1998

The Irony of Deregulatory Takings

Jim Rossi

Follow this and additional works at: https://scholarship.law.vanderbilt.edu/faculty-publications
Part of the Energy and Utilities Law Commons, and the Property Law and Real Estate Commons

Recommended Citation
Available at: https://scholarship.law.vanderbilt.edu/faculty-publications/987
Laws change and, as they do, reliance interests are often affected. For instance, if Congress or the Internal Revenue Service were to abolish tax benefits for certain investment activities, this would undoubtedly affect the revenues of individuals and corporations who have made investments—perhaps who were induced by incentives in the law to make investments—with expectations set under previous rules. Were Congress to modify intellectual property laws, retracting or modifying currently protected copyrights or patents, it would wreak havoc on investors who have sunk millions into new technologies, anticipating big payoffs from government-protected monopolies in new inventions.

When, if ever, does a change in law warrant litigation against the government? Of course, if the change stems from the action of an administrative agency, extensive review of decisionmaking procedures is provided under the Administrative Procedure Act. Congress, though, can rarely be sued for fault in its decisionmaking procedure, although one can point
to classic instances when Congress has seen its actions reversed for denying
due process or infringing on other rights protected under the Constitution.

In *Deregulatory Takings and the Regulatory Contract: The Competitive
Transformation of Network Industries in the United States*, J. Gregory
Sidak and Daniel F. Spulber seek to add more certainty to government reg-
ulation by arguing that government can be sued for breach of contract or
under the Takings Clause of the Constitution if it does not act to protect
expectations as it attempts to deregulate natural monopoly industries, such
as telecommunications and electricity. Since the early 1970s, liberal con-
sumer advocates have urged legislatures to use caution before deregulating
a variety of industries. Today, these advocates find allies in Sidak and
Spulber—hardly proregulation liberals—who see legal and policy impediments
to government deregulation, but who invoke these to the benefit of
the firm and its investors. Sidak and Spulber’s book is clearly written,
accessible, and timely, especially given the debate over deregulation that
has been brewing for nearly twenty years. It is also provocative and
controversial, as the micropolitics of the deregulation debate might suggest.

This review assesses Sidak and Spulber’s argument in the context of
the case law and normative principles of regulation. Part I explains the
concept of a deregulatory taking, summarizing briefly the authors’ argu-
ment and showing its practical importance to current policy issues in the
telecommunications and electricity industries. Part II argues that the case
law fails to provide solid support for the extreme argument for compensa-
tion advanced in *Deregulatory Takings*; although the law does not preclude
some deregulatory taking claims, successful claims will be far fewer than
Sidak and Spulber intimate. Part III addresses faults with the efficiency
argument for compensation. It suggests that the efficiency issue should not
be seen as one of unilateral risk of breach of a contract with the state, but
shared risk for regulatory change in the face of uncertainty; in such
circumstances, private markets are often in a better position to insure
against risks, and the turn to government for compensation has adverse
policy implications for utility regulation and law more generally.

At its core, the deregulatory takings argument is imbued with irony.
It reaches the opposite of the result one might expect: it relies on a *faux*
progressive notion of regulation—the regulatory compact, a shield pro-
protecting vested interests in regulation—while invoking a conservative’s

---

2. Sidak is a fellow with the conservative American Enterprise Institute of Public Policy Research;
Spulber, a professor of management strategy at Northwestern University’s J.L. Kellogg Graduate
School of Management, is one of the most prolific economists in the country, having written regularly
on the benefits of competition over regulation. *See, e.g.*, Daniel F. Spulber, *Retail Price and
Investment Competition*, 28 RAND J. ECON. 207 (1997); Daniel F. Spulber, *Market Making by Price-
Setting Firms*, 63 REV. ECON. STUD. 559 (1996); Daniel F. Spulber, *Open Access and the Evolution
artillery—the Takings Clause as a mechanism for insuring investor confidence. I conclude by suggesting that Deregulatory Takings is not only fraught with intellectual tension, but also overstates its case as a matter of both law and economics in order to influence the policy debate to the advantage of utilities and their investors. Perversely, however, were utilities or investors to advance their legal arguments for compensation prematurely and lose in the courts, such losses might make it more difficult for them to obtain relief from the political process.

I. Sidak and Spulber's Deregulatory Takings Argument

Deregulatory Takings addresses how deregulation of network industries can reduce the economic value of private property and give rise to government liability for breach of contract and as an unconstitutional taking, requiring just compensation. The book pulls together and refines a series of controversial arguments the authors previously put forward in articles published in the New York University Law Review, the Columbia Law Review, and the Yale Journal on Regulation. In its simplest form, Sidak and Spulber's deregulatory takings argument can be stated as follows: Breach of the regulatory contract, brought about through the elimination of entry barriers, may give rise to liability for breach of contract or as a taking to the extent that there is a decline in a firm's investment-backed expected revenues. The state is responsible for providing a regulatory mechanism to compensate for the full value of lost expected revenues at the time the state makes a decision to deregulate.

As a building block for their argument, Sidak and Spulber advance an account of regulation known as the "regulatory compact," according to which regulated industries receive benefits in exchange for assuming certain burdens. Although the terms "regulatory contract" and "regulatory


compact" may be relatively recent,\(^6\) the idea has roots in cases decided by the Supreme Court between 1877 and 1927, and even earlier.\(^7\) The doctrine is recognized in classic opinions such as *Charles River Bridge v. Warren Bridge*,\(^8\) in which Justice John McLean stated in his concurrence,

> [W]here the Legislature, with a view of advancing the public interest by the construction of a bridge, a turnpike road, or any other work of public utility, grants a charter, no reason is perceived why such a charter should not be construed by the same rule that governs contracts between individuals.\(^9\)

Later opinions, such as *Russell v. Sebastian*,\(^10\) also endorsed the basic notion that regulation is based on contractual principles. There, Justice Hughes, in assessing a gas company's rights pursuant to the State of California's modification of a municipal franchise, stated that "[t]he company, by its investment, had irrevocably committed itself to the undertaking and its acceptance of the offer of the right to lay its pipes, so far as necessary to serve the municipality, was complete."\(^11\)

Sidak and Spulber observe that, as a matter of economics, three components are necessary to establish a regulatory compact: entry controls, rate regulation, and utility service obligations.\(^12\) For example, traditional telephone and electric utilities assume obligations to serve customers in exchange for the grant of a monopoly franchise, protecting the utilities against entry and guaranteeing recovery of their costs in rates. Because under rate regulation government commissions have allowed utilities to recover a return on prudently incurred capital costs in rates, utilities have been encouraged to build capacity to meet customer demand.\(^13\) Thus, to

---


\(^7\) Among the doctrine's supporters, the authors observe, were Chief Justice William Howard Taft and Justices Stephen J. Field, Joseph R. Lamar, and George Sutherland. See p. 133 (citing IRSTON R. BARNES, *THE ECONOMICS OF PUBLIC UTILITY REGULATION* 14 & nn.43-46 (1948)). For further analysis of the historical origins of the doctrine, see George L. Priest, *The Origins of Utility Regulation and the "Theories of Regulation" Debate*, 36 J.L. & ECON. 289 (1993). See also Andrew P. Morriss, *Implications of Second-Best Theory for Administrative and Regulatory Law: A Case Study of Public Utility Regulation*, 73 CHI.-KENT L. REV. 135, 184-88 (1998) (arguing that a contractual framework can be used to explain past forms of utility regulation and to elucidate a second-best understanding of utility regulation).

