CHAPTER ONE

Regulatory Law

Purposes, Powers, Rights and Responsibilities

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The law of regulation serves the purpose of regulation. This chapter begins by explaining that purpose, as viewed from varied perspectives. It then describes the specific purpose of utility regulatory law: to define the powers, responsibilities, rights and procedures that direct, guide and constrain the actors and agencies with a stake in utility regulation. The chapter closes by describing the subjects and sources of regulatory law and relating those topics to the organization of this work.

1.A. Purposes of regulation

Regulation’s purpose varies with one’s perspective. Economists see regulation as a means to exploit economies of scale from natural monopolies while reducing economic loss in markets with imperfections; imperfections such as high entry barriers, unique products and insufficient information. Absent regulation, those imperfections can lead to destructive competition, unanticipated scarcity, insufficient innovation, negative or positive “externalities” arising from “public goods,” and the “deadweight” economic loss that results when demand and supply curves intersect suboptimally.1

Then there are perspectives of interest groups: consumers (“Protect us from abuse of monopoly power”), shareholders (“Set rates that allow us to earn a fair return on investment”), lenders (“Ensure cash flow sufficient to pay down debt”), competitors of the incumbent utility (“Create conditions allowing new entrants to compete and win on the merits”), low-income advocates (“Make essential services affordable”), environmental advocates (“Minimize environmental damage associated with production and consumption”), rural residents (“Ensure universal service”) and large industrial customers (“Set rates that allow us to compete globally”). Each of these perspectives occupies a narrow band on the private interest spectrum. Some are conflicting. A regulator will find it hard to honor them all.

Overlapping with interest group perspectives are political perspectives. Depending on one’s views, regulation reduces inequities in wealth; protects the vulnerable from deceptive sales practices and price-gouging; “eliminat[es] price as the basis of exchange” in resources that have special societal value (such as worker safety, cultural treasures and endangered species);2 or responds when people “demand more for society than any individual will seek for herself as a consumer.”3 These purposes too can come into conflict—with each

2. See Sidney A. Shapiro & Joseph P. Tomain, Regulatory Law and Policy: Cases and Materials 58–62 (2003). This citation is not meant to imply that the authors have that perspective or exclude other perspectives; it is one among many they identify.
3. Lisa Bressman, Edward Rubin & Kevin Stack, The Regulatory State 62, 79–87 (2010). Again, this perspective is only one among many identified by the authors.
other and with a view that regulation is less able to solve these problems than are unregulated markets.

Given these possibilities of conflict, some describe the role of regulation as “balancing” the interests of shareholders and consumers. A balance presumes opposition of interests. But customers’ and shareholders’ legitimate interests—reasonable prices, reasonable returns, satisfied customers and satisfied shareholders—are consistent and mutually reinforcing. High-quality performance and efficient consumption benefit multiple interests: consumers, shareholders, bondholders, employees, the environment and the nation’s infrastructure. What regulation must balance is not competing private interests but competing components of the public interest—e.g., long-term versus short-term needs, affordable rates versus efficient price signals, environmental values versus global competitiveness.4

For the practitioner and decisionmaker seeking clarity of purpose, the best single lodestar is the statutory language. Regulatory statutes commonly direct regulators to act “in the public interest.” This command necessarily presumes that private interests, absent regulation’s constraints and inducements, will diverge from the public interest. Universal, reliable, safe service at reasonable rates doesn’t happen by itself. In short, regulation is necessary to align private behavior with the public interest.5 Regulation defines standards for performance, then assigns consequences, positive and negative, for that performance. The purpose of regulation is performance.

