, DEMOCRACY AND DISTRUST: A THEORY OF JUDICIAL REVIEW 75-88 (1980).

88. 512 U.S. at 200 (citing Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 473 n.17 (1981) (other internal citations omitted)).

89. For an elaboration of this view, see Maxwell L. Stearns, *A Beautiful Mend: A Game Theoretical Analysis of the Dormant Commerce Clause Doctrine*, 45 WM. & MARY L. REV. 1 (2003).

Some rent transfers are permissible, if not desirable, in state and local political processes. For example, rent seeking in the form of a neutral corporate tax exemption for utilities, or rent seeking in the setting of utility rates to favor industrial growth, is likely permissible, and subject only to the safeguards of the local political process. However, rent seeking in the form of exclusionary regulation that limits access to the interstate market is more suspect as an approach to regulating economic matters, especially where market exchange is the background norm as a matter of national policy. Florida's Supreme Court rejected a dormant commerce clause challenge to the use of the state's restrictive power plant siting statute to restrict the building of new plants by out-of-state suppliers,[90] but the inadequacy of a record establishing discrimination against out-of-state merchant suppliers may have impeded the development of this legal argument. At a minimum, dormant commerce clause jurisprudence would require states and localities to explain how regulatory actions and legislation restricting power supply in the wholesale market or transmission expansion might serve legitimate purposes, such as environmental or consumer protection.

More challenging is the constitutional status of state or locally franchised monopolies against the backdrop of dormant commerce jurisprudence. On the political process account, the town of Clarkstown, New York violated the dormant commerce clause by granting a monopoly that imposed a veiled tax on users of waste disposal outside of the locally sponsored facility, including out-of-state use. Its monopoly franchise was invalidated.[91] In *Carbone*, Justice Souter wrote a dissent, joined by Chief Justice Rehnquist and Justice Blackmun, arguing that the majority had ignored the distinction between private and public enterprise and that the flow control ordinance monopoly is easily distinguished from the "entrepreneurial favoritism" the Court had previously condemned as protectionist.[92] What distinguishes this monopoly from a constitutionally permissible monopoly? Or do local and state electric, natural gas, and telecommunications monopolies risk the same fate if they do not open their service territories and network facilities to competitors? The historical lack of a background norm of competition excuses many historical monopolies from the

90. Tampa Elec. Co. v. Garcia, 767 So. 2d 428, 436 (Fla. 2000).

91. C&A Carbone, Inc. v. Town of Clarkstown, 511 U.S. 383, 386 (1994).

92. *Id.* at 416 (Souter, J., dissenting). According to the dissent, "The Commerce Clause was not passed to save the citizens of Clarkstown from themselves." *Id.* at 432. Thus, the dissent rejects extending the political process account beyond scenarios that discriminate between local and out-of-town participants.

constitutional reach of the dormant commerce clause: if there is no interstate market, a state or locally imposed monopoly cannot discriminate against out-of-state commerce. With the development of interstate markets in telecommunications and electric power, however, more difficult questions emerge. Will any state or local monopoly raise commerce clause problems? For example, is it unconstitutional for a utility to impose a surcharge on all users of its distribution service, regardless of whether they purchase their power from local or out-of-state suppliers?

If a municipality, such as the town of Clarkstown, operates a government-owned monopoly over telecommunications or electric distribution service, the market participant exception to the dormant commerce clause shields its conduct from the reach of the commerce clause. Franchised private utilities—such as investor-owned utilities—pose a potential problem but are not necessarily unconstitutional, even under the political process account of the dormant commerce clause. The political process account, however, warns state and local governments to approach the financing of such operations with care. In the *Carbone* case, the town of Clarkstown promised to make up losses from operating the transfer facility at competitive rates, presumably by taking these losses out of its general revenues.[93] What the dormant commerce clause seems to prohibit is a local government explicitly indemnifying a private monopoly out of the public fisc, even where it imposes the same monopoly and fees on both in- and out-of-state providers of service. The Takings Clause does not require governments to take on such obligations, but the dormant commerce clause may prohibit them if they are the result of rent seeking that imposes burdens on the interstate market. Further, as in *Carbone*, authorizing above-market fees solely for purposes of maintaining the monopoly may be constitutionally suspect. As we move from local to state monopoly franchises, concerns with a single firm capturing the political process are weaker—a single firm that dominates municipal politics may have little power in state-wide regulatory and political processes. Thus, state-franchised monopolies may be more likely to pass constitutional muster, but even neutral financing arrangements may be suspect if they favor local enterprise and have the "practical effect and design" of impeding out-of-state competitors.

As an example, consider recent state moratoria on the siting of new electric power generation and transmission facilities. The Florida example, mentioned above, concerned power generation, but electric power transmission line siting poses a much greater problem

93. *Id.* at 387.

for deregulated markets, as it threatens to limit access to essential network facilities. A recent example of how state and local siting of transmission may interfere with deregulated wholesale power markets involves the Cross-Sound transmission project. Regulatory officials in the state of Connecticut have strongly opposed the Cross-Sound Cable, a twenty-three-mile merchant transmission line that would allow Long Island Power Authority ("LIPA") to import power to Brookhaven, Long Island from New Haven, Connecticut, causing significant delays in the operation of the project. The project was built in 2002, following FERC's approval of retail sales at negotiated transmission rates[94] and permit approvals by the Army Corp of Engineers, the New York Public Service Commission, the Connecticut Siting Council, and the Connecticut Department of Environmental Protection.[95] It complied with all state siting and environmental statutes, except for a provision of its state-issued permit which required its lines to be buried at a certain depth.[96] Expansion of transmission access to locations such as New York City would provide important capacity, and may have helped in absorbing some of the transmission shortages that exacerbated the Summer 2003 blackout.[97]

In burying the transmission line, the project sponsor encountered some problems. It discovered hard sediments and bedrock protrusions along portions of the route, and immediately notified the Army Corps and the Connecticut Department of Environmental Protection.[98] Some Connecticut officials cited environmental concerns in support of their opposition to the project, such as impacts on shellfish beds and dredging operations into the New Haven Harbor. The transmission line was built, however, and according to the project's CEO the line was "buried to the permit depth along 98 percent of the entire span, and over 90% of the route within the Federal Channel to an average of 50.7 feet below mean lower low water, well below the required level of minus 48 feet."[99]

Nevertheless, Connecticut's officials' opposition kept the

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94. TransEnergie U.S., Ltd., 91 F.E.R.C. ¶ 61,230 (2000).

95. *See Regional Energy Reliability & Security: DOE Authority to Energize the Cross Sound Cable: Hearing Before the House Subcomm. on Energy & Air Quality of the Comm. on Energy & Commerce*, 108th Cong. 56 (2004) [hereinafter *Regional Energy*] (statement of Jeffrey A. Donahue, Chairman & CEO, Cross-Sound Cable Co., LLC).

96. *Id.*

97. The technical advantage to operating two transmission lines between Connecticut and Long Island, as opposed to one, is that this would allow electric power to travel in a semi-circular loop—in and out of Long Island, depending on load. *Id.* at 56-57.

98. *Id.* at 56.

99. *Id.*

transmission line from becoming operational until 2004.[100] This may be a well-intentioned dispute over environmental regulation, but the line was not only opposed by environmental interests in the state of Connecticut. As often is the case with blocking a new entrant to a state's power industry, there was also an anticompetitive angle to opposition to the Cross-Sound line. Northeast Utilities, a major investor-owned utility whose customers reside primarily in Connecticut (and which also services customers in Massachusetts and New Hampshire), owns an older, competing transmission line (the 1385 cable) that runs parallel to the Cross-Sound Cable and supports updating its line over approving the Cross-Sound line, with which it would compete, and has requested FERC to use its authority under section 210 of the FPA to order New York to assist in replacing the 1385 cable.[101]

After the Cross-Sound transmission line was built, Connecticut passed a moratorium on the siting of new or expanded transmission lines across Long Island Sound,[102] effectively limiting the ability of the project's sponsors to make the project comply with Connecticut's understanding of the permits. The Cross-Sound cable was authorized to operate under an emergency order issued by the U.S. Secretary of Energy following the August 2003 blackout, but that order was lifted in early 2004, leaving the Cross-Sound line without permission to go live.[103] So effectively, the Cross-Sound cable was completed in 2002 but remained dormant as a permanent transmission alternative until Summer 2004 due to a regulatory impasse between the state of Connecticut, on the one hand, and Cross-Sound's investors and the state of New York, on the other.

As FERC Chairman Pat Wood indicated before Congress in May 2004, federal regulation seems ill-quipped to resolve the issue.[104] In the context of the 1385 line dispute, LIPA requested that FERC use its authority under the Federal Power Act to direct Cross-Sound to recommence commercial operation of the line, notwithstanding the objections of state regulators. However, although FERC has

100. *Conn. Governor Signs Moratorium on Grid Projects, Keeping Cross Sound in Limbo*, POWER MARKETS WK., June 30, 2003, at 31.

101. *Cross-Sound Cable Project Reenergized After Parties Reach Settlement*, FOSTER ELECTRIC REP., June 30, 2004, at 7.

102. *Conn. Governor Signs Moratorium on Grid Projects, Keeping Cross Sound in Limbo*, POWER MARKETS WK., June 30, 2003, at 31.

103. *Regional Energy*, *supra* note 95, at 40-41 (Statement of Hon. Patrick Wood, III, Chairman, FERC). Under Section 202(c) of the FPA, the U.S. Secretary of Energy can mandate operation of a transmission line over objections of state regulators, but only in the context of an emergency—not where it is merely found to be in the public interest. 16 U.S.C. § 824a(c) (2000).

