

1

Regulatory Law: Purposes, Powers, Rights and Responsibilities

- 1.A. Purposes of Regulation
- 1.B. Purposes of Regulatory Law
 - 1.B.1. Powers
 - 1.B.2. Responsibilities
 - 1.B.3. Rights
 - 1.B.4. Procedures
- 1.C. Subjects and Sources of Regulatory Law
 - 1.C.1. Subjects
 - 1.C.2. Sources

The law of regulation serves the purposes of regulation. Those purposes vary with one's perspectives. To achieve those purposes, regulatory law defines the powers, responsibilities, rights and procedures that direct, guide, empower and constrain the actors and agencies that have a stake in regulatory outcomes. After explaining the purposes of regulation and regulatory law, this Chapter describes the subjects and sources of regulatory law, then relates those subjects and sources to the book's organization.

1.A. PURPOSES OF REGULATION

Regulation's purposes vary with one's perspective. Economists see regulation as a way to exploit economies of scale from natural monopolies; reduce economic loss from market imperfections, such as entry barriers and insufficient information; prevent destructive competition and product scarcity; increase innovation where unregulated markets do so insufficiently; and address negative externalities like pollution and positive externalities like public goods. Economists use regulation to prevent, or at least reduce, the deadweight economic loss society suffers when demand and supply curves intersect suboptimally.¹

Interest groups have other perspectives. Utility customers want protection from abuses of monopoly power. Shareholders want predictable dividends, fair returns and low risks. Lenders want utility rates that produce cash flow sufficient to pay interest and retire debt. A utility's competitors want opportunities to enter the utility's market and win on the merits. Low-income advocates want essential services to be affordable; environmental advocates want to minimize the damage from production and consumption; rural residents need universal service; and large industrial customers want rate discounts so they can compete globally. Each of these perspectives occupies a narrow band on the private interest spectrum.

Overlapping with interest group perspectives are political and policy perspectives. Regulation can reduce inequity in income and wealth. It can prevent deceptive sales practices and price gouging. Regulation can "eliminat[e] price as the basis of exchange" in resources with special societal value, such as worker safety, cultural treasures and endangered species.²

These varied purposes can conflict not only with each other, but also with the notion that some problems are better solved not by regulation but by unregulated markets.

These value conflicts cause some to view regulation's purpose as "balancing" interests—most often, the interests of shareholders and consumers. But a balance presumes opposition of interests. What courts view as customers' and shareholders' *legal* interests—legitimate interests in reasonable prices, reasonable returns, satisfied customers and satisfied shareholders—are not in opposition; they are consistent and mutually reinforcing. High-quality performance and efficient consumption benefit multiple interests: consumers,

1. See FREDERICK M. SCHERER & DAVID ROSS, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 21–23 (1990); RICHARD PIERCE & ERNEST GELLHORN, *REGULATED INDUSTRIES* 38–62 (1999); JOSEPH P. TOMAIN & RICHARD D. CUDAHY, *ENERGY LAW IN A NUTSHELL* 26–32 (2004).

2. See SIDNEY A. SHAPIRO & JOSEPH P. TOMAIN, *REGULATORY LAW AND POLICY: CASES AND MATERIALS* 58–62 (2003). These authors do not necessarily espouse this view; rather, they cite it as one among many perspectives.

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 societal needs, short-term economic needs, investor satisfaction, affordability, efficient price signals, environmental values, and global competitiveness.³

For all these regulatory purposes, the legal lodestar is the regulatory statute. Most regulatory statutes tell regulators to act “in the public interest.” This command implies a statutory judgment—that absent regulation's constraints and inducements, private behavior will diverge from the public interest; that whether the market structure is monopolistic or competitive, universal, reliable, safe utility service at reasonable rates won't happen by itself. Effective regulation therefore aims to align private behavior with the public interest.⁴ Regulation defines standards for performance, then assigns consequences, positive and negative, for that performance. The common purpose of all regulation is performance.

1.B. PURPOSES OF REGULATORY LAW

Regulatory law establishes the powers, responsibilities and rights that achieve regulation's purposes. How does law distribute these elements among those with a stake in regulatory outcomes?⁵

1.B.1. Powers

Legislative bodies get their powers from constitutions. Using those powers, they establish the rights and responsibilities of citizens and businesses. Legislatures also delegate some of their powers to regulatory commissions—by enacting statutes that detail goals, duties and procedures. In a minority of states, utility commissions receive powers directly from their state constitutions.⁶ Regulated entities can receive powers too, such as when statutes

3. Cf. *Columbia Gas Transmission Corp. v. FERC*, 750 F.2d 105, 112 (D.C. Cir. 1984) (interpreting Natural Gas Act as vesting the Commission with “wide discretion to balance competing equities against the backdrop of the public interest”). For the author's views on balancing, see Scott Hempling, *The Regulatory Mission: Do We “Balance” Private Interests, or Do We Align Them with the Public Interest?*, SCOTT HEMPLINGLAW.COM (Nov. 2008), <http://www.scotthemplinglaw.com/essays/the-regulatory-mission>.