1.B. Purposes of regulatory law

Regulatory law establishes the powers, responsibilities and rights that achieve regulation’s purpose. How does law distribute these powers, responsibilities and rights among those with a stake in regulatory outcomes?6

1.B.1. Powers

Legislatures receive their powers from constitutions. Using those powers, they establish the responsibilities and rights of citizens and businesses. Legislatures also delegate a portion of their powers to commissions by enacting statutes spelling out duties, procedures, conditions and instructions. Some state commissions also receive powers directly from

4. Cf. Columbia Gas Transmission Corp. v. FERC, 750 F.2d 105, 112 (D.C. Cir. 1984) (interpreting statute to mean that “Commission is vested with wide discretion to balance competing equities against the backdrop of the public interest”).

5. The premise is neither universally shared nor permanently held. Policymakers revisit regulatory statutes when they perceive changes in the facts supporting the original enactment. That has been the case with each of the federal statutes discussed in this book, and many state statutes. The wisdom of regulatory statutes, and their changes, is a subject of continuous debate. The point here is that when a regulatory statute does exist, it exists because its enactors concluded that constraints and inducements were necessary to align private actions with the public interest.

6. Experienced lawyers are welcome to skip this short section, but non-lawyers and new lawyers will benefit from understanding how law organizes its multiple components to produce public interest results.
their state constitutions. Regulated entities can receive powers, too, such as when statutes grant utilities the power to take private land by eminent domain or to cut off customers who violate tariff provisions.

A commission’s regulatory power has substantive scope, also called “jurisdiction.” A commission’s jurisdiction, whether established by statute or constitution, specifies the actors and actions to be regulated. A statute can either order or authorize. It can order a commission to take specified actions under specified circumstances, such as issuing by a specified date a rule on transmission pricing or area-code renumbering, or acting on a merger application or rate increase request. Or the statute can merely empower the commission to act, implicitly leaving the commission with discretion not to act. The commission’s discretionary power can be exercised affirmatively, such as by issuing rules on corporate structure or instituting enforcement proceedings on service quality, or reactively, such as by processing a utility’s merger application or a customer’s complaint seeking a rate decrease.

1.B.2. Responsibilities

A commission’s responsibilities are those mandated by its statute: its specified duties to act affirmatively or to react expediently. But a commission’s responsibilities are not limited by these mandates. It has an obligation to use its discretionary powers actively, to pursue the statute’s public interest purposes. Failure to exercise this discretion brings, in the rare case, a writ of mandamus in the more common case, legislative pressure through oversight hearings and budget amendments.

Utilities have responsibilities also: to provide the obligatory services defined by their franchise agreements and statutes, to maintain quality levels defined by commission rule, and to comply with tariffs ordered or approved by commissions. Utilities have discretion in how they carry out their responsibilities; but their failure to exercise that discretion timely and prudently can bring investigations, penalties and cost disallowances.

7. See, e.g., Ariz. Corp. Comm’n v. Arizona, 830 P.2d 807 (Ariz. 1992) (finding that state commission could limit interaffiliate transactions although no statute granted that power; authority came from the state constitutional provision authorizing commission to set retail rates).

8. See infra Chapter 2.E on eminent domain.

9. A writ of mandamus is an extraordinary order from a court to a public official or agency to take specified action. See, e.g., Cnty. of Santa Fe v. Pub. Serv. Co. of N.M., 311 F.3d 1031 (10th Cir. 2002) (reversing lower court’s denial of mandamus sought by landowners against county; county had a “non-discretionary” duty to stop utility’s unlawful construction of power line); N. States Power Co. v. U.S. Dep’t of Energy, 128 F.3d 754, 758–59 (D.C. Cir. 1997) (granting writ of mandamus precluding DOE from excusing its failure to accept nuclear waste timely; the “remedy of mandamus is a drastic one, to be invoked only in extraordinary situations; . . . only if (1) the plaintiff has a clear right to relief; (2) the defendant has a clear duty to act; and (3) there is no other adequate remedy available to plaintiff”) (quoting other sources).

10. See infra the discussion of “management prerogative” at Chapter 2.D.3.d.

customers have responsibilities: to pay for service timely, to refrain from actions that endanger or disrupt service and to cooperate with the utility in solving service problems.12

1.B.3. Rights
Statutes and constitutions create rights in both regulated entities and those whom regulation protects.