104. *Regional Energy*, *supra* note 95, at 39 (statement of Hon. Patrick Wood, III, Chairman, FERC).

embraced wholesale deregulation, FERC does not have the authority to preempt the state environmental siting process over the transmission line. Connecticut's Attorney General, backed by environmental interest groups and Northeast Utilities, has threatened litigation if the Cross-Sound line is allowed to go live again, instead favoring expansion of the existing transmission line owned by Northeast Utilities.[105]

To the extent transmission remains entirely within the control of local, rather than national, regulators, states have strong incentives to protect their own incumbent firms or citizens, rather than support interstate cooperative market norms. Only when FERC threatened to approve expansion of the 1385 cable was FERC able to force the parties to the bargaining table.[106] FERC could not preempt the states and mandate operation of the Cross-Sound transmission line, but the threat of FERC making a decision elsewhere led stakeholders to negotiate a settlement, allowing the line to operate.[107]

The Cross-Sound transmission line is not a unique example of state or local regulation blocking the expansion of infrastructure that is critical to interstate power markets. As Ashley Brown and Damon Daniels report, transmission expansion projects spawn massive NIMBY (not in my backyard) concerns, frequently generating state and local opposition.[108] To make matters worse, many state legislatures fail to authorize state siting boards to even take into account interstate concerns. Twenty-two states even authorize localities to block transmission expansion projects. The Cross-Sound transmission line illustrates the tension between state siting laws (often used for environmental purposes) and deregulation of the wholesale power market. FERC's statutory jurisdiction over the matter is admittedly limited, since FERC cannot preempt state siting laws.

However, to the extent FERC has deregulated wholesale power, such disputes raise potential issues of great concern under the dormant commerce clause. While the state of Connecticut certainly

105. Bruce W. Radford, *Cross-Sound Cable Puts Feds on the Spot*, FORT.'S SPARK, June 2004, at 1.

106. *Parties Set Deal to Energize Cross Sound Cable*, INSIDE F.E.R.C., June 28, 2004, at 1.

107. Bruce Lambert, *New York and Connecticut Agree to End Cable Dispute*, N.Y. TIMES, June 25, 2004, at B6. Interestingly, the most vocal opponent of the transmission line, Connecticut Attorney General Richard Blumenthal, was excluded from the negotiations. Michele Jacklin, Editorial, *They Can Bury the Cable, but Not the Controversy*, HARTFORD COURANT, July 7, 2004, at A9.

108. Ashley C. Brown & Damon Daniels, *Vision Without Site: Site Without Vision*, ELECTRICITY J., Oct. 2003, at 25.

may impose legitimate environmental restrictions on permits, its moratorium raises serious anticompetitive concerns—particularly where it is used to keep a project that has already been built from becoming operational. The dormant commerce clause will be a likely tool for challenging such restrictions, especially where, as in Connecticut, competitors stand to benefit from the restriction. State and local environmental regulation can survive such dormant commerce clause challenges. However, refusing siting based on state-based claims of need, or where in-state competitors are aligned with environmental interests, will increasingly raise concerns under the dormant commerce clause. In such a context, deference to state regulators will impede interstate commerce, harming social welfare. While such deference may not have mattered under cost-of-service regulation due to the limited nature of interstate power markets, with deregulation courts thus have an important role to play in reviewing such challenges to state and local regulation.

B. *The Deference Trap of State Action Immunity in Deregulated Markets*

In contrast to the dormant commerce clause—an affirmative restriction on state power to act derived from the constitution—state action immunity is a defense to enforcement of the antitrust statutes.[109] To the extent the state action defense provides private firms immunity from antitrust liability, it encourages the formation of state monopolies, or monopolistic conduct, where states intend to take private conduct outside of the pale of antitrust enforcement. This judicially created antitrust defense originated when the Supreme Court rejected a Sherman Act challenge to a California marketing program brought by a grower because the program derived "its authority and its efficacy from the legislative command of the state."[110] Such immunity serves the federalism purpose of facilitating participation in the state regulatory process,[111] which lends legitimacy to the development of regulation.[112]

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109. *See supra* notes 53-58 and accompanying text.

110. Parker v. Brown, 317 U.S. 341, 350 (1943).

111. *See* Robert P. Inman & Daniel L. Rubinfeld, *Making Sense of the Antitrust State-Action Doctrine: Balancing Political Participation and Economic Efficiency in Regulatory Federalism*, 75 TEX. L. REV. 1203, 1271 (1997).

112. The state action doctrine also may serve a judicial avoidance purpose, providing federal courts a way of disposing of complex and technical issues, especially in ways that have a binding impact on state law. Other legal doctrines, such as abstention (which advises federal courts to abstain from exercising jurisdiction out of comity), adequately protect the precedent-creating risk of federal court review of state regulation. *See* 16 AM. JUR. 2D *Constitutional Law* § 122 (1998). Abstention can be invoked where a federal

In applying state action immunity, the Supreme Court has adopted a two-part test to determine which state regulations are exempt from antitrust enforcement: "First, the challenged restraint must be 'one clearly articulated and affirmatively expressed as state policy'; second, the policy must be 'actively supervised' by the State itself."[113] This test seems simple enough. Only if a state law expressly envisions monopolistic conduct and if the state actively supervises such conduct, will the conduct escape antitrust enforcement. In application, though, courts have struggled in applying state action immunity, often because within a state different bodies take on the regulatory role and because the nature of regulation varies so much from industry to industry.

State action immunity's application to local governments, such as municipal bodies (as opposed to states) is one of the questions that has presented the most difficult challenges for courts.[114] Local government lawmaking presents an opportunity for extension of the political process insights of dormant commerce clause jurisprudence to the state action context. The Supreme Court has read state action immunity narrowly in the context of municipal (as opposed to state) regulation. *Community Communications Co. v. City of Boulder*,[115] for example, subjected municipal governments to antitrust enforcement for monopolistic conduct. Speaking for the majority, Justice Brennan distinguished between states regulating as states—which are entitled to the state action defense under a federalism rationale—and states regulating as political

court is making a decision that has a binding effect on state law. By contrast, in antitrust litigation courts are not normally passing judgment on the merits of state regulation but are focused on the merits of private conduct under federal law.

113. Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 105 (1980) (quoting City of Lafayette v. La. Power & Light Co., 435 U.S. 389, 410 (1978) (Brennan, J., plurality opinion)).

114. Commentary on the applicability of state action immunity to local governments has been robust. *See, e.g.*, John Cirace, *An Economic Analysis of the "State-Municipal Action" Antitrust Cases*, 61 TEX. L. REV. 481 (1982); Frank H. Easterbrook, *Antitrust and the Economics of Federalism*, 26 J. LAW & ECON. 23 (1983); Daniel J. Gifford, *The Antitrust State-Action Doctrine After* Fisher v. Berkeley, 39 VAND. L. REV. 1257 (1986); Herbert Hovenkamp & John A. Mackerron III, *Municipal Regulation and Federal Antitrust Policy*, 32 UCLA L. REV. 719 (1985); John E. Lopatka, *State Action and Municipal Antitrust Immunity: An Economic Approach*, 53 FORDHAM L. REV. 23 (1984); Glen O. Robinson, *The Sherman Act as a Home Rule Charter*: Community Communications Co. v. City of Boulder, 2 S. CT. ECON. REV. 131 (1983); C. Paul Rogers III, *Municipal Antitrust Liability in a Federalist System*, 1980 ARIZ. ST. L. REV. 305.

115. 455 U.S. 40 (1982).

subdivisions—which are exempt from antitrust enforcement only insofar as they are implementing state policy but not when they are acting as municipal governments only.[116] The City of Boulder's moratorium on cable television expansion was thus subject to antitrust challenge because Colorado, at the state level, had not clearly expressed a policy to regulate cable television; in fact, Justice Brennan thought it apparent that Colorado had no state-wide policy at all—that there was a gap in state regulation.[117]

This rationale for narrowing the availability of the state action defense for municipal governments is striking in its similarity to the political process account of dormant commerce jurisprudence. Like the municipally franchised monopoly in *Carbone*, which the Court believed to impair external market competition, the City of Boulder's moratorium on cable effectuates a tax on its citizens that goes too far. This impairs internal market competition, and possibly external competition as well. As such, a certain coherence, if not convergence, exists between these two independent doctrines. To the extent both doctrines respond to incompleteness in regulatory law and emphasize the incentives private firms face in bargaining with state and local governments in the lawmaking process, a narrow reading of state action immunity to antitrust enforcement against private firms is justified in the municipal context, for the very same reasons that the political process account of the dormant commerce clause makes sense.[118]

More recent cases, however, depart from the municipal-state distinction in antitrust immunity that Justice Brennan laid down in the context of cable television regulation. In *Town of Hallie v. City of Eau Claire*,[119] the Court abandoned the clear articulation requirement in assessing municipal state action immunity.[120] Instead, Justice Powell reasoned in his majority opinion that as long as a state confers permissive authority in general terms for a municipality to deal with a matter in the municipal government's discretion, this is sufficient to exclude the conduct from antitrust

116. *Id.* at 54.

117. *Id.* at 55.

118. Reacting to the prospect of liability created by the *City of Boulder* case, Congress abolished money damage liability under the antitrust laws for municipalities, their officials, and private persons acting under the direction of local governments and their officials in the Local Government Antitrust Act of 1984. *See* H.R. REP. NO. 98-965, at 2, 18-19 (1984), *reprinted in* 1984 U.S.C.C.A.N. 4602, 4603, 4620-22. Congress continued, however, to authorize antitrust liability for private conduct that is sanctioned or authorized by municipal governments.

119. 471 U.S. 34 (1985).