\(^8\) 36 U.S. (11 Pet.) 420 (1837).

\(^9\) Id. at 558 (McLean, J., concurring).

\(^10\) 233 U.S. 195 (1914).

\(^11\) Id. at 210; see also New York Elec. Lines Co. v. Empire City Subway Co., 235 U.S. 179, 193 (1914) (noting that franchise grants "are made and received with the understanding that the recipient is protected by a contractual right from the moment the grant is accepted and during the course of performance as contemplated").

\(^12\) See pp. 113-29.

\(^13\) See p. 120.
the extent such a compact or contract exists with the state, the authors argue that regulated utilities, unlike unregulated firms, have been induced by government to invest their capital in order to meet their obligations.\textsuperscript{14}

Deregulation—particularly retail competition, currently under consideration in many states—will (at the extreme) terminate or (perhaps more modestly) cause a reassessment of this regulatory compact. The transition to competition in historically regulated utility industries is not a Pareto superior move. Clearly, deregulation will produce both winners and losers. For example, with deregulation of electric utilities, some consumers will see lower priced services while others may see increases in rates.\textsuperscript{15} The challenge regulators face is to make a transition to competition worth pursuing. This, of course, is what liberal consumer advocates have long maintained with respect to deregulation in a variety of contexts, such as the trucking, airline, and natural gas industries. Sidak and Spulber, not progressive liberals, add an interesting twist to the debate by suggesting that regulators should not concern themselves solely with the consumer and social welfare impacts of deregulation. For the authors, the wealth of the firm and its investors is of equal—if not superior—importance in deciding whether to move forward with a regulatory change.

Consider, for example, competition in the electricity industry. Most economists see overall efficiency gains from moving towards competition in power generation markets, traditionally dominated by the staid public utility.\textsuperscript{16} However, as Sidak and Spulber convincingly argue, the transition to competition will burden some more than others.\textsuperscript{17} For example, in a competitive environment many formerly regulated utilities will still own nondepreciated assets purchased with the expectations set under government regulation, and often approved explicitly by regulators in past rate or need proceedings.

Microeconomic theory advises that, in the natural monopoly context, regulators set price as close as possible to marginal cost, in order to mimic

\begin{itemize}
\item \textsuperscript{14} See pp. 118-29.
\item \textsuperscript{15} Some predict that large industrial and residential customers will square off in a civil war in the restructuring debate: large industrial customers hope to see almost immediate benefits, while small residential customers may see increases in rates. See Peter Navarro, \textit{A Guidebook and Research Agenda for Restructuring the Electricity Industry}, 16 \textit{Energy L.J.} 347, 348 (1995). Small residential customers are especially likely to face rate increases if industrial customers are allowed to leave the incumbent utility without paying some exit fee.
\item \textsuperscript{17} See p. 8 ("[T]he transition from regulated monopoly to competition, like the transition from dirty air to clean, is not free.").
\end{itemize}
the results of a competitive market.\textsuperscript{18} To encourage firms to enter natural monopoly markets and to provide for realities of rate regulation, however, regulators routinely base rates on average costs.\textsuperscript{19} Regulated and competitive markets would yield identical costs only if the average regulated price of an asset equaled the marginal cost of duplicating that asset today. Due to the divergence between average costs in regulated markets and marginal costs in competitive markets for identical services, regulated firms may own assets for which they have not received full compensation. To the extent that these assets no longer generate adequate revenues to cover their remaining capital costs—or are "stranded costs"\textsuperscript{20}—Sidak and Spulber argue that government bears a legal responsibility for compensation, as a matter of both contract and constitutional law.\textsuperscript{21} In addition to developing a legal argument to support government liability for deregulation, the authors support their position with economic analysis, contributing to a growing literature on the law and economics of networks.

In advancing their case for government compensation, Sidak and Spulber present a mish-mash of legal and policy arguments for what should constitute a deregulatory taking. Four conditions, they suggest, are necessary and sufficient to establish a deregulatory taking: (1) the existence of a regulatory compact, (2) evidence of investment-backed expectations, (3) the elimination of regulatory entry barriers, and (4) a decline in the regulated firm's expected revenues.\textsuperscript{22} As a matter of economic policy, they argue, compensation under such circumstances is warranted, because it creates the appropriate incentives to encourage future investment.\textsuperscript{23} In so doing, they echo Frank Michelman's takings analysis, which suggests that regulation should be undertaken without compensation only when the

\textsuperscript{18} See Mark Seidenfeld, Microeconomic Predicates to Law and Economics 61-63 (1996) (noting that regulated industries are more efficient than monopolies but must set prices slightly higher than the market price in order to encourage investment).

\textsuperscript{19} See id. (explaining that regulators must set price at average cost in order to encourage entrants in the regulated industry); see also Stephen Breyer, Regulation and Its Reform 15-16 (1982) (stating that "where economies of scale render competition wasteful, the classical economist or regulator will try to set price near incremental cost in order to induce the natural monopolist to expand its output to a socially preferred level").

\textsuperscript{20} Although some might refer to these as stranded assets, this is a misnomer. In most cases, the assets will not be retired completely due to deregulation but will continue to have at least some economic value.


\textsuperscript{22} See p. 450.

\textsuperscript{23} See pp. 215-16.
efficiency gains of regulation outweigh the lesser of demoralization costs—
measured in part by the adverse effects of the government decision on
incentives for future investments—and settlement costs—the costs of reach-
ing compensation settlements adequate to avoid demoralization costs.24

The breach of contract basis for compensation of utility investments,
Sidak and Spulber argue, finds some support in United States v. Winstar
Corp.25 a Supreme Court case that the authors read to indicate “how the
Court would likely view a case involving recovery of stranded costs arising
from breach of the regulatory contract . . . .”26 In Winstar, the Court
decided whether the United States was liable for breaching contracts the
Federal Home Loan Bank Board had signed with thrifts to encourage
healthy thrifts to merge with failing ones during the 1980s savings and loan
crisis.27 The agreements allowed healthy thrifts to amortize supervisory
goodwill over a period of twenty-five to forty years, allowing these thrifts
an opportunity to recover the costs of supporting the sick thrifts. The
savings and loan crisis continued, though, and in 1989 Congress enacted
the Financial Institutions Reform, Recovery, and Enforcement Act of 1989
(FIRREA).28 FIRREA prohibited thrifts from counting supervisory good-
will toward capital requirements, essentially voiding the contracts the Board
had signed.29 The thrifts sued and won a breach of contract claim against
the government.30 On appeal, the Supreme Court upheld the damages
award against the government, although the justices split on the rationales
for doing so.31 The case, according to Sidak and Spulber, illustrates how