Customers have the substantive right to receive service at commission-set quality levels, at a “just and reasonable” rate authorized by the commission.13 They also have the procedural rights to intervene in commission proceedings and to petition courts for judicial review of commission decisions.

Utilities have the substantive right to charge rates that provide a reasonable opportunity to earn a fair return14 and to receive commission approval of corporate structures, mergers, acquisitions and reorganizations that satisfy statutory standards.15 They also have the procedural rights to present facts that support their substantive rights and to confront opposing witnesses, along with the right to judicial review.

Landowners have rights—to protest when the utility proposes to lay pipes and powerlines on their property and to be paid the constitutionally required “just compensation” if they lose.16

Where statutes or commissions have authorized competition in previously monopoly markets, the new competitors have rights, such as electric generators’ right to non-discriminatory transmission access and competitive local exchange carriers’ right to buy or rent “unbundled network elements.”17

1.B.4. Procedures
Policymakers act in multiple ways. They gather information, pass statutes, promulgate rules, issue orders that adjudicate disputes, and bring enforcement actions. These actions must conform to procedural law, as established by statutes, the Constitution and a commission’s

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13. See infra Chapter 2.D on service quality; Chapters 6 and 7 on cost-based and market-based rates, respectively; and Chapter 9 on the filed rate doctrine.


15. Corporate structure will be covered in the companion volume.


17. See infra Chapter 4.B on “unbundling.”
own rules. Procedural law induces accountability, by empowering the public to observe and influence agency decisionmaking, and by authorizing courts to review the results. Procedures protect against arbitrariness—actions lacking in fact, logic or legal authority—whether those actions are by regulators setting rates, imposing penalties or passing on mergers; or by utilities taking private land or cutting off service. When a commission sets rates, for example, it is exercising a legislative function, because the legislature could set rates directly. While the ratesetting function is legislative, the procedures are often adjudicatory, requiring expert testimony under oath, cross-examination, orders based on substantive evidence and prohibitions on *ex parte* contacts. This work does not cover procedural law. Its focus is regulators’ statutory powers, what they do with those powers, and the constitutional limits on those powers.18

1.C. Subjects and sources of regulatory law

1.C.1. Subjects

Regulatory jurisdiction is defined by nouns and verbs: actors and actions, regulated companies performing regulated activities. Examples of *regulated actors*—the nouns—include: for electricity, generating companies, transmission owners, local distribution companies, vertically integrated companies that combine some or all of those functions, regional transmission organizations, and holding companies; for gas, producers, pipelines, local distribution companies, marketers and storage providers; and for telecommunications, local exchange companies (incumbent and competitive, national and rural), wireless providers, equipment sellers and Internet service providers. Examples of *regulated actions*—the verbs—include: selling at wholesale or retail; merging, acquiring, consolidating or disposing of companies or assets; issuing equity and debt securities; and acquiring and building on land.

To deal with these actors and actions, to perform the regulatory function of aligning private actions with the public interest, legislatures and commissions have created substantive legal principles in four areas.

*Market structure*: Who has a right to sell which products and own which facilities? How easy is entry and exit? Are customers served best—in terms of efficiency, innovation and accountability—by a competitive market or a monopoly market? These are questions of market structure, addressed in Part 1. Its four chapters discuss the responsibilities and rights of the traditional regulated monopoly, including the obligation to serve, quality of service, the power of eminent domain and limits on liability for negligence (Chapter 2); the process of authorizing competition to allow entry by newcomers (Chapter 3); the distinct step of ensuring that authorized competition becomes effective competition, by

“unbundling” competitive from noncompetitive services and by reducing entry barriers (Chapter 4); and then monitoring the new markets to prevent anti-competitive behavior, such as price squeeze, predatory pricing, tying and market manipulation (Chapter 5).