120. *Id.* at 43.

enforcement.[121] Thus, when the state of Wisconsin granted municipalities the authority to establish sewage treatment plants, this impliedly granted municipal governments the power to make decisions about who would be served. Justice Powell recognized that municipalities may exercise "purely parochial public interests," which, at some level, could be subject to antitrust enforcement;[122] however, in his view, a state delegation to a municipal government alone is sufficient to meet the "clearly expressed and fully articulated" criterion of the state action immunity test, thus exempting from antitrust enforcement a large range of municipal regulation.[123]

In addition, state action immunity requires courts to determine how active and involved a regulatory scheme must be for purposes of deeming it "active supervision." In the *Eau Claire* case, however, the Supreme Court effectively abandoned the requirement of state supervision, at least insofar as it applies to municipalities.[124] In so holding, the Court explained that the purpose of the state supervision is to ensure that regulatory policies are pursued for public purposes and not to enrich private actors. According to the Court, "[w]here a private party is engaging in the anticompetitive activity, there is a real danger that he is acting to further his own interests, rather than the governmental interests of the State."[125] But, where a state has clearly authorized a municipality to act, the Court reasoned that there is no such problem. Instead, the "only real danger is that it will seek to further purely parochial public interests at the expense of more overriding state goals."[126] Thus, where it is clear that some clear state authorization exists, the Court held that there is no need for the state to actively supervise the municipality's regulation of the private activity.

Courts following this approach need only identify a clear legislative purpose, but beyond this they engage in judicial restraint, deferring to state monopoly regulation under the antitrust laws. While deference has its appeal in a complex regulatory environment, the Court's relaxation of a state supervision requirement for municipalities is counterintuitive. The premise that municipal regulation is not likely to be captured by private interests at the expense of the public good ignores the high risk of interest group capture at the local level, where the incentives for ex

121. *Id.* at 42-44.
122. *Id.* at 47.
123. *Id.*
124. *Id.* at 46-47.
125. *Id.* at 47.
126. *Id.*

ante lobbying of the regulator are perhaps strongest. At the local level, the costs to firms of organizing and lobbying regulators are much lower than at the state level. Although the Court seems to embrace a federalism-based formalism as a rationale for deference to municipal regulation, this account of federalism proves too much. It can result in state delegation to municipal governments with no strings attached, insulating private behavior at the local level from almost all antitrust enforcement. Further, it places focus on the mere formalistic existence of state goals without addressing their purpose. States, as well as municipal governments, sometimes regulate in ways that allow private interests to place their own economic well being ahead of the public good. Allowing the law to insulate such private conduct from antitrust scrutiny may have serious consequences in deregulated markets.

The Court's state action immunity cases in the context of municipal regulation seem to view the clear articulation and active supervision requirements as one and the same. In a more recent case on the topic, however, the Court made it clear that the active supervision requirement is alive and well as an independent criterion where what is at issue is the conduct of state, as opposed to municipal, regulators. In *FTC v. Ticor Title Insurance Co.*,[127] the Court addressed the application of state action immunity to the rate-setting activities of title insurance companies in several states.[128] Most of the states regulating the title insurance defendants permitted private insurers to jointly file rates, which state officials could review or allow to remain in effect.[129] The record of the case suggested that no significant review of the rates actually took place by these states.[130] The FTC had conceded that the state statutes authorizing the acceptance of jointly filed rates met the clear articulation requirement,[131] but the Court found the agency's review did not constitute active supervision and thus failed the second step of *Midcal*.[132] Hence, the allegedly anticompetitive acts of the insurers could be challenged.

Since it plays a gate keeping function for antitrust enforcement,

127. 504 U.S. 621 (1992).

128. *Id.* at 624-25.

129. *Id.* at 629.

130. *Id.* In Wisconsin, for example, no rate hearings had occurred. *Id.* at 630.

131. *Id.* at 631. Below, the Third Circuit, following a previous decision of the First Circuit, held that the existence of a funded and authorized state program met the active supervision requirement. Ticor Title Ins. Co. v. FTC, 922 F.2d 1122, 1137 (3d Cir. 1991) (citing New England Motor Rate Bureau, Inc. v. FTC, 908 F.2d 1064, 1071 (1st Cir. 1990)), *rev'd*, 504 U.S. 621 (1992).

132. *Ticor*, 504 U.S. at 640; *see supra* note 47 and accompanying text.

state action immunity will increasingly play an important role as formerly regulated firms are deregulated.[133] Yet, the gates largely remain closed, allowing private firms to escape antitrust scrutiny. Despite *Ticor's* signal that active supervision is alive and well, lower courts generally continue to take a deferential approach to state action immunity. Even where what is at issue is state, not local, regulation, and even where competitive markets for service are emerging, lower courts are not inclined to allow the Sherman Act to apply to private conduct in formerly regulated industries where there is some state regulatory scheme, however incomplete it may be.

Illustrative of this deferential and narrowing approach to judicial review, courts have consistently provided for broad antitrust immunity for electric utilities, despite the introduction of competition to certain segments of the industry. For example, the Tenth Circuit extended antitrust immunity to Oklahoma Gas and Electric Company's ("OG&E") conduct based on evidence that the state regulatory agency had "general supervision" authority over the utility, "including the power to fix all of OG&E's rates for electricity and to promulgate all the rules and regulations that affect OG&E's services, operation, and management."[134] The power to engage in review alone was deemed sufficient for meeting the active supervision requirement. While the Tenth Circuit cited a previous case, which "found that the use of similar authority over an electric utility satisfied the active supervision requirement"[135] as a basis for this conclusion, it made no effort whatsoever to discern evidence of the affirmative use of such authority by the regulator with respect to the utility whose conduct was at issue.

The Eighth Circuit has taken a similarly deferential approach to state action. North Star Steel, a customer located within the exclusive service territory of MidAmerican Energy Co., an electric utility in Iowa, sought to purchase competitively priced electricity and requested that MidAmerican wheel power to it.[136] MidAmerican refused, and North Star sued, alleging that the utility violated the antitrust laws by refusing to allow access to its transmission lines.[137]

133. *See*, Jeffery D. Schwartz, Comment, *The Use of the Antitrust State Action Doctrine in the Deregulated Electric Utility Industry*, 48 AM. U. L. REV. 1449 (1999).

134. Trigen-Oklahoma City Energy Corp. v. Okla. Gas & Elec. Co., 244 F.3d 1220, 1226 (10th Cir. 2001).

135. *Id.* (citing Lease Lights, Inc. v. Public Service Co. of Okla., 849 F.2d 1330, 1334 (10th Cir. 1988)).

136. North Star Steel Co. v. MidAmerican Energy Holdings Co., 184 F.3d 732, 734 (8th Cir. 1999).

137. *Id.*

The court found that active supervision of the utility's conduct existed due to the fact that, by statute in Iowa, new customers were assigned to exclusive service providers and that the regulator had determined which provider should "occupy" the area in the event there was a conflict over which provider was in control of a given area.[138] The court found that Iowa's legislation "affirmatively expressed" a policy of displacing competition in the market for retail electric service.[139] The court refused, however, to explore the substantive basis for the agency's regulatory determinations in defining exclusive service territories. For instance, even though the state had experimented with limited "pilot" retail wheeling programs, the court did not evaluate whether the state agency's efforts to promote competition in power supply might coexist with maintaining exclusive service territories over transmission and distribution, effectively deferring to state regulators on all of these issues. In fact, the only regulatory action that was discussed by the court related to the definition of distribution service territories,[140] not the allocation of power supply or generation. The court also reasoned that "less pervasive regulatory regimes have been held to satisfy the active supervision prong."[141]

One of these "less pervasive" regulatory regimes is state prohibition of certain types of pro-competitive conduct. For example, according to Florida's regulators and courts, Florida has adopted a statutory prohibition on retail electric competition, outside of self-wheeling arrangements. Although Florida does not have a clear legislative statement regarding the issue, Florida's Public Service Commission ("PSC") prohibited retail wheeling to provide access to competitive power supply outside of "self-wheeling" arrangements (for example, a supplier transmitting power over the utility's lines for the supplier's own use).[142] The Florida Supreme Court held that cogenerators were not authorized under Florida law to sell their power in the retail market.[143] Accepting both the regulation and the Florida Supreme Court's characterization of Florida law, the Eleventh Circuit applied state action immunity to preclude an antitrust action by a cogeneration facility against a

138. *Id.* at 738-39.

139. *Id.* at 738. Given a previous ruling by the Iowa Supreme Court, the Eighth Circuit assumed for collateral estoppel purposes that "under Iowa law the exclusive service territory provisions include the generation of electricity for retail sales." *Id.* at 737-38.

140. *Id.* at 739.

141. *Id.*

142. FLA. ADMIN. CODE ANN. r. 25-17.0882 (1985).

143. PW Ventures, Inc. v. Nichols, 533 So. 2d 281 (Fla. 1988).

utility which refused to wheel power at a competitive rate.[144] The court reasoned that "the doors to the PSC were open to all with standing to complain,"[145] but nowhere did the court identify how a cogenerator might raise such issues before the Florida PSC. Apparently, it could not, other than by challenging the agency rule authorizing the anticompetitive conduct. One way of understanding the claim raised before the Eleventh Circuit was as a collateral attack on the agency rule based on a substantive violation of federal antitrust law. The Eleventh Circuit opinion seems to suggest that the existence of an agency rule authorizing anticompetitive conduct is enough to trigger active supervision. If this holds, however, not only can the actions of a state legislature insulate private conduct from antitrust liability, a unilaterally adopted agency rule can also excuse private conduct from antitrust enforcement, even if this rule prohibits pro-competitive conduct with little or no agency oversight.