24. See Frank I. Michelman, Property, Utility, and Fairness: Comments on the Ethical
Foundations of “Just Compensation” Law, 80 HARV. L. REV. 1165, 1214-15 (1967). In Michelman’s
view, when a taking has occurred, “compensation is due whenever demoralization costs exceed
settlement costs, but not otherwise.” Id. at 1215.
27. Winstar, 518 U.S. at 843 (“The issue in this case is the enforceability of contracts between
the Government and participants in the regulated industry, to accord them particular regulatory
treatment in exchange for their assumption of liabilities that threatened to produce claims against the
Government as insurer.”).
in an amount not less than 3 percent of the savings association’s total assets”); 12 U.S.C. § 1464(q)(9)(A) (defining “core capital” to exclude “unidentifiable intangible assets”); see also Winstar,
518 U.S. at 857 (noting that the statute defines “core capital” to exclude “goodwill”).
30. The thrifts sued and won summary judgment on the liability portion of a breach of contract
claim against the government in the United States Claims Court. See Winstar v. United States, 25 Cl.
Ct. 541 (1992); Statesman Sav. Holding Corp. v. United States, 26 Cl. Ct. 904 (1992). This finding
of liability was affirmed on appeal to the U.S. Court of Appeals for the Federal Circuit. See United
States v. Winstar, 64 F.3d 1531, 1551 (Fed. Cir. 1995).
31. In short, the plurality and concurring opinions disagree as to whether the government’s
sovereign defenses were applicable to the disputed contract. See Winstar, 518 U.S. at 919-21 (Scalia,
J., concurring) (distinguishing his conclusions from those of the plurality opinion). Justice Souter wrote
the four-justice plurality opinion that held that the contract was enforceable because the government’s
sovereign defenses were inapplicable. See id. at 871-910. Scalia’s concurrence, joined by two other
government can be held liable, under the Tucker Act,\textsuperscript{32} for breach of contract.\textsuperscript{33}

Sidak and Spulber also advance the possibility of recovery under the Takings Clause of the Constitution. The strongest case laying the foundation for Sidak and Spulber’s deregulatory takings argument is \textit{Northern Pacific Railway v. North Dakota}.\textsuperscript{34} There, the Court held unconstitutional a North Dakota statute that set maximum rates on the interstate carriage of coal, forcing two railroad companies to carry coal at an uncompensatory rate. In reaching its decision, the Court reasoned that the state cannot “appropriat[e] . . . property to public uses upon terms to which the carrier had in no way agreed.”\textsuperscript{35}

Sidak and Spulber’s argument also builds on the notion of regulatory takings, a principle Justice Holmes may have anticipated when he famously stated, “while property may be regulated to a certain extent, if regulation goes too far, it will be recognized as a taking.”\textsuperscript{36} In \textit{Penn Central Transportation Co. v. New York City},\textsuperscript{37} the Court explicitly recognized a regulatory takings test.\textsuperscript{38} Under \textit{Penn Central}, courts are to assess a variety of factors in determining whether regulation constitutes a taking, including “the character of the governmental action,” its “economic impact,” and “the extent to which the regulation has interfered with distinct investment-backed expectations.”\textsuperscript{39}

\begin{thebibliography}{9}
\bibitem{32} 24 Stat. 505 (1887) (codified in various sections of 28 U.S.C. (1994)).
\bibitem{33} See p. 198 (citing 28 U.S.C. § 1491(a)(1) (1994); \textit{Winstar}, 518 U.S. at 914-16). Under the Tucker Act, Congress waived its sovereign immunity defense in contract actions. See 28 U.S.C. § 1491(a)(1). The Tucker Act does not apply to claims against states, which are largely responsible for allowing competition in both retail electricity and local telephony. See 28 U.S.C. § 1346 (waiving only United States sovereign immunity for specified types of claims); Brazos Elec. Power Coop., Inc. v. United States, 144 F.3d 784, 787 (Fed. Cir. 1998) (noting that an element of Tucker Act claims is that they are brought against the United States). As Sidak and Spulber observe, though, many states have also waived sovereign immunity for claims in contract and tort. See p. 194.
\bibitem{34} 236 U.S. 585 (1915).
\bibitem{35} Id. at 598.
\bibitem{36} Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 415 (1922). While many, such as Richard Epstein, Chief Justice Rehnquist, and Justice Scalia, read \textit{Mahon} as one of the first regulatory takings cases, one recent author argues that Holmes’s opinion does not endorse—or necessarily provide an intellectual precursor to—a strong regulatory takings test. See William Michael Treanor, \textit{Jam for Justice Holmes: Reassessing the Significance of Mahon}, 86 Geo. L.J. 813, 815 & n.8, 816 (1998) (arguing that minimal scrutiny of economic legislation is the proper reading of \textit{Mahon}, understood in the context of Holmes’s jurisprudence).
\bibitem{37} 438 U.S. 104 (1978).
\bibitem{38} Id. at 124.
\bibitem{39} Id. For further discussion of the doctrine, see \textsc{William A. Fischel}, \textit{Regulatory Takings} (1995). Fischel’s book, advancing one of the more novel interpretations of regulatory takings, argues that compensation for a regulatory taking should only occur for regulations by local governments of property that is immovable or inelastic in supply. In defending this position, he argues that the political
Deregulatory Takings

Sidak and Spulber remind us that for breach of contract under the Tucker Act, deregulation should be treated no differently than regulation. Sidak and Spulber also argue that measures of just compensation should mirror awards of damages given in the contractual setting—specifically, the change to the firm's investment-backed expectations. To give some rigor to this measurement in the deregulation context, the authors, relying on the work of several economists, endorse in general the efficient component-pricing rule (ECPR), which states that “the price of an input should equal its average incremental cost, including all pertinent incremental opportunity costs.” Under the ECPR, “the economic cost of the input to be sold by the incumbent [utility] to another company is the [utility's] direct cost of making the input plus the opportunity foregone by the [utility] from making the sale.

The issues Sidak and Spulber address are critical for a variety of network industries, and are the subject of pending litigation in the telecommunications and electric utility industries. For example, electric utilities have invested tens of billions of dollars in power plants to meet their obligations to serve customers within their service territories. Once retail competition is implemented, however, incumbent utilities will lose their guarantee of recovery of the value of these assets through regulated rates. Many electric utilities have already claimed significant stranded costs, which are alleged to total as much as $200 billion for the entire industry, exceeding the value of equity in electric utilities today.