4. This view is neither universally shared nor permanently held. Policymakers revisit regulatory statutes when they perceive changes in the facts supporting the original enactment. The wisdom of regulatory statutes is a subject of continuous debate. The point here is that a regulatory statute exists because its enactors concluded that constraints and inducements were necessary to align private actions with the public interest.

5. Experienced lawyers are welcome to skip this short section, but non-lawyers, law students and new lawyers will benefit from understanding how law organizes its multiple components to produce public interest results.

6. See, e.g., *Ariz. Corp. Comm'n v. Arizona ex rel. Woods*, 830 P.2d 807 (Ariz. 1992) (finding that the Commission, created by the state Constitution, had power to limit interaffiliate transactions even though no statute granted that power; Commission's authority came from the state constitutional provision authorizing Commission to set retail rates).

grant utilities the power to take private land by eminent domain⁷ or to cut off customers who violate tariffs⁸ or fail to pay their bills.

A commission's regulatory powers have substantive scope—its jurisdiction. That 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: to issue a rule on solar transactions, storage investments or area-code renumbering; to approve or disapprove a merger application or rate increase request; or to resolve a customer complaint. Or the statute can merely authorize the commission to act, leaving the commission with discretion not to act. The commission can exercise its discretionary power 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 proposal for smart grid investments or a consumer advocate's petition for low-income assistance programs.

1.B.2. Responsibilities

A commission's responsibilities are not limited to its specifically mandated duties. It also has discretionary power—the power to pursue and achieve the legislature's public interest purposes by filling in policy details that the legislature lacked the expertise or consensus to enact. Failing to exercise this discretion brings public pressure through petitions and protests; legislative pressure through oversight hearings and budget amendments; and in the rare case, a writ of mandamus.⁹

Utilities have responsibilities too: to provide, safely and cost-effectively, the obligatory services defined by their franchise agreements and statutes; to maintain quality levels defined by commission rule; and to comply with tariffs approved and orders issued by their commissions. Utilities have discretion in how they carry out their responsibilities;¹⁰

7. See Chapter 2.E (discussing eminent domain).

8. A tariff is a legal document, filed with and approved by the utility commission. It describes the terms and conditions under which the utility provides service. The tariff details the type, quality and price of the service provided, as well as the customer's rights and responsibilities. A utility will have multiple tariff sheets, one for each type of service (e.g., firm or interruptible) and type of customer (e.g., commercial, industrial or residential). A tariff is like a contract, in that it establishes the rights and responsibilities of seller and buyer. But it is not technically a contract, because its source is a commission order rather than the outcome of two parties' negotiations, and because enforcement occurs at the commission rather than at a court.

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., *Cty. of Santa Fe v. Pub. Serv. Co.*, 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); *Northern 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 Chapter 2.D.3.d (discussing "management prerogative").

but their failure to exercise that discretion timely and prudently can bring investigations, penalties and cost disallowances.¹¹

Finally, customers have responsibilities: to pay for service timely, to refrain from endangering or disrupting service, and to cooperate with the utility in solving service problems.¹²

1.B.3. Rights

Statutes and constitutions create rights—in regulated entities and in those whom regulation affects. Here are common examples:

Customers have substantive rights to receive service at commission-set quality levels, and to pay rates no higher than a “just and reasonable” rate set by the commission.¹³ They have procedural rights to intervene and participate in commission proceedings, and to petition courts for judicial review of commission decisions.

Utilities have substantive rights to charge rates that provide a reasonable opportunity to earn a fair return;¹⁴ and to receive commission approval of corporate structures, mergers, acquisitions and reorganizations that satisfy statutory and regulatory standards.¹⁵ They also have procedural rights: to present facts that support their substantive rights, to confront opposing witnesses, and to challenge adverse commission decisions in court.