Such a deferential approach to gatekeeping in antitrust enforcement can have some serious implications for the enforcement of antitrust laws in deregulated markets. In California's deregulated electric power market, for instance, wholesale power suppliers possessing market power have allegedly engaged in tacit collusion to withhold supply and thus artificially inflate their prices.[146] FERC may have made its own determinations that individual firms lacked market power and approved market-based tariffs. State agencies as well approved the sale of power by these suppliers through the state-sanctioned market exchange. To the extent that the behavior of these firms raises a plausible section 1 (or even a section 2) claim under the Sherman Act, the mere existence of a state sanctioned and supervised market should not give rise to state action immunity. Courts need to devise a more principled way of assessing their gatekeeping function in such contexts.

C. *Rethinking Judicial Deference in State Action Immunity*

Since *Eau Claire*, the Supreme Court and lower courts have abandoned the political process-informed municipal-state distinction in assessing state action immunity from antitrust enforcement. In place of this perspective, courts serving as gatekeepers for antitrust challenges to private conduct have adopted a highly deferential stance to applying state action immunity. With a state-regulated

144. TEC Congeneration, Inc. v. Fla. Power & Light Co., 76 F.3d 1560, 1567-70 (11th Cir. 1996).

145. *Id.* at 1570.

146. Robert B. Martin, III, *Sherman Shorts Out: The Dimming of Antitrust Enforcement in the California Electricity Crisis*, 55 HAST. L.J. 271 (2003).

activity, courts reviewing private conduct under complex regulatory schemes are increasingly likely to imply a regulatory policy, even absent clear articulation of regulatory purpose by the state. The active supervision prong of the doctrine is often judicially implied as well. Courts generally do not evaluate the degree of scrutiny provided by state or local regulators, let alone whether the purpose of the supervision overlaps with the pro-competitive goals of the Sherman Act. The result is a serious lapse of judicial gatekeeping in the consideration of antitrust challenges to private conduct in formerly regulated industries.

Judge Merrick Garland has been one of the strongest defenders of this deferential approach to considering the relevance of state regulation.[147] He argues that there is no principled basis for distinguishing between municipalities and states for federal antitrust law purposes. Put simply, his view is that state and local legislation should not be assessed by the federal courts for their efficiency effects in antitrust cases. Just as advocates of deregulatory takings try to reinvigorate *Lochner v. New York* in determining government liability for regulatory transitions, Garland sees relaxed state action immunity as invoking a *Lochner*-type review of regulation.

Not every scholar agrees with the deference approach to state action immunity defended by Judge Garland. Responding to *Eau Claire*, John Shepard Wiley proposes that courts directly address the efficiency, and in particular the public choice, implications of state and local legislation in deciding whether to invoke state action immunity.[148] According to Wiley, if anticompetitive legislation is inefficient and the result of producer-interest lobbying, state action immunity should not protect it from invalidation under the Sherman Act.[149] In similar spirit, Matthew Spitzer argues that federal courts should invalidate state or local legislation if it is inefficient or if it transfers wealth from consumers to producers.[150] John Cirace also argues that courts should employ an efficiency test to assess the validity of state and local legislation under the Sherman Act.[151]

Defenders of deference have responded by arguing that, in effect, reviewing state and local laws for efficiency and public choice

147. *See* Merrick B. Garland, *Antitrust and State Action: Economic Efficiency and the Political Process*, 96 YALE L.J. 486 (1987).

148. John Shepard Wiley, Jr., *A Capture Theory of Antitrust Federalism*, 99 HARV. L. REV. 713 (1986).

149. *Id.* at 788-89.

150. Matthew L. Spitzer, *Antitrust Federalism and Rational Choice Political Economy: A Critique of Capture Theory*, 61 S. CAL. L. REV. 1293, 1326 (1988).

151. Cirace, *supra* note 114, at 514-15.

implications is tantamount to federal courts returning to *Lochner*-like review, encroaching on the states' ability to engage in economic regulation. Judge Garland, for example, favors exempting from judicial review under the Sherman Act all regulatory actions by state and local governments except for delegations of the power to restrain the market to private parties.[152] But if judicial review of private conduct is approached with care, a deferential stance to antitrust immunity would certainly not be necessary to limit the scope of judicial review. As Daniel Gifford has argued, federal courts have the capacity to review state and local legislation without directly addressing their substantive efficiency effects.[153] Gifford would have courts apply the same "free market" approach in the state action immunity context that they apply under the dormant commerce clause. State action immunity would protect the internal market from trade restraints, while the dormant commerce clause would extend to the external market.

State action immunity from antitrust enforcement serves purposes similar to those the political process account of the dormant commerce clause embraces, but, apart from Gifford, courts and commentators have only explicitly recognized the connection on rare occasions.[154] For example, although they do not discuss the similarities between the doctrines, Inman and Rubinfeld argue that state action immunity should only be invoked where regulation imposes substantial spillover costs on out-of-state interests.[155] State action immunity should not free all private monopolies from antitrust enforcement but only those which are actively supervised by the state for purposes of limiting the harms that flow from unregulated monopoly. State supervision is not inherently anti-commerce, but it recognizes the necessity of regulation to correct for market failures. On this understanding, for state action immunity to make sense in its application, enforcement of pro-commerce norms is necessary where the federalism-based value of participation comes into conflict with efficiency, as may occur if state regulation creates spillover costs.

Here, state action immunity might take a lesson from its cousin, dormant commerce clause jurisprudence. Specifically, in markets with competitive background norms, courts must have a relatively

152. Garland, *supra* note 147, at 506-07.

153. *See* Daniel J. Gifford, *Federalism, Efficiency, the Commerce Clause, and the Sherman Act: Why We Should Follow a Consistent Free-Market Policy*, 44 EMORY L.J. 1227, 1228-29 (1995).

154. One of those rare occasions is *Parker v. Brown*, which raised both dormant commerce clause and antitrust challenges to the California raisin marketing program. 317 U.S. 341, 344 (1943).

155. Inman & Rubinfeld, *supra* note 111, at 1271-99.

high doctrinal threshold for invoking a gatekeeping function, as they do in determining when state action immunity precludes antitrust enforcement. Recent cases involving utility restructuring illustrate the problem of the low threshold many lower courts currently embrace. Especially in a process of restructuring or deregulation—which gives birth to the norms of competition—private firms face strong incentives to use the regulatory process to enact partial regulatory schemes for purposes of establishing immunity from the antitrust laws. As states have begun to deregulate industries such as telecommunications and electric power, the nature of state regulation has changed. Rather than regulating utilities through rate and traditional certificate-of-necessity proceedings, increasingly, regulators are laying down general structural rules or approving structural rather than pricing tariffs. As one Department of Justice lawyer recognized: "If a state opens its retail market to competition, then the state action doctrine would not apply to conduct that relates directly to retail competition."[156] The reality is not always so simple, as states frequently endorse competition in some, but not all, aspects of formerly regulated industries, such as electric power and telecommunications. How involved must regulatory oversight be in order to extend state action immunity?

A bargaining framework to lawmaking in this context is consistent with the overall goal of protecting markets in both the internal and external contexts. But it advises a different emphasis for state action immunity than do previous efforts, such as Gifford's, to read dormant commerce clause jurisprudence and state action immunity in ways consistent with free market principles.[157] Understanding state and local legislation as based in bargains focuses on the negotiation process that leads to lawmaking rather than on unregulated markets themselves. Between states, bargaining frequently fails and may be costly to achieve, given the Compact Clause. Within a state, as in other lawmaking processes, private interest groups frequently face incentives to lobby lawmakers to secure benefits and may prefer open-ended regulatory schemes, which leave details to be worked out by an agency on a firm-by-firm basis. The more local the lawmaking process, the less costly it is for such interest groups to organize and influence the process. At the local level, this capture may be more visible, but it also may be more stable, given the ability to capture the political as

156. Joseph F. Schuler, Jr., *State Action Doctrine Losing Relevance, Department of Justice Attorney Says*, PUB. UTIL. FORT., May 15, 1999, at 70 (quoting Milton A. Marquis, attorney with the U.S. Department of Justice, Antitrust Division).

157. *See supra* note 153 and accompanying text.

well as the regulatory process. Thus, if courts were to focus on the quality of the political process leading to enactment of a market restraint, the municipal-state distinction would make sense—it would require courts to apply more scrutiny to local, as opposed to state, regulations in restraint of trade. Instead of simply being seen as protecting markets per se, state action immunity, like the dormant commerce clause, can be understood as reinforcing representation. The main difference is that, in the Sherman Act context, Congress has already declared that the overriding purpose is to promote competition, so the primary source of the competitive norm is legislation, not cooperation between the states.

This understanding also has implications for the approach courts should take in applying state action immunity to lawmaking at the state level. As Frank Easterbook has suggested, legal presumptions can play an important role in antitrust law, particularly where they serve as filters for judicial consideration of antitrust claims.[158] If approached as a type of default rule for guiding judicial intervention, such presumptions can set incentives in the bargaining process of state law making.

First, as to the clear purpose requirement, some have argued that courts should interpret this as a type of clear statement rule designed to promote more democratic decision making at the state level. State action immunity, implied from the Sherman Act, affords immunity for the purpose of promoting federalism. Thus, it is valued because of the democratic legitimacy it affords, not because state decisions in and of themselves are sacrosanct. Clear statement rules skew decision making towards the political process.[159] If the state legislature adopts a clear statement, or expressly articulates policy to regulate in restraint of trade, courts will decline to interfere under the first prong of the *Midcal* test. Otherwise the legislature will play an important role in deciding whether courts review the action. As William Page has argued in some of the leading articles on state action immunity, such a clear statement heightens the visibility of legislation by encouraging participants in the political process to acquire information about and debate policies.[160] Absent such a statement, private conduct that is

158. Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 9 (1984).