Sidak and Spulber develop a creative argument as to why recovery of stranded costs may be justified. Although some states, such as California, have allowed full recovery of stranded costs as a part of their state restructuring plans, in other states, such as New Hampshire, deregulation of the
industry has proceeded with less than full recovery. When regulators provide less than full recovery of utility investment-backed expectations, Sidak and Spulber’s argument aids utilities in their battle to compel compensation for federal and state regulators’ reinvention of the regulatory compact. For instance, the Pennsylvania Public Utility Commission’s rejection of a competition transition charge intended to facilitate recovery of stranded costs, proposed by a utility, PECO Energy, led the utility to file takings challenges in federal and state court in January 1998.

II. Taking Liberties With Takings Jurisprudence

Although Sidak and Spulber provide an extensive and historically interesting discussion of legal doctrine, at times their legal analysis of deregulatory takings is at odds with the case law, properly read. They overstate the judicial support for their position, often ignoring arguments that call into question their interpretation of the law. They also gloss over several practical impediments to asserting claims for recovery of damages for deregulatory takings.

A. The Weak Legal Foundations

Sidak and Spulber correctly observe the principle of the regulatory compact in some of the cases, particularly those from the Gilded Age. In addition, the potential impact of government action on the firm, as Sidak and Spulber stress, is an important factor in assessing whether a taking has occurred: as the Permain Basin Rate Cases observed, “the power to regulate is not a power to destroy.” Many cases following the New Deal, however, substantially limit the availability of recovery against the government for takings claims brought by regulated utilities.

Most notably, in Market Street Railway v. Railroad Commission the Supreme Court refused to require compensation where the government did not authorize full recovery of the costs of obsolete technology—there, San Francisco streetcars and bus lines valued by regulators at less than one-third the amount at which rate base would have been valued using...

49. See pp. 240-41.
51. Id. at 769 (quoting Stone v. Farmers' Loan & Trust Co., 116 U.S. 307, 331 (1886)).
52. 324 U.S. 548 (1945).
historical or reproduction costs.\textsuperscript{53} Since this case, courts have consistently imposed on regulated firms the risk of changing technological and economic circumstances.\textsuperscript{54}

Sidak and Spulber’s efforts at distinguishing key takings cases, such as \textit{Market Street Railway}, are flawed. The authors correctly emphasize that \textit{Market Street Railway} was concerned primarily with changing economic and technological forces, not with an independent government decision to impose a policy on industry. As Sidak and Spulber observe, the Court itself had noted that by 1919 the Secretary of Commerce and Secretary of Labor had advised President Wilson that the urban street railway industry was “virtually bankrupt.”\textsuperscript{55} But the authors greatly understate the extent to which economic and technological forces have played a significant role in making competition in the electricity and telecommunications industries feasible.\textsuperscript{56}

Sidak and Spulber also fail to recognize structural similarities between the industry at issue in \textit{Market Street Railway} and current industries undergoing restructuring. The authors argue that the major distinction between the 1945 urban street railway industry and the current electricity industry is that “today’s electric power industry does not face steadily diminishing demand for electricity and the looming obsolescence of its transmission and distribution infrastructure.”\textsuperscript{57} Paradoxically, Sidak and Spulber do not generalize to the industry level when addressing the facts of \textit{Market Street Railway}. In the early- to mid-twentieth century, the transportation industry, taken as a whole, was in a state of transition, much like today’s electric power and telecommunications industries; some transportation sectors, such as street cars, were in a precarious economic state, while other sectors, such as subways, railroads, and later, automobiles, were undergoing periods of stability or growth.\textsuperscript{58} The analogy is a close one if Sidak and Spulber’s analysis of the facts of \textit{Market Street Railway} is

\textsuperscript{53} Id. at 557, 564-65.
\textsuperscript{54} See infra notes 60-71 and accompanying text.
\textsuperscript{55} P. 258 (citing \textit{Market St. Ry.}, 324 U.S. at 565 n.8).
\textsuperscript{57} P. 258.
\textsuperscript{58} See INTERSTATE COMMERCE COMM’N, INTERSTATE COMMERCE COMMISSION ACTIVITIES, 1887-1937, at 46 (1937) (describing prosperity in the interstate railway industry between 1920 and 1929); HERMAN MERTINS, JR., NATIONAL TRANSPORTATION POLICY IN TRANSITION 13-20 (1972) (describing shifts in the transportation industry between 1920 and 1939).
applied consistently to today's electric power industry: certain generation resources, such as nuclear power, are obsolete, much as the urban street railway infrastructure was at the time of the Court's opinion. Given the strong analogies between the urban street railway industry then and today's nuclear or single cycle coal-fired generation industry, the problems at issue in Market Street Railway are structurally similar to restructuring in today's electric power industry, despite the authors' claims to the contrary.

Nor do later cases support Sidak and Spulber's argument for mandatory compensation. In Duquesne Light Co. v. Barasch the Court held that the legislature's failure to allow a utility to recover $35 million for canceled plants that regulators had previously deemed prudent was not a taking, because the cancellation would only reduce the utility's annual revenue by 0.5%. In reaching its conclusion, the Court focused on two factors: (1) whether "slightly reduced rates jeopardize the financial integrity of the companies, either by leaving them insufficient operating capital or by impeding their ability to raise future capital"; and (2) whether "rates are inadequate to compensate current equity holders for the risk associated with their investments under a modified prudent investment scheme." As Duquesne illustrates, complete recovery of investments induced by government is not constitutionally guaranteed.

Despite Penn Central's explicit recognition of a regulatory takings doctrine, later regulatory takings cases also do not compel compensation in every instance where changes in regulation causing economic losses can be asserted. For example, in Ruckelshaus v. Monsanto Co., the Court refused to find a taking based on the data-disclosure provisions of the Federal Insecticide, Fungicide, and Rodenticide Act where there was no explicit guarantee by the government of confidentiality and exclusive

59. See Bamaby J. Feder, Nation's Biggest Atomic Utility to Shut 2 Units, N.Y. TIMES, Jan. 16, 1998, at A10 (observing that many utilities are reducing operations at nuclear and coal-fired plants to prepare for competition); Erik Gunn, CBS Corp.: British Company, Engineering Firm Buy Westinghouse Units, CHI. TRIB., June 27, 1998, § 2, at 2 (noting that "nuclear power is becoming obsolete" in the United States).


61. Id. at 312.

62. Id.

63. Id.

64. Id. There are, of course, exceptions favoring utility recovery of investments. For example, the D.C. Circuit has held that the Federal Energy Regulatory Commission was required to hear a complaint alleging a taking in which the agency excluded from the rate base the unamortized portion of a $397 million investment in an unfinished nuclear plant. See Jersey Cent. Power & Light Co. v. Federal Energy Regulatory Comm'n, 810 F.2d 1168, 1170, 1187-88 (D.C. Cir. 1987). But see Cook Inlet Pipe Line Co. v. Alaska Public Utils. Comm'n, 836 P.2d 343, 350 (Alaska 1992) (concluding that no taking had occurred where a utility's rate base had been reduced 57% because the utility had failed to demonstrate that the reduced rates affected the company's financial integrity).