-
11. See, e.g., Order Instituting Investigation on the Commission’s Own Motion into the Operations and Practices of Pacific Gas and Electric Company to Determine Violations of Pub. Util. Code § 451, General Order 112, and Other Applicable Standards, Laws, Rules and Regulations in Connection with the San Bruno Explosion and Fire on Sept. 9, 2010, Decision 15-04-024, 2015 Cal. P.U.C. LEXIS 230, at *124–26, 147 (Cal. Pub. Utils. Comm’n Apr. 9, 2015) (imposing \$1.6 billion fine because of poor performance leading to fatal gas pipeline explosion); In the Matter of an Investigation into the Reliability and Quality of the Electric Distribution Service of Potomac Electric Power Company, Order No. 84564, Case No. 9240, 295 P.U.R.4th 373, 2011 Md. PSC LEXIS 37, at *3–4 (Md. Pub. Serv. Comm’n Dec. 21, 2011) (imposing \$1 million fine for utility’s poor outage performance, including “inconsistent and sometimes contradictory tree trimming practices” over a decade, and “fail[ure] to conduct periodic inspections of its sub-transmission and distribution lines or to direct after-storm inspections or patrols”). See also Chapter 2.D (discussing service quality).
 12. See, e.g., Weber v. Union Light, Heat & Power Co., Case No. 2000-066, 2000 Ky. PUC LEXIS 1342, at *6 (Ky. Pub. Serv. Comm’n Aug. 4, 2000) (utility’s commission-approved tariff makes customer responsible for “maintenance and upkeep of the service line on the customer’s side from the point of delivery”); In the Matter of Peoples Natural Gas Company’s Request to Establish a Tariff for Repairing and Replacing Farm-Tap Lines, Dkt. No. G-011/M-91-989, 1993 Minn. PUC LEXIS 92 (Minn. Pub. Serv. Comm’n May 25, 1993) (describing customer’s obligation to allow utility to inspect taps for leaks).
 13. See Chapter 2.D (service quality), Chapter 6 (cost-based rates), Chapter 7 (market-based rates) and Chapter 9 (filed rate doctrine).
 14. See Chapter 6.B (statutory and constitutional mandates for rates that compensate utilities commensurate with their performance and their risks).
 15. I address corporate structure in the companion volume, SCOTT HEMPLING, REGULATING MERGERS AND ACQUISITIONS OF U.S. ELECTRIC UTILITIES: INDUSTRY CONCENTRATION AND CORPORATE COMPLICATION (2020).

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

New competitors have rights. Where statutes or commissions have authorized competition in previously monopolistic markets, the new competitors usually have rights to buy nondiscriminatory transportation over monopoly facilities and to receive other “unbundled” services, while being protected from incumbents’ anticompetitive practices.¹⁷

1.B.4. Procedures

Regulators act. They gather information, make rules, adjudicate disputes, issue orders and bring enforcement cases. These actions must heed procedural law, as established by the Constitution, statutes and a commission’s own rules. Procedural law induces accountability: by empowering the public to observe and influence agency decisionmaking, and by authorizing courts to review the results for lawfulness. Procedural law also protects against arbitrariness—actions lacking in fact, logic or legal authority—whether that arbitrariness is committed 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, it is exercising a legislative function, because the legislature could set rates directly. The rate-setting function is legislative, but the procedures are often adjudicatory: prohibitions on *ex parte* contacts, expert testimony under oath, cross-examination by adverse parties, and commission orders supported by written opinions based on substantive evidence. This book does not cover procedural law.¹⁸ Its focus is substance: regulators’ statutory powers, what they do with those powers, and the constitutional limits on those powers.

1.C. SUBJECTS AND SOURCES OF REGULATORY LAW

1.C.1. Subjects

Regulatory jurisdiction—the power to act—is defined by nouns and verbs, actors and actions, regulated companies performing regulated activities. Here are examples of *regulated actors*—the nouns:

-
16. See Chapter 2.E (eminent domain) and Chapter 6.B (Fifth Amendment’s guarantee of “just compensation”).
 17. See Chapter 4.B (unbundling).
 18. There are numerous texts on administrative law, including the law of procedure. See, e.g., STEPHEN G. BREYER & RICHARD B. STEWART, *ADMINISTRATIVE LAW AND REGULATORY POLICY* (1979); SIDNEY A. SHAPIRO & JOSEPH P. TOMAIN, *REGULATORY POLICY: CASES AND MATERIALS* (2003); LISA BRESSMAN, EDWARD RUBIN & KEVIN STACK, *THE REGULATORY STATE* (2010).

Electricity: generating companies, transmission owners, local distribution companies, vertically integrated companies (i.e., companies that combine some or all of those functions), regional transmission organizations and holding companies.

Gas: producers, pipelines, local distribution companies, marketers and storage providers.

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.

If regulators regulate actions, which actions? The common answer, from local speed limits to international trade rules, is this: actions that, if unregulated, would harm the public interest—however that public interest is defined by the relevant regulatory statute. And if regulators regulate actors, which actors? Those whose self-interest could lead them to act inconsistently with that public interest. In utility regulation, those actors are nearly always sellers—sellers of electricity, gas, water, transmission service, pipeline service, broadband service or cab rides.¹⁹ But sometimes regulators regulate entities other than sellers. Companies hoping to buy utilities or major utility assets, or to acquire control of utility franchises, usually face both state and federal review.²⁰ To ensure electricity reliability, the Federal Energy Regulatory Commission (FERC) regulates the actions of “users, owners and operators” of the “bulk power system.”²¹ And FERC’s market manipulation rule targets “any entity” that acts fraudulently in connection with the purchase or sale of products or services subject to FERC’s jurisdiction—namely, electric energy, transmission services, natural gas