159. William N. Eskridge, Jr. & Philip P. Frickey, *Quasi-Constitutional Law: Clear Statement Rules as Constitutional Lawmaking*, 45 VAND. L. REV. 593, 597 (1992).

160. William H. Page, *Antitrust, Federalism, and the Regulatory Process: A Reconstruction and Critique of the State Action Exemption After* Midcal Aluminum, 61 B.U. L. REV. 1099, 1123-24 (1981); William H. Page, *Interest Groups, Antitrust, and State Regulation:* Parker v. Brown *in the Economic*

consistent with or authorized by broad delegations to municipal governments or regulatory agencies would be subject to review under the Sherman Act.

Dillon's rule, a canon that only broadly applied in state courts to invalidate broad state delegations to municipalities (most states have moved away from this with the growth of "home rule"), may serve the same overall goal of providing a higher level of supervision for municipal lawmaking.[161] The effect of the clear articulation requirement, however, is not to create a federally enforced version of Dillon's rule. Dillon's rule invalidates delegations to municipalities absent express consideration by the state legislature.[162] In contrast to Dillon's rule, which automatically invalidates the delegation, the clear articulation requirement subjects the delegation to scrutiny under the Sherman Act, but still allows it to stand if it does not unlawfully restrain trade or is not otherwise anticompetitive.

Yet, traditional clear statement rules are limited by the fact that they assume that a legislature itself speaks with a single purpose and voice. As Kenneth Shepsle and many others before and after him have put it, a legislature is a "they," not an "it."[163] A clear statement rule is a hermeneutic effort to get at legislative intent—to pay fidelity to past preferences, which are judicially constructed as a fiction—but a legislature will rarely have a clear intent on an issue of complex economic regulation. Courts may abuse clear statement rules by using them as backdoor ways to impose a constitutional design, allowing "judicial modesty [to cloak] judicial activism."[164] Moreover, a clear statement rule assumes that the major problem is the legislature, not the interest groups that interact with it. In contrast, a different type of interpretive canon—a default rule—could be a better way of conceptualizing the clear articulation requirement. Einer Elhauge has recently argued for a "penalty default rule" in judicial interpretation of statutes: Where a court interpreting a statute is unsure of Congress's intent, the court adopts the interpretation of the statute that is most unfavorable to the interest group which is most capable of persuading Congress to reverse the interpretation.[165] Much like penalty default rules in

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Theory of Legislation, 1987 DUKE L.J. 618, 619.

161. Clayton P. Gillette, *In Partial Praise of Dillon's Rule, or, Can Public Choice Theory Justify Local Government Law?*, 67 CHI.-KENT L. REV. 959, 960-61 (1991).

162. *See* Merriam v. Moody's Executors, 25 Iowa 163, 170 (1868).

163. Kenneth A. Shepsle, *Congress Is a "They," Not an "It": Legislative Intent as Oxymoron*, 12 INT'L REV. L. & ECON. 239 (1992).

164. Eskridge & Frickey, *supra* note 159, at 646.

165. Einer Elhauge, *Preference-Eliciting Statutory Default Rules*, 102 COLUM. L. REV. 2162, 2169 (2002).

contract law,[166] such an approach would encourage a different type of private behavior in future transactions. Specifically, Elhauge envisions such an approach as influencing private behavior to procure more explicit legislative action in the future, which could increase the accountability of the political process. The clear articulation requirement might serve a similar purpose. Understood as a penalty-enhancing default rule, a clear articulation requirement does not give rise to automatic state action immunity. Instead, a clear statement rule relegates ambiguity to a purpose that the interest groups most likely to reverse the interpretation (that is, those with monopoly power in an industry) would disfavor—antitrust enforcement.

A preference-eliciting default rule is only a partial solution to the problems created by regulatory incompleteness in state lawmaking. A clear articulation of purpose is necessary and does a lot of the heavy lifting in state action immunity analysis, but it is not a sufficient basis for suspending judicial review of market conduct under the Sherman Act. For example, Oregon has clearly expressed a legislative policy to remove market competition by authorizing regulators to approve allocations of service territories.[167] What matters in judicial gatekeeping in the consideration of antitrust claims is not just the legislature's clarity in delegating to the regulator but also what the regulator does in exercising its discretion. Recognizing this, the Ninth Circuit properly refused to extend state action immunity to a utility's purported anticompetitive conduct in dividing Portland into exclusive service territories, given that regulators had not made firm-specific decisions to displace competition with regulation.[168] Although the utility claimed that its conduct was consistent with previous contracts and orders agreed to under generally delegated ratemaking authority, the only way the regulator could have mandated service territories was pursuant to a statute under which the regulator had not acted.[169] According to the Ninth Circuit, "mere 'state authorization, approval, encouragement, or participation in restrictive private conduct confers no antitrust immunity.'"[170]

If clear articulation alone were sufficient to provide a shield from the Sherman Act, private interests could lobby for a delegation

166. Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729, 757 (1992).

167. *See* OR. REV. STAT. §§ 758.405-758.450 (2003); Columbia Steel Casting Co. v. Portland Gen. Elec. Co., 111 F.3d 1427, 1433 n.2 (9th Cir. 1997).

168. *Columbia Steel Casting Co.*, 111 F.3d at 1441-42.

169. *See id.* at 1442.

170. *Id.* at 1440 (quoting Phonetele, Inc. v. AT&T, 664 F.2d 716, 736 (9th Cir. 1981)).

under clear statutory language (however broad) and then engage in conduct that would otherwise be impermissible under the Sherman Act, even where the conduct completely escaped the scrutiny of agency regulators. By encouraging firms to lobby for antitrust exclusion in state legislation, this could have forum selection effects. For example, a state restructuring plan that stated that a scheme of competitive restructuring was intended to displace antitrust enforcement could alone eviscerate the competitive norms of the antitrust laws, regardless of how such a scheme organized the industry and monitored firm behavior. While the Sherman Act allows positive state regulation, it does not authorize state repeal of federal antitrust law through ambiguous delegations or even through plain language overrides.[171] Thus, to the extent the preference-eliciting default rule interpretation of state action immunity eviscerates the active scrutiny requirement, it concedes too much. This result is not required by deference or notions of federalism and may prove harmful to social welfare.

Under existing doctrine, active supervision of the conduct, as well as a clear statement of purpose, is required in order to trigger state action immunity from antitrust enforcement. Although the U.S. Supreme Court has not had the recent occasion to address this issue, lower courts (particularly in the Eighth, Tenth, and Eleventh Circuits) have been alarmingly deferential to regulators in applying this second prong of the *Midcal* test.[172] Consistent with the Supreme Court's pronouncements in the context of municipal regulation, lower courts have read out of state action immunity analysis any serious scrutiny of supervision, focusing instead on whether the legislature has delegated authority to supervise to an agency. In most cases, potential supervision of conduct alone has been sufficient to trigger state action immunity from enforcement of the antitrust laws.

However, judicial deference to regulatory power, or potential regulation, without more, invites interest group manipulation of the regulatory forum for enforcement of competitive norms. For example, in the context of electric power restructuring debates at the state level, firms seeking immunity from the antitrust laws might lobby for delegation of decisions regarding competitive access to essential facilities, as well as pricing, to the regulator. Delegation of this authority, however, does not mean that the regulator has exercised it in ways that are consistent with the pro-competitive

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171. *See* William H. Page & John E. Lopatka, *State Regulation in the Shadow of Antitrust:* FTC v. Ticor Title Insurance Co., 3 SUP. CT. ECON. REV. 189, 191-93 (1993).

172. *See supra* notes 134-46 and accompanying text.

goals of the Sherman Act. Allowing state action immunity to preclude antitrust enforcement in such circumstances creates strong incentives for delegation to state regulators with little or no guarantee that such authority is exercised in ways that promote federalism or social welfare, let alone competition.

Courts thus need to depart from their current and past practice of diluting the active supervision requirement. Again, a preference-eliciting approach would be useful.[173] Rather than implying active supervision from the historical fact of delegation, a general presumption against active supervision would force litigants to present evidence of a pattern of regulatory activity and would elicit more explicit future lobbying of regulators by monopolies. Put simply, an opportunity for regulation is not the same as active supervision—although courts seem to consistently reach this conclusion. The opportunity for regulation is the first step of the active supervision analysis, but it hardly concludes it. A preference-eliciting default rule approach would also have courts assess how frequently, and under what circumstances, supervisory authority is exercised.

The Ninth Circuit has recognized as much in allowing an electric cooperative to sue a utility for refusing access to essential transmission facilities. Although the utility claimed that the state regulatory scheme clearly envisioned the utility refusing to wheel—to the extent the state had adopted a clear policy to displace competition among electric suppliers—the Ninth Circuit did not allow this to trigger immunity from antitrust liability.[174] Under Idaho state law, the utility could decline the customer's wheeling request without the substantive review of a state agency or state courts, but the court reasoned that "[t]his is the type of private regulatory power that the active supervision prong of *Midcal* is designed to prevent."[175] Thus, the Ninth Circuit reasoned, a self-policing regulatory scheme may not require active supervision to qualify for state action immunity,[176] but where the regulator has discretion to exercise active supervision it is an appropriate inquiry for a court. Similarly, departing from its previously deferential approach, the Tenth Circuit refused to extend state action immunity to lock-up contracts between Southwestern Bell that were "neither mandated, nor authorized, nor reviewed, nor even known about" by

173. Elhauge, *supra* note 165, at 2284.

174. Snake River Valley Elec. Ass'n v. PacifiCorp, 238 F.3d 1189, 1190-91 (9th Cir. 2001).

175. *Id.* at 1194.