65. See supra notes 37-39 and accompanying text.

use. 67 In applying *Penn Central*, the Court reasoned that "[a] 'reasonable investment-backed expectation' must be more than a 'unilateral expectation or an abstract need.'" 68 With respect to some data, however, which by statute the EPA was prohibited from disclosing publicly, the Court reasoned that Monsanto had a reasonable investment-backed expectation. 69 *Kaiser Aetna v. United States*, 70 a case in which the Court found a taking, can be distinguished: there, the Court stressed that a physical invasion was present due to the state's imposition of a navigational servitude on a marina. 71 For the most part, the deregulatory takings cases Sidak and Spulber anticipate are not physical invasion cases.

In addition, after the Supreme Court's opinion in *United States v. Winstar Corp.*, the availability of breach of contract claims against the government is much narrower in the regulated utility context than Sidak and Spulber suggest. *Winstar* simply reaffirmed, by a five-to-four margin, the traditional unmistakability doctrine—that promises by the government to forego certain types of future regulatory action will be enforced by the Court only if these are set forth in unmistakably unambiguous language, which a plaintiff bears the burden of proving. 72 There is a presumption that general language in statutes and regulations "'is not intended to create private contractual or vested rights but merely declares a policy to be pursued until the legislature shall ordain otherwise.'" 73

*Eastern Enterprises v. Apfel*, 74 a case decided by the Supreme Court in 1998, after the publication of *Deregulatory Takings*, further illustrates the shakiness of Sidak and Spulber's suggestion that most justices on the Court would endorse their argument. In *Eastern Enterprises*, the Court addressed whether the Coal Industry Retiree Health Benefit Act, 75 which imposed liability on a mining company for its activities as far back as thirty to fifty years ago to finance benefits for retired workers, violated the Due

---

67. Id. at 1005.
68. Id.
69. Id. at 1011.
71. Id. at 180.
72. Although Justices Stevens, O'Connor, and Breyer joined in the portion of Justice Souter's plurality opinion that recognizes a general exception to the unmistakability doctrine for government indemnification agreements, see United States v. Winstar Corp., 518 U.S. 839, 871-87 (1996), five justices rejected this exception. Justices Kennedy and Thomas joined in Justice Scalia's concurrence, see id. at 920-24 (Scalia, J., concurring), and Justice Ginsburg joined Chief Justice Rehnquist's dissent, see id. at 924-31 (Rehnquist, C.J., dissenting).
Process and Takings Clauses. The plurality opinion, written by Justice O'Connor and joined by Chief Justice Rehnquist and Justices Scalia and Thomas (who filed a separate concurrence), reasoned that the pension statute interfered with the company's reasonable investment-backed expectations and thus was a taking without just compensation. The remaining five justices, however, did not believe that the statute raised a takings problem. Although the Court held the statute unconstitutional, only four justices agreed that the statute violated the Takings Clause; Justice Kennedy, joining the majority's result, held the statute unconstitutional on due process retroactivity grounds.

Ultimately, when one cuts through Sidak and Spulber's extensive but selective description of the cases, one finds the authors suggesting something akin to a regulatory estoppel argument, precluding legislatures or agencies from deregulating without full compensation for losses. Yet it is well recognized that neither federal nor state law supports this strong version of regulatory estoppel. On the whole, the case law suggests a much more modest notion of deregulatory takings than Sidak and Spulber imply. Of course, deregulation can, in extreme situations, constitute a taking. Under the case law, however, the state only has an obligation to provide compensation after a firm has suffered and proved a loss to its investment-backed expectations caused by an independent change in government policy. In most cases, this will be extremely difficult for utilities and investors to prove.

B. An Illustration of the Litigation Problem

This more modest understanding of deregulatory takings jurisprudence may have some success in courts; but it is unlikely to compel compensation

76. Id. at 2137.
77. Id. at 2153. Justice Thomas's brief concurrence reasons that the Ex Post Facto Clause, as well as the Takings Clause, should apply in this context. Id. at 2154 (Thomas, J., concurring).
78. Id. at 2161.
79. Id. at 2157.
80. Although no doctrine of estoppel applies to the legislature, a doctrine of regulatory estoppel exists under which an agency may be estopped from violating its own laws. For a discussion of the basic principles applicable to administrative agencies, see Peter Raven-Hansen, Regulatory Estoppel: When Agencies Break Their Own "Laws," 64 TEXAS L. REV. 1, 5-9 (1985) (analyzing Supreme Court cases that form the basis for the regulatory estoppel doctrine, which holds that agencies are bound to follow their own rules because these rules have the force and effect of law), and Joshua I. Schwartz, The Irresistable Force Meets the Immovable Object: Estoppel Remedies for an Agency's Violation of Its Own Regulations or Other Misconduct, 44 ADMIN. L. REV. 656, 660-68 (1992) (observing that the Supreme Court has repeatedly rejected equitable estoppel claims against administrative agencies, but has not completely closed the door). Sidak and Spulber briefly discuss promissory estoppel as applicable to regulatory agencies, see pp. 210-12, but do not address the case law behind, or specifics of, the regulatory estoppel argument.
Deregulatory Takings

in many—and certainly not most—contexts. Consider, for example, recent litigation raising a takings challenge to deregulation policies for the electric utility industry in Pennsylvania. PECO Energy, a utility, drafted a partial settlement that would have established a competitive transition charge to recover what it claimed were over $5 billion in stranded costs. The Pennsylvania Public Utility Commission (PUC) rejected PECO’s compromise, which contained a mandated rate reduction, in large part because it believed the utility was overreaching in its claim for stranded costs. In the end, the Commission allowed recovery of some stranded costs, but substantially less than the utility had sought.\(^\text{81}\) Although the case has since settled,\(^\text{82}\) the facts raise several difficult legal issues.

First, could PECO establish the existence of a regulatory compact? Whether deregulation is a “taking” will depend upon a showing of a regulatory compact, a commitment on behalf of government to bear the bulk of the risk of regulatory change. The evidence of such a commitment proffered by PECO would include statutes, regulations, orders approving plant construction projects, rate orders, and tariffs. In other words, PECO would have to rely almost entirely on sources of public law to establish the existence of a contract, but probably would not have an express government statement—and certainly would not have unmistakably unambiguous language in these sources of law—that government will protect industry from regulatory change. Instead, as with most statements of law, some ambiguity as to the future would likely be implicit. It is hardly going to be easy for utilities to prove the existence of a government commitment, which will be necessary to compel compensation under the deregulatory takings jurisprudence Sidak and Spulber advocate.

Second, could PECO prove that the PUC’s breach of the regulatory compact is causally related to the damage it claims it suffered? Causation complications arise, because endogenous changes in regulation are often the result of—or at least occur simultaneously with—changing technological and economic conditions, which Sidak and Spulber characterize as exogenous. According to Sidak and Spulber,

Exogenous shocks are external effects such as fluctuations in market demand, variations in the cost of labor, equipment, and technology, and environmental factors such as the effects of weather on electric power usage, or the effects of adverse weather conditions on the

\(^\text{81}\) See Isser & Mitnick, supra note 48, at 40 (noting that the “most important modification of the stranded cost claim was the rejection of the company’s calculation of the expected costs associated with its generation assets”).