**Pricing:** Prices, set properly—that is, consistent with the statutory “just and reasonable” standard and the Constitution’s “just compensation” mandate—both compensate the seller for its performance and induce customers to consume efficiently. Part 2 addresses pricing’s many facets. In noncompetitive markets, regulators set the prices based on some version of cost (Chapter 6). In markets that allow competitors but that are still subject to a “just and reasonable” statute, some commissions allow sellers to set prices on their own—so-called “market pricing”—subject to regulatory screening and monitoring (Chapter 7). Then there are three longstanding restrictions on sellers’ pricing discretion: the ban on undue discrimination (Chapter 8), the requirement to charge only the “filed rate” (Chapter 9), and the ban on retroactive ratemaking (Chapter 10). A fourth feature of regulated rates is the *Mobile-Sierra* doctrine, an interpretation of federal regulatory statutes that defines when regulators may let parties out of their contracts (Chapter 11).

**Jurisdiction—Federal, state and future:** Our nation’s founders gave us two levels of government. Each level makes law through legislatures, agencies and courts. As a result, regulators and utilities are accountable to six fora simultaneously: state legislatures (which might also delegate franchising powers to municipalities), Congress, state agencies, federal agencies, state courts, and federal courts. With technological advances, utility–customer transactions that once were mostly intrastate have become interstate, complicating the relationship between federal and state regulation. How federal and state decisionmakers share the same regulatory road, without burning brakes, grinding gears or colliding, is the subject of Chapter 12. The present book concludes with Chapter 13, which identifies regulation’s current uncertainties—uncertainties arising when statutes drafted under one set of industry facts must address new industry facts.

**Corporate structure, mergers and acquisitions:** Mergers, acquisitions, divestitures, product diversification, territorial expansion, holding company structures, interaffiliate transactions, and issuances of debt and equity—these actions affect everything else: market structure, pricing, service quality, financial strength and competitive viability. They will be the subject of a separate volume.

1.C.2. Sources
Decisions affecting market structure, pricing, corporate structure, control changes and financial structure are made by government and private actors. Their actions are authorized, directed, guided and confined by substantive statutory law and constitutional law.

**Substantive statutory law** establishes (1) the regulator’s duties and powers; (2) the sellers’ and buyers’ obligations, rights and powers; and (3) each player’s remedies against the others. The range of substantive law looks like an entire law school curriculum: specific
substantive statutes like the Interstate Commerce Act, Federal Power Act, Natural Gas Act and Communications Act and their state-level counterparts; and more general legal subjects like antitrust law, torts, contracts and property law.

Constitutional law protects parties by defining and limiting the government’s powers. The Commerce Clause authorizes Congress to act, but confines those actions to matters involving or affecting interstate commerce. The “dormant” Commerce Clause restricts states’ powers to regulate, and discriminate against, interstate commerce. The Contract Clause restricts states’ powers to impair existing contracts. The Takings Clause prohibits government from “taking” private property without paying the owner “just compensation.” The Supremacy Clause allows Congress to preempt states from enacting or applying state laws inconsistently with congressional intent. The Due Process Clause requires fair hearing procedures and applies the Takings Clause to the states. State constitutional law makes an occasional appearance also—especially in the minority of states whose regulatory commission was created by state constitution rather than statute.

Procedural law also plays a role, establishing procedures for making decisions and resolving grievances.

The relationship among subjects, sources, decisionmakers, decisions, regulated actors and regulated actions is displayed in Figure 1. The citizenry’s desire to involve regulators in market structure, sales and other matters leads to statutes, which combine with pre-existing general law and constitutional boundaries to create a body of law—the body discussed in this work. That body of law is expressed by the various regulatory decision-makers through statutes, orders, rules and other means. Those decisions apply to the actions of regulated actors, as those actions and actors are specified by the regulatory decisions.
### Regulatory Law

**Figure 1**

**Decisionmakers Use Law to Regulate Actors and Their Actions**

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