176. *Id.* (citing Liquor Corp. v. Duffy, 479 U.S. 335, 344 n.6 (1987); FTC v. Ticor Title Ins. Co., 504 U.S. 621, 640 (1992)).

state regulators.[177]

Cognizant of the potential gap that a low active supervision threshold can create, some lower courts recognize that active supervision "would be satisfied if the state or state agencies held ratemaking hearings on a consistent basis."[178] Such an inference is a good starting point for analysis of the application of antitrust laws in a deregulated environment and might be a good starting place for a presumption of state action immunity. In *Ticor*, for instance, the Supreme Court found it relevant that the Wisconsin state regulatory body had not held rate hearings prior to approving a jointly filed insurance rate.[179] Mere private contracts, however, do not meet this standard. For example, a contract provision prohibiting a customer from entering into the electricity market as a competitor in the future, offered by a utility in exchange for a discounted rate, is not protected by state action immunity.[180] Without meaningful agency review of the specific private conduct at issue, state action immunity can be abused in a deregulatory environment.

In interpreting the active supervision requirement, courts must be true to the overall federalism purposes of state action immunity. Fidelity to federalism would not limit assessment of supervision to states only, but would also include other regulatory bodies, such as municipalities. In addition, fidelity to federalism would require that some attention be given to the process which gives rise to regulatory supervision. If the purposes of regulatory action overlap with the overall consumer welfare goals of the Sherman Act, deference to supervision by the state or local actor is appropriate. However, if the purpose is blatantly protectionist in ways that do not even arguably improve consumer welfare and that impose spillover costs on those in other jurisdictions who have not participated in the process leading to the adoption of regulation, intervention of the antitrust laws may be appropriate. A penalty-enhancing default rule would align private incentives to ensure more explicit procurement of state action immunity via legislation and regulatory activity.

While the Ninth Circuit should be applauded for recognizing the role of the importance of active supervision, a later case addressing state antitrust immunity in the very same antitrust claim

177. Telecor Communications, Inc. v. Southwestern Bell Tel. Co., 305 F.3d 1124, 1140 (10th Cir. 2002).

178. Green v. Peoples Energy Corp., 2003-1 Trade Cases (CCH) ¶ 73,999 (N.D. Ill. 2003) (finding active supervision where lengthy hearings were held on gas supplier's rates on a consistent basis).

179. 504 U.S. at 629-31.

180. United States v. Rochester Gas & Elec. Corp., 4 F. Supp. 2d 172, 176 (W.D.N.Y. 1998).

undermines the active supervision prong by allowing it to hinge on the nature of the regulatory program put in place by a state legislature. Following the Ninth Circuit's recognition that there was no state action immunity,[181] the Idaho legislature amended its Electric Supplier Stablization Act, under which the utility had previously declined a wheeling request absent agency review.[182] The amendments allowed an electricity supplier to refuse to wheel power if the requested wheeling "result[ed] in retail wheeling and/or a sham wholesale transaction," subject to review of the state regulatory agency.[183] In addition, the Idaho legislature prohibited competing suppliers from serving customers or former customers of other electric suppliers unless the competing supplier petitioned the Idaho regulator and the regulator issued an order allowing the service.[184] The Ninth Circuit held that, unlike the previous statutory arrangement which left the decision not to wheel entirely to private choice, the amended statute "ha[d] not left unregulated a private preserve without competition" and thus met the active supervision requirement for state action immunity.[185] The Ninth Circuit emphasized that the Idaho statute precluded a private utility from wheeling without a contrary order from the state regulator.[186] The result is that statutes and regulations that prohibit competitive conduct can eviscerate any active supervision requirement. If a private firm is successful in lobbying for a statute that prohibits it from engaging in competitive conduct, it will be immune from antitrust challenges. However, a court should not take a prohibition on allowing access to a network facility at face value, but it should evaluate carefully the scope of the regulator's discretion to override the private choice, including the criteria the regulator should apply in making such a decision.

Revival of the active supervision portion of judicial review in state action immunity analysis does not imply that courts should subject state and local regulation to strict scrutiny review, as advocates of deference seem to suggest. Rather, to make the connection explicit, the type of judicial review called for in evaluating state action immunity is more akin to what courts provide under the political process account of the dormant commerce clause. State action immunity is less consequential than other

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181. *See supra* text accompanying notes 174-76.

182. Snake River Valley Elec. Ass'n v. PacifiCorp, 357 F.3d 1042, 1048 (9th Cir. 2004).

183. IDAHO CODE § 61-332D(1) (Michie 2002).

184. IDAHO CODE §§ 61-332B, -334B(1) (Michie 2002).

185. *Snake River Valley Elec. Ass'n*, 357 F.3d at 1049.

186. *Id.* at 1048.

judicial review of legislation or regulation, as it does not result in condemning public conduct or necessarily striking legislation but instead merely subjects private conduct to review under the antitrust laws. If the type of regulation does not present veiled wealth transfers—benign rent seeking would not impair the political process—private conduct that is supervised by the regulator generally would be shielded from the scope of the Sherman Act. Rent seeking that thwarts the representative political process, however, would not be used by private firms as a strategy to escape judicial review under the antitrust standards of the Sherman Act. Such an approach preserves federalism values by protecting the type of democratic participation that forms the core of federalism. It also reduces the incentive for private interest groups to lobby state and local regulators in ways that allow state action immunity to become a strategy (much like the filed tariff doctrine) for opting out of antitrust enforcement in ways that impose spillover costs outside of a state.

IV. TURNING FEDERAL PREEMPTION ON ITS HEAD: NUDGING LAWMAKERS TO REVEAL THEIR PREFERENCES

Federal preemption is perhaps the most comprehensive way of bolstering interstate market coordination in deregulated industries. Congress, for example, can pass comprehensive legislation, or a federal agency may adopt comprehensive regulations, concerning the management of network facilities in deregulated markets. Explicit federal preemption is one way of bolstering the goals of the interstate market coordination goals of the dormant commerce clause in this context. For example, some have suggested that Congress needs to expand FERC's authority over transmission line siting.[187]

However, as in the contexts of the filed rate doctrine, the dormant commerce clause, and state action immunity, the judicial approach in this context contains a deference trap for those who do not approach carefully. First, under the *Chevron* doctrine, which federal courts frequently invoke in deferring to reasonable agency interpretations of law,[188] a federal agency's construction of its

187. Professor Richard Pierce embraces expanded congressional authorization for FERC to resolve transmission siting disputes. Richard J. Pierce, Jr., *Environmental Regulation, Energy & Market Entry*, DUKE ENVTL. L. & POL'Y F. (forthcoming 2005). For more than a decade, Pierce has been arguing for the same basic congressional solution. Richard J. Pierce, Jr., *The State of the Transition to Competitive Markets in Natural Gas and Electricity*, 15 ENERGY L. J. 323, 334 (1994). But Congress has consistently failed to act.

188. *See* Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S.

jurisdictional statutes is generally upheld. Because deference to a federal agency leads to national uniformity, judicial deference in reviewing regulations involving federalism issues implicitly adopts a national supremacy understanding of federalism. Courts have a general preference for a federal supremacy approach to the resolution of jurisdictional battles and for uniformity in their legal resolution. However, notwithstanding a deferential posture which favors federal over state authority (since often federal and state regulators share jurisdictional turf) a jurisdictional commons may create problems of regulatory inaction.[189] Where both state and federal regulators possess jurisdiction, neither federal nor state regulators may act if the political costs of regulating are high. For example, in the context of California's failed deregulation plan, federal regulators blamed California's retail price cap as a cause of the failure of its competitive policies, while California regulators blamed FERC for skyrocketing power procurement costs due to FERC's failure to impose a price cap on whole power sales.[190]

Second, courts largely defer to federal regulatory processes, treating states as black boxes in the formulation of regulatory solutions. The result of deference is to presumptively favor imperfect federal solutions while largely ignoring states. However, as the recent turn to focus on state and local governance chronicles,[191] states are complex and nuanced regulatory systems whose governance features should not be ignored.

A different public law approach would not embrace automatic deference to federal and state regulators in this context. Where Congress does not act—and Congress certainly is not the institution on which the success of deregulated markets should hinge—federal courts have the power to nudge states towards action by empowering state siting boards to take into account federal goals in interstate transmission markets, even absent state legislative authorization.

837, 843-44 (1984). As the Supreme Court stated in *Chevron*, "[A]n agency to which Congress has delegated policymaking responsibilities may, within the limits of that delegation, properly rely upon the incumbent administration's views of wise policy to inform its judgments." *Id.* at 865.

189. William W. Buzbee, *Recognizing the Regulatory Commons: A Theory of Regulatory Gaps*, 89 IOWA L. REV. 1, 22 (2003) (noting that "a regulatory commons creates predictable incentives for political inattention").

190. Jim Rossi, *The Electric Deregulation Fiasco: Looking to Regulatory Federalism to Promote a Balance Between Markets and the Provision of Public Goods*, 100 MICH. L. REV. 1768, 1785-86 (2002).

191. *See, e.g.*, Richard Briffault, *Our Localism: Part I—The Structure of Local Government Law*, 90 COLUM. L. REV. 1 (1990); Gillette, *supra* note 161, at 959.

A. *Congress's Obstacles*

Proposals to expand FERC's authority over transmission siting are not new. For more than a decade, industry experts have recognized that such modifications to the FPA will be necessary for competition to thrive. The most recent proposals do not vest FERC with primary authority over siting but envision FERC as playing a back-up role where individual states fail to reach closure on siting disputes on their own. Regional Transmission Organizations ("RTOs") would provide an important forum for the resolution of these disputes, with FERC having the ultimate authority to order expansion where states fail to do so themselves.[192] It is likely that such proposals will continue to be made to Congress, although it is questionable whether any will be adopted into law.