\(^\text{82}\) See Pennsylvania Settlement Will Open Market, supra note 48, at 1 (observing that settlement of the takings litigation gave PECO $1.4 million more in stranded cost recovery than the Commission had allowed).
operation of the utility's facilities. Endogenous shocks are
determined by the effects of the regulator's actions on the riskiness
of the utility's stream of earnings over time.83

Sidak and Spulber suggest that changes in economic and technological
conditions, as in Market Street Railway, do not necessarily warrant
compensation, but that independent government changes in regulation
do.84 Yet separating endogenous from exogenous factors is not a task that
a court will be able to perform easily. The task will be greatly complicated
to the extent that endogenous government regulation is a reaction to—or an
effort to mitigate—the very exogenous shocks that the authors claim do not
necessarily warrant compensation as a matter of law and policy.85

Third, and related to the causation issue, what is the damage that
PECO incurred? PECO followed the Commission's decision by taking a
$3.1 billion write-off, in anticipation of losses it claimed to be a result of
the Commission's decision. Yet PECO's common stock prices were
$22.93 a share before it filed its settlement, and $23.96 a share immedi-
ately after the Commission's decision. The day after the PUC's decision
and again later, Standard & Poor's affirmed its ratings of PECO.86
Several months later, PECO's stock had climbed to $30 a share.87
Assuming a taking can be established, damages will be extremely difficult,
if not impossible, to prove ex ante. While ripeness and finality require-
ments are satisfied as soon as regulators have adopted specific plans for
deregulation, it could take years for a taking to materialize for purposes of
measuring compensation.

Sidak and Spulber argue that efficient investment markets will immedi-
ately recognize losses due to deregulation.88 Two problems, however,
plague investment market data measures of damages. To begin, what today

83. See p. 437.
84. See p. 494 ("To establish a deregulatory taking, it should be necessary and sufficient for a
regulated firm to show the existence of a regulated contract; evidence of investment-backed
expectations; the elimination of regulatory entry barriers; and a decline in the regulated firm's expected
revenues."). Sidak and Spulber attempt to distinguish local telecommunications and retail electric
competition from deregulation of railways, airlines, wholesale electricity, the long-distance telephone
industry, and the natural gas industry. In these latter industries, the authors claim, "regulators have
afforded the incumbent utility the opportunity to recover costs stranded by regulatory change rather than
exogenous declines in demand for the utility's services." Id.
85. In addition, it will be difficult to establish which economic losses can be attributed to
deregulation and which result from the existence of other laws. For example, regardless of whether
deregulation occurs, the sale of obsolete generation assets may lead utilities to take a big tax hit, to the
extent the tax basis of these assets has been completely depreciated. Thus, utilities may also suffer
some losses because of tax laws. For a discussion of causation in the context of takings jurisprudence,
86. See Isser & Minick, supra note 48, at 41 (concluding from the bond markets' reaction to the
PUC decision that the decision was "not . . . a disaster" for the utility).
Deregulatory Takings

is considered obsolete technology may still have some substantial economic value in a deregulated environment. For example, while “many predict that nuclear power will not be able to compete in the increasingly deregulated electricity market,” utilities that possess such assets have engaged in serious negotiations aimed at selling them. Not all generation assets that utilities today claim as stranded by deregulation will necessarily lack economic value in the competitive environment. Due to loss aversion, the potential losses from changing the status quo are more likely to influence investors than are uncertain gains. Uncertainty about the future may lead investors to discount the benefits to the firm of a competitive market.

A second problem that complicates the analysis relates to the proof of damages. Aggregate, firm-wide financial data will be of little assistance to regulators because deregulation will bring benefits to many utilities that also claim losses. For example, many utilities that own inefficient or obsolete generation facilities also will incur stranded benefits in a competitive industry due to their valuable distribution and transmission systems, including their rights of way. Without complete data, courts would be foolish to compensate utility write-offs taken for strategic economic reasons in the face of future uncertainty about the nature and degree of competition in the industry. Strategic behavior by utilities may bias the information regarding losses available to investors today, leading to exaggerations in the costs of deregulation as measured by investor behavior data.

Not surprisingly, the cases to date directly addressing the deregulatory takings argument provide only cursory analysis in rejecting the claim. For instance, a New York state court rejected several utilities’ challenges to the New York Public Service Commission’s restructuring plan, observing that the constitutional protections of “just and reasonable” rates “do not necessarily guarantee utilities net revenues nor do they immunize utilities from the effects of competition.” Similarly, a Michigan appellate court, addressing whether retail wheeling constitutes a taking without just

---

90. See id. (describing GPU, Inc.’s negotiations with a potential buyer for nuclear generators, including Three Mile Island Unit 1).
92. Due to cognitive problems, firm-generated data regarding losses, once circulated, may be overrated by investors. See id. at 399-400.
93. Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 600, 603 (1944) (upholding “just and reasonable” and “end result” tests against takings and nondelegation challenges).
compensation under a theory of per se physical invasion, rejected the utilities' claims, relying on authority similar to the New York court's.95

The only reported judicial decision to use the term "deregulatory takings" is Gulf Power Co. v. United States.96 In Gulf Power the court found a physical invasion of utility poles, which was mandated under the Pole Attachment Act (as amended by the Telecommunications Act of 1996),97 to be a per se taking, but held that the FCC, in the first instance, is the appropriate institution to address the just compensation issue.98 This, though, is a per se physical invasion case; it does not address the stranded cost issue posed by deregulation.

Despite Sidak and Spulber's claims, the case law does not overwhelmingly support compensation in the context of utility industry restructuring. Although the cases to date that address the deregulatory takings issue provide little reasoning, the results they reach are probably correct. We simply do not know the value of the loss until it is incurred, which suggests that the wait-and-see approach of a more modest deregulatory takings position is more tenable than Sidak and Spulber's position. Indeed, this is the approach endorsed by the court in Gulf Power, which held that a judicial determination of just compensation in the first instance is not required upon each occasion of a taking of property.

III. The Policy Failures of Deregulatory Takings

Sidak and Spulber's analysis of the efficiency of compensation, as well as their formulation of pricing rules, also gives short shrift to some of the important intellectual contributions of public choice theory and the law and economics of risk and legal transitions. In the course of their book, Sidak and Spulber argue that economic efficiency requires compensation of all investment-backed expectations that are upset by deregulation. This argument places the risk of endogenous regulatory change on government, which in turn will likely pass this on to consumers, if the state authorizes utility recovery of the costs of deregulation, or taxpayers, if the costs of deregulation come out of the public fisc.

Their argument gives short shrift to one jurisprudential understanding of the Takings Clause, which is reinforced by the law and economics literature. The Takings Clause is commonly understood to be Lockean in nature—a substantive safeguard protecting minority property interests against the will of majorities—but it has also been described as a type of

95. See In re Retail Wheeling Tariffs, 575 N.W.2d 808, 815-16 (Mich. Ct. App. 1998) (arguing that "reasonable interference" with a public utility's "equipment and services" is constitutional and supported by Michigan law because the utility is a "regulated entity" whose "property is used for a public purpose").
98. Id. at 1396-97.
assurance against governmental action without careful consideration by regulators of the social welfare implications of their actions. Because lawmakers may be required to pay compensation if they effect a taking, they are more likely to consider carefully the costs and benefits of regulation prior to adopting laws—instead of responding to the naked rent seeking of powerful, well-organized interest groups, who may seek to enhance their own wealth at costs to the public.99 In other words, the Takings Clause not only works to protect private property owners against burdens imposed by the will of majorities; it can also work to improve the lawmaking process in circumstances in which special interest groups are likely to use the process to extract private benefits at significant costs to others.

This understanding of takings jurisprudence has some basis in the law and economics literature, particularly public choice theory. As public choice theory teaches, governmental decisions are often influenced by regulated industry.100 Oliver Williamson makes this observation in his response to an early Sidak and Spulber article, to the extent he suggests that inefficiencies resulting from opportunism in the regulatory process may excuse some deregulatory takings.101 Industry may play an active role in formulating regulation, or may willingly submit to regulation where government has instituted mechanisms designed to compensate industry for the burdens it imposes. For example, under rate regulation, utilities themselves face incentives to assume service obligations independent of any government mandate—even obligations to provide service below total cost—because they are guaranteed recovery of the costs of service and cross-subsidization of service may be facilitated through ratemaking.102


100. See George J. Stigler, The Theory of Economic Regulation, 2 BELL J. ECON. & MGMT. SCI. 3, 11 (1971) (suggesting that large industries will support complacent government representatives whose offices are dependent on those industries). For a general survey of public choice theory, see DENNIS C. MUELLER, PUBLIC CHOICE II (1989). For discussions of public choice theory in law, see DANIEL A. FARBER & PHILIP P. FRICKER, LAW AND PUBLIC CHOICE: A CRITICAL INTRODUCTION (1991) and JERRY L. MASHAW, GREED, CHAOS & GOVERNANCE: USING PUBLIC CHOICE TO IMPROVE PUBLIC LAW (1997). One renowned public choice theorist advises against allowing utilities stranded cost recovery. See William A. Niskanen, A Case Against Both Stranded Cost Recovery and Mandatory Access, REGULATION, Number 1, 1996, at 16, 16 (claiming that allowing utilities to recover their stranded costs is an expansion of property rights because it requires the customers to pay to protect the investors’ value against changes in the market or technology); see also WILLIAM A. NISKANEN, JR., BUREAUCRACY AND REPRESENTATIVE GOVERNMENT (1971) (presenting a classic application of public choice theory to bureaucracy).

101. See Williamson, supra note 3, at 1013-14.

If the strong deregulatory takings position were adopted as a legal rule, it would likely have perverse implications for future legal and regulatory processes. A rule in favor of compensation based on lost expected revenues creates incentives for private industry to seek out government assistance in the regulatory process, regardless of the public good. In other words, an industry might realize that, by entering into a compact with government, the state can indemnify it against the risks of changing technology and new entrants. The result may be more government regulation than is socially optimal.

Consider, for example, a phenomenon familiar to students of regulation—the Averch-Johnson effect. Economists have observed that the traditional rate regulation process may have led to overinvestment in capital, including power generation facilities, as utilities have strategically sought to guarantee income streams. Under Sidak and Spulber's analysis, once competition is introduced to a formerly rate-regulated industry, such as telecommunications or electricity, government should bear the responsibility for this overinvestment. To be sure, utilities probably would not have invested in certain generation assets absent rate recovery. At the same time, though, utilities have strategically used this process to ensure revenue streams. To suggest that government bears the entirety of the responsibility for overinvestment oversimplifies the dynamic nature of the regulatory process.

Because of the role of interest groups in the decisionmaking process, adoption of some of Sidak and Spulber's legislative and regulatory proposals could recreate many of the same problems with ratemaking that brought about the need for deregulation in the first place. As regulators attempt to construct stranded cost surcharges, utilities will likely seek recovery of many questionable and speculative items. For example, the very existence of regulator-endorsed surcharges for stranded cost recovery could encourage utilities to take write-offs and to exaggerate their risks, including long-term contracts that could perhaps more efficiently be renegotiated in light of increased industry competition. Without a rigorous regulatory system for determining surcharges—one which, like the rate regulation process, scrutinizes carefully all proposed items of inclusion—Sidak and


104. See Joskow & Schmalensee, supra note 16, at 86 (summarizing the Averch-Johnson theory that regulation has resulted in distorted levels of capital investment and excess capacity).


106. See Michaels, supra note 6, at 21 (warning against rent seeking in the stranded cost compensation process).
Spulber's proposals for recovery have little basis in sound economic theory.

For these reasons, the specific recovery mechanism Sidak and Spulber embrace, the market-determined ECPR, may overstate the efficient level of compensation in a competitive environment. The ECPR, as Sidak and Spulber present it, entitles regulated utilities to the recovery of both historical and opportunity costs.\(^\text{107}\) Although Sidak and Spulber claim that the ECPR will be set by the market, cost information will need to be presented to regulators to ensure appropriate market oversight.\(^\text{108}\) Claims to recovery of historical costs, however, will be based on past investment decisions made in the context of rate regulation. Under the case law, as Market Street Railway illustrates, there is no guarantee of full recovery of these historical costs. Further, to the extent that the past regulatory process may have contributed to exaggeration of these costs (as public choice theory would predict), these historical inefficiencies will continue under the ECPR.\(^\text{109}\) As Oliver Williamson has observed, strategic investment concerns arise under the ECPR.\(^\text{110}\)

In addition to slighting some of the lessons of public choice theory, Sidak and Spulber fail to fully address counterarguments from the law and economics of risk. Because contracts governing all risks are costly to write ex ante—a principle that Sidak and Spulber, who find liability based on a regulatory contract, seem to play down—some mechanism for interpreting risk bearing ex post, such as superior risk-bearer analysis, is necessary.\(^\text{111}\)

A risk analysis of the regulatory contract, it has been noted, should consider two factors: first, "which party could best adapt to ensure against the risk that a costly contingency would ensue";\(^\text{112}\) and second, "which party could mitigate damages at least cost by changing the likelihood of that contingency arising or the magnitude of costs due to breach of the

---


108. See p. 368.

109. For criticism of the ECPR, see Nicholas Economides & Lawrence J. White, Access and Interconnection Pricing: How Efficient is the "Efficient Component Pricing Rule?", 40 ANTITRUST BULL. 557, 573-74 (1995) (arguing that if the ECPR is above marginal cost there will be an economic distortion). For discussion of its limits and assumptions, see Jean-Jacques Laffont & Jean Tirole, Access Pricing and Competition, 38 EUR. ECON. REV. 1673, 1693-94 (1994) (noting that to be optimal the ECPR must be subject to certain conditions, among them a benchmark pricing rule of marginal cost pricing).

110. See Williamson, supra note 3, at 1019 (predicting that established monopolies will be in a position to take disproportionate advantage of the ECPR relative to other firms).


contract."113 With respect to each of these factors, there is reason to believe that industry may be in the better position to bear the risks and costs. For example, given uncertainty regarding the recovery of stranded costs, many utilities have voluntarily sought to securitize the risks associated with generation assets,114 with an expectation of takings compensation, it is unlikely utilities would have voluntarily pursued such innovative approaches towards the stranded cost issue. In addition, the possibility of industry opportunism in the regulated environment gives some efficiency basis for placing a portion of the risk of change on the regulated industry. To suggest that government bear the entirety of the risk is to ignore the comparative institutional advantages of government vis-à-vis industry in taking actions to minimize the costs of legal transition. Sidak and Spulber fail to pay sufficient attention to the contribution of superior risk-bearer analysis to the deregulatory takings issue.

In assessing risk bearing in this context, regulators should consider not only reliance interests and expectations, as Sidak and Spulber urge, but also the relationship between risk and incentives. In his analysis of legal transitions, Louis Kaplow observes, "anticipated ex post results—including the effects of transitional relief—affect ex ante incentives."115 Compensation may, public choice theory reminds us, create additional incentives favoring government regulation regardless of whether this is welfare enhancing. For this reason, the optimal compensation scheme from an economic efficiency perspective may provide for only partial indemnification of expectation or reliance losses from changes in regulation.116 The law and economics of transitions—a literature the authors ignore completely—presents a much more nuanced approach to these issues, one that generally disfavors compensation and which does not

113. Id.

114. Securitization entails setting up either a limited liability company of which the utility is the sole member or a trust in which the utility owns all of the equity interest, which then issues securities and covers the principal and interest with the collection of tariffs under a rate charge. This provides a means to achieve a low financing cost from the higher rating assigned to the security. See M. Douglas Dunn & Albert A. Pisa, The Stranded Cost Problem and the Securitization Solution, 12 NAT. RESOURCES & ENV'T 248, 248 (1998) (arguing that securitization is an attractive opportunity for utilities to mitigate the loss of unrecoverable or stranded costs); Walter R. Hall II, Securitization and Stranded Cost Recovery, 18 ENERGY L.J. 363 (1997). For a skeptical analysis of securitization's benefits, see Robert J. Michaels, Securitized Transition Costs: Rethinking Who Wins and Who Loses, ELECTRICITY J., June 1998, at 58, 58 ("In reality though, the savings from securitization are small and highly sensitive to financial forecasts, and the predatory elimination of competitors may be an inferior use of the cash produced by the securities.").


116. The argument is presented in more detail in Steven Shavell, Risk Sharing and Incentives in the Principal and Agent Relationship, 10 BELL J. ECON. 55, 59-60 (1979).
attempt to ground the analysis, as do Sidak and Spulber, in the language of rights and entitlements.\textsuperscript{117} At a minimum, a comparative institutional analysis of risk bearing and incentives would suggest some tempering of the recommendations presented in \textit{Deregulatory Takings}.

A further problem with Sidak and Spulber's argument is that, if it were correct as a matter of law or policy, it would have few limits. The argument can be used to find takings in a variety of licensing renewal or modification contexts. For instance, in the hydropower relicensing context, the Federal Energy Regulatory Commission's recent efforts to decommission hydroelectric projects could constitute a taking under their analysis.\textsuperscript{118} In the licensing and permitting context, their argument would suggest an expansion of litigation against the government as it attempts to modify the conditions under which licenses and permits are issued, regardless of whether this modification is implemented for deregulatory purposes.\textsuperscript{119}

Line drawing, though, is a very serious problem for Sidak and Spulber; it reveals the degree to which their deregulatory takings argument tends to become its own \textit{reductio ad absurdum}. If tax laws are changed, why shouldn't individual and corporate investors be allowed to sue Congress or the Internal Revenue Service for losses to their investment-backed expectations? Why shouldn't the owner of rights to a book or a web page be allowed to sue the government if intellectual property laws are changed, altering their investment-backed expectations? The logic of deregulatory takings, taken to an extreme, makes any legal transition a very risky enterprise for government. It turns our notion of a modern government, one which retains an experimental and flexible approach to lawmaking, on its head.


\textsuperscript{119} In this respect, their argument is eerily similar to the position of Richard Epstein. See Richard A. Epstein, \textit{The Permit Power Meets the Constitution}, 81 \textit{Iowa L. Rev.} 407, 419-22 (1995) (arguing for rigorous enforcement of takings restrictions in the permitting process to protect individual liberty).
IV. Conclusion

Sidak and Spulber's argument in *Deregulatory Takings* harbors an irreconcilable intellectual tension. Their reading of the law is at odds with much of the Supreme Court's post-New Deal takings jurisprudence. Throughout their analysis, Sidak and Spulber fuse a progressive understanding of the nature of regulation with a conservative reading of takings jurisprudence that values reliance interests and demoralization costs over incentives and risk reduction. In addition, the faux progressive understanding of regulation presented by Sidak and Spulber ignores much of the post-World War II learning on public choice theory. The intellectual tension behind their analysis makes it highly unlikely that their argument will find support among a majority of justices on the Supreme Court, or that it will appeal to a substantial number of lower court judges.

Were industry to advance Sidak and Spulber's argument prematurely and lose, this adjudicative defeat could have unanticipated consequences in the legislative and administrative spheres as utilities seek political relief. The relative efficiency of compensation for past risk taking in a regulated environment has large political and economic ramifications. But this is not generally the kind of issue courts are likely to address successfully through either the Takings Clause or an expansion of government liability for breach of contract, especially when the political process has not fully run its course. Should industry press the deregulatory takings claim unsuccessfully in court, industry may undermine appeals to the legislative process for compensation. Indeed, it seems that in the political process the fairness and equity arguments are most likely to generate a sympathetic response from regulators. Given the legal impediments to establishing a deregulatory taking, the industry and investors, as a matter of strategy, might better first seek relief through the political process.

Despite their book's practical and intellectual faults, Sidak and Spulber peddle their deregulatory takings argument at a propitious time. Regulation is under attack in the United States and around the world. *Deregulatory Takings* challenges us to reflect upon how regulation can transform itself while also minimizing the costs associated with any transition. More importantly, their book challenges us to think about how the costs of regulatory transformation should be allocated among stakeholders.

120. *See* Richard J. Pierce, *Public Utility Regulatory Takings: Should the Judiciary Attempt to Police the Political Institutions?*, **77** Geo. L.J. 2031, 2033 (1989) (arguing that the courts should refrain from ratemaking because the political process will produce the superior alternative of a competitive market).