As others have suggested, FERC's authority to preempt state siting of transmission lines needs to be modified.[193] Unfortunately, Congress faces some institutional obstacles of its own in implementing reforms. In a recent defense of the "presumption against preemption," which would empower states to take the initiative to solve many of these issues on their own, Roderick Hills summarizes three main failures of the federal government, and particularly Congress, in setting legal reform agendas.[194] Each of these is applicable to energy legislation such as that recently proposed to expand FERC's transmission jurisdiction.

First, Hills observes that collective action problems allow narrowly focused interest groups to control even national regulatory processes, echoing what Richard Stewart has referred to as "Madison's Nightmare"[195]—a faction-ridden maze of capture of national majoritarian political processes by interest groups. In the energy legislation context, it is quite common for Congress to bundle together multiple unregulated reforms, producing logrolling solutions that may confront obstacles due to one or two high-profile objectionable provisions. For example, the primary energy bill before Congress in 2003 contained provisions that would have more clearly expanded FERC's authority over transmission in order to enhance reliability.[196] This bill failed to pass primarily because of

192. *See* Energy Policy Act of 2004, H.R. 4503, 108th Cong. § 1221.

193. *See supra* note 187 and accompanying text.

194. RODERICK M. HILLS, JR., AGAINST PREEMPTION: HOW FEDERALISM CAN IMPROVE THE NATIONAL LEGISLATIVE PROCESS, 8-15 (John M. Olin Center for Law & Economics Working Paper Series, Working Paper No. 16, 2003), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=412000.

195. *Id.* at 8-11; *see also* Richard B. Stewart, *Madison's Nightmare*, 57 U. CHI. L. REV. 335 (1990).

196. *See* Energy Policy Act of 2003, H.R. 6, 108th Cong. § 16012.

unrelated statutory provisions limiting state tort liability for the fuel oxygenate methyl tertiary butyl ether (better known as MTBE).[197]

In addition, as Hills suggests, individual representatives are frequently preoccupied with pleasing constituents—by approving earmarks and pork-loaded packages—leading Congress to neglect general policymaking.[198] Again, energy legislation provides an example of the failures of the national political process. The 2003 energy bill contained multiple provisions on different topics aimed at local or regional constituents, such as provisions aimed to provide federal aid for, among others, a Shreveport, Louisiana shopping mall which houses the chain restaurant "Hooters."[199] Senator John McCain dubbed the proposed legislation a bill for "Hooters and polluters."[200]

Finally, Hills observes, what Samuel Beer has called "political overload"[201] plagues the ability of Congress to set the regulatory agenda, since only a small number of issues can effectively occupy Congress's agenda.[202] In the energy context, again, Congress is unlikely to even consider national energy legislation unless a major national or international crisis brings it to the agenda—the Mideast oil embargo (leading to passage of President Carter's energy plan in 1978),[203] the Gulf War (leading to passage of the Energy Policy Act of 1992),[204] or post-September 11 concerns over the relationship between terrorism and oil (leading to Congress's failed energy bill in 2003).[205] On occasion, individual members of Congress propose stand-alone bills designed to expand FERC's authority, but these generally have little support in Congress and frequently disappear

197. Peter Behr & Dan Morgan, *Without Energy Legislation, Grid, Power Policy in Limbo*, WASH. POST, Nov. 27, 2003, at E1; Carl Hulse, *Even with Bush's Support, Wide-Ranging Legislation May Have Been Sunk by Excess*, N.Y. TIMES, Nov. 26, 2003, at A17.

198. HILLS, *supra* note 194, at 11-13; *see also* BRUCE CAIN ET AL., THE PERSONAL VOTE: CONSTITUENCY SERVICE AND ELECTORAL INDEPENDENCE (1987).

199. *See* Energy Policy Act of 2003, H.R. 6 § 1366; *see also Hitchin' a Ride: Pork Projects in the Energy Bill*, PUB. CITIZEN, *at* http://www.citizen.org/cmep/energy_enviro_nuclear/electricity/energybill/2005/articles.cfm?ID=11084 (last visited Mar. 4, 2005).

200. Dan Morgan, *The GOP Congress, High on the Hog*, WASH. POST, Jan. 18, 2004, at B01.

201. Samuel H. Beer, *Political Overload & Federalism*, 10 POLITY 5 (1977).

202. HILLS, *supra* note 194, at 13-15; *see* JOHN W. KINGDON, AGENDAS, ALTERNATIVES, AND PUBLIC POLICIES 15-17 (2d ed. 1995).

203. Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117 (codified at 16 U.S.C. §§ 2601-2644 (2000)).

204. Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776 (1992).

205. *See supra* notes 196-97 and accompanying text.

without a hearing.[206]

Even if Congress fails to expand FERC's authority—as much of the political science to which Roderick Hills cites would predict—the Cross-Sound line dispute[207] illustrates that FERC may increasingly play a role in related regulatory proceedings over which it has jurisdiction and can play a positive role in the process. The Cross-Sound dispute illustrates that FERC has some power, albeit limited, to act on its own without congressional authorization under new statute enactment. For example, in the Cross-Sound dispute, FERC threatened to make a decision in a related proceeding, involving updating of an older transmission line. This threat of regulatory action brought state regulators to the negotiation table. This move demonstrated that FERC's cognate authority over related projects is a powerful tool to bring parties to the bargaining table. Although not every environmental concern was placated by the resulting settlement, LIPA, Cross-Sound, and CP&L each agreed to contribute $2 million to a fund, to be administered jointly by New York and Connecticut, dedicated to the study and preservation of Long Island Sound.[208] In some instances, FERC may be able to use its clear regulatory authority—over mergers, transmission tariffs, and RTOs—to bring parties to the table if impasses occur, even if it is unable to preempt state siting processes. Yet, it is well recognized that FERC cannot solve these disputes on its own.

As counterintuitive as it might sound, absent action by Congress and FERC, the presumption should be in favor of state siting board regulators acting to solve the problems with interstate transmission. If nothing else, a presumption in favor of state jurisdiction might work to set the national lawmaking agenda, but more importantly, it might place clear incentives on state regulators, making action more likely in a situation where state and federal regulators seem to have reached an impasse.

B. How Federal Courts Can Overcome Recalcitrant State Legislatures

Many state siting statutes were adopted with old regulatory structures (based on a nationally uniform cost-of-service structure)

206. In 2004, Senator Hillary Clinton proposed a stand-alone reliability bill, presumably because she had concluded that the larger energy bill was doomed. *See Sen. Clinton to Push Reliability Bill, Urges Leaders to Pass It Apart from the Energy Bill*, ELECTRIC UTIL. WK., Jan. 19, 2004, at 3. However, with an election year in 2004, many considered a more streamlined bill unlikely to pass Congress unless it was very modest.

207. *See supra* notes 94-107 and accompanying text.

208. Bruce Lambert, *New York and Connecticut Agree to End Cable Dispute*, N.Y. TIMES, June 25, 2004, at B6.

in mind. In many states, siting statutes do not authorize state or local regulators to do anything to open up their network access facilities to out-of-state competitors. In this sense, one barrier to interstate power markets is state legislatures, which do not have the institutional incentive to modify old regulatory statutes. To the extent the problem is state legislature recalcitrance (whether tacit or explicit), federal courts might attempt to draw on preemption principles to overcome impasses by introducing greater competition in the state political process, reducing the ability of any one branch or level of state or local government to be recalcitrant through inaction.

As an illustration, consider the issue of a state legislature's failure to authorize regulatory action by state or local agencies under state siting statutes. State siting bodies may not be able to act to site facilities or even to consider the interstate implications of siting absent authorization by a state legislature. In the context of deregulated wholesale power markets, individual states frequently face strong incentives to defect in order to protect firms in their own internal market, such as local utilities. Several states have adopted moratoria on exempt wholesale generators or have limited regulators' authority to site such plants to in-state utilities only. Florida's Supreme Court, for example, has interpreted a state power plant siting statute to limit plant siting to those suppliers who are Florida utilities or who have contracts with Florida utilities.[209] Effectively, merchant power plants are precluded from siting in Florida for purposes of entering the interstate market. Perhaps taking a cue from Florida's success in blocking the development of new wholesale power plants that do not directly serve in-state customers, other state and local governments, particularly in the southeastern United States, have imposed moratoria on merchant plants.[210] Pursuant to the siting statute passed by the Florida Legislature, Duke Energy's application was rejected by the Florida Supreme Court, even though the state agency initially had accepted it, believing it had the legal jurisdiction to do so.

However, even where a state legislature is recalcitrant and fails to authorize local or state-wide regulatory agencies to take into

209. Tampa Elec. Co. v. Garcia, 767 So. 2d 428, 435 (Fla. 2000) (holding that the state's power plant siting statute "was not intended to authorize the determination of need for a proposed power plant output that is not fully committed to use by Florida customers who purchase electrical power at retail rates").

210. *See* Chris Deisinger, *The Backlash Against Merchant Plants and the Need for a New Regulatory Model*, 13 ELECTRICITY J. 51 (2000); *Nervous of NOx, Southern Govs. Put Plants on Hold*, ELECTRICITY DAILY, Aug. 28, 2001; *State Limits on Merchant Plants a Growing Worry*, GENERATION WK., Aug. 22, 2001.

account federal goals (such as concerns with reliability in deregulated wholesale power markets) while siting transmission lines or power plants, courts could presumptively authorize such officials to act to pursue federal goals. Roderick Hills has argued for a presumption against preemption[211]—the political science reasons he gives for it have particular resonance in the context of electric power—but in many instances (as in Florida) state officials and local political bodies lack the authority to act. As Hills has argued elsewhere, state regulator initiative on issues might be facilitated by "dissecting the state"—if state and local agencies are presumptively authorized to implement federal goals, even where state enabling legislation is ambiguous as to state agency jurisdiction.[212] When a federal program gives grant money directly to a state governor or local governments, it plays the executive branch or local governments against the state. Similarly, when Congress passes a statute (such as the Federal Power Act), and a federal agency clearly articulates general goals for implementing the statute (as FERC has articulated the goal of deregulated interstate wholesale power markets), even if Congress has not delegated specific implementation authority to the agency, it might be implied that it has given remedial implementation authority to state agencies, overriding state constitutional doctrines such as separation of powers. Presumptive preemption of structural constraints in state constitutions serves the function of allowing states to work towards correcting congressional failures that may remain in statutes.

Instead of deferring to state court interpretation of limited authority for siting boards, an alternative approach to reviewing the agency's jurisdiction would have ignored the ambiguous jurisdictional limits in the state statute, presumptively authorizing the state officials to consider the application of—and to site—the facility if this were related to the pursuit of clear (albeit general) federal goals in reliable deregulated wholesale power markets. This presumption would be overcome only if the state legislature were explicit in its recalcitrance, adopting a statute that would preclude consideration of the issue by state regulators.

By simultaneously embracing a presumption against federal preemption in interpretation of statutes and regulations and a presumption in favor of state or local regulatory action (that is, authorizing state and local officials to act notwithstanding a tacitly recalcitrant legislature), public law could align incentives to favor

211. *See* HILLS, *supra* note 194, at 2.

212. Roderick M. Hills, Jr., *Dissecting the State: The Use of Federal Law to Free State and Local Officials from State Legislatures' Control*, 97 MICH. L. REV. 1201, 1232 (1999).

national reform of statutes or regulations in the context of economic regulation. In contrast to the current approach, a presumption against preemption would leave responsibility clearly in the hands of state actors. State and local officials would presumptively be authorized to act to pursue federal goals, although if a state legislature wished to override the authority of a state agency to implement a federal program it would possess the authority to do so expressly. So understood, a judicially imposed set of default rules could promote coordinated federalism, even where Congress has not acted. Judicially led coordinated federalism would replace court-mediated competition between the federal government and the states—which often leads to regulatory impasse—with cooperation. Simultaneously, federal courts may stimulate regulatory action to address interstate network problems in states where none currently exist by introducing competition within the branches of state government. There are two primary objections to such a set of default rules. The first is that federal courts lack the power to implement them and that they are internally inconsistent. The second is that this approach glorifies states' rights or idealizes states as innovators.

To address the second objection first, this is not a states' rights view of economic regulation. Indeed, there is no such thing, given that Congress has broad power to override states on most, if not all, issues of economic regulation. Even this, though, does not make states black boxes in discussion of the allocation of jurisdictional authority. States have an important role to play. The point is not, however, that states are inherently superior to the national government as innovators. Nor is it to promote decentralization as an end state of affairs. Instead, it is that states would act as facilitators and agenda-setters in national lawmaking, helping national solutions to adapt to regulatory problems where the national lawmaking process fails to on its own. Judicially led coordinated federalism is a second-best solution to congressional reforms of national regulatory statutes that fail to give federal agency regulators the necessary jurisdiction, but it also may prove necessary to overcome existing obstacles to regulatory reform in network industries.

The first objection—that federal courts lack the power to apply these default rules, and that they are internally inconsistent—also does not withstand scrutiny. These proposals are not premised on any constitutional power on which the conventional set of default rules in public law does not also rely. The power to vest state and local officials with authority to implement federal goals, like the conventionally accepted judicial power to create implied preemption, can be derived from the Commerce Clause. Where Congress or federal regulators, within their constitutional authority, have stated a general goal, courts presumably would look to state or local regulators to implement it. This is not coercive, as state political actors still would have to make the choice to regulate. If the state political process, such as legislation, explicitly overrides this choice, state action is more likely to exist for purposes of mounting a dormant commerce clause challenge if the state approach imposes spillover costs on interstate commerce. This approach downplays the significance of "independent" state constitutions, but many states already recognize in their constitutional jurisprudence that state constitutions are not to be interpreted in isolation where a state is implementing a federal program.[213] As a matter of constitutional law, federal courts have as much power to implement such a set of default rules as they do to read implied preemption of state law into federal statutes and regulations. In fact, to the extent the presumptive authorization of state executive or local agency regulation to implement federal goals is based on political process considerations, rather than a substantive legal mandate that altogether precludes state regulation, it should be less controversial than implied preemption of substantive law, under which a federal court forces a state to make a substantive policy choice that is consistent with federal law even where Congress has not clearly spoken. Rather than reading judicial power broadly by expansive jurisdictional readings of federal statutes and regulations—as traditional jurisdictional federalism would envision—the default rules for preemption envision a more modest role for the courts, as they align political incentives to favor cooperative federalism approaches even where Congress has not explicitly done so. While a presumption against preemption of substantive statutes and regulations may seem at odds with a presumption that preempts state constitution allocations of powers, these default rules are no less inconsistent than the conventional public law approach, which favors preemption of substantive law but disfavors preemption of state constitutions.

Such an approach gives state and local governments a more

213. *See, e.g.*, Dep't of Legal Affairs v. Rogers, 329 So. 2d 257, 265-66 (Fla. 1976); McFaddin v. Jackson, 738 S.W.2d 176, 177 (Tenn. 1987); Ex parte Elliott, 973 S.W.2d 737, 741-42 (Tex. App. 1998). Thus, even where federal courts do not exercise such authority, state courts might authorize such action as the best interpretation of state constitutional separation of powers doctrine. As I have argued elsewhere, implicit authorization for state executive and local agencies to act on behalf of federal goals is the best interpretation of state separation of powers—a matter of state constitutional law. Jim Rossi, *Separation of Powers and State Implementation of Federally Inspired Regulatory Programs and Standards*, 46 WM. & MARY L. REV. 1343 (2005).

positive role to play in deregulated markets than judicial federalism currently envisions under public law. It creates a political process that is more likely to clarify jurisdictional responsibility while also lowering the costs of using state government to implement federal goals. In the long run, it might also promote a more stable national solution to important issues than the conventional approach of relying on courts to draw the lines between incomplete federal regulation and the states.

For example, in the context of electricity transmission siting, if state and local regulatory commissions are granted presumptive authority to consider national goals in reliable wholesale power markets, states would clearly share responsibility with Congress for transmission expansion. At least some state regulators in each state would clearly possess the regulatory power to expand transmission to accommodate deregulated markets. States might also be implicitly authorized to build pricing for such transmission expansion into their own regulatory structures for retail rates. This would not solve every problem with regulation of electric power transmission; for that, a national solution is necessary. Some states may choose to expand transmission, allowing deregulated markets to work, while others may not, creating chokehold regions that could force consideration of a more national solution to state-based transmission regulation. At the same time, responsibility for the lag clearly would sit with the states or with Congress. If states were presumptively authorized to take such goals into account, presumably a state's failure to act to site transmission in response to requests for transmission expansion could be brought within the realm of the dormant commerce clause, ultimately facilitating the emergence of more cooperative solutions between states where national regulators fail to take action. At a minimum, recalcitrant state legislatures would be required to explicitly reject state participation in national markets. Designing default rules for judicial review with these bargaining problems in mind will not bring an end to all jurisdictional conflicts and impasses. Such design can, however, make explicit previously hidden institutional preferences within states for recalcitrance with national competition policies, better facilitating disruption of the jurisdictional impasses that plague the current approach to federal preemption.

V. CONCLUSION

For most of the twentieth century, the doctrines of public law have, at their core, largely advised deference to regulators and other political bodies. Deference may have suited the cost-of-service ratemaking paradigm, in which regulatory jurisdiction was settled and most utilities did not compete well in interstate markets.

Previous authors, such as Garland, Sunstein, and Pierce, have debated the strength of deference in such a context.[214]

However, the regulatory context has changed. As the vignettes in this Article illustrate, in deregulated industries and other competitive industries in transition, deference can lead to adverse private conduct as well as to undemocratic law making. The filed rate doctrine illustrates how deference can lead to strategic manipulation of regulatory enforcement. As the dormant commerce clause and state action immunity doctrine illustrate, deference can lead to private manipulation of the lawmaking process in ways that do not encourage the development of interstate and intrastate markets. And federal preemption, which implicitly embraces a type of deference to federal agencies and encourages federal courts to ignore state political processes, may create regulatory commons in which jurisdictional problems fester.

Lifting public law out of the deference trap would require courts to be more mindful of incentives in the lawmaking process and their adverse effects on social welfare—especially in a partially deregulated industry. Deference will have an important place in evaluating many regulatory disputes. Courts should not, for example, impose their own policy and market preferences on regulators. However, rather than embracing blanket deference in reviewing every complex regulatory law dispute, public law should take into account ex ante incentives of private parties in the lawmaking process as well as the behavior of law makers themselves. Judicial deference may be appropriate in some contexts, such as in direct review of clearly jurisdictional agency regulations, but in the political decision-making contexts discussed in this Article, courts could improve the functioning of deregulated markets by taking into account ex ante incentives for strategic private behavior as well as the incentives associated with the lawmaking process. Finally, if the analysis of this Article is correct, courts will increasingly share some of the blame with Congress, states, and regulatory agencies for dysfunctional deregulation of industries such as electric power. Overbroad deference to regulators and states does not excuse courts from taking responsibility for such dysfunction.

214. *See supra* notes 8 and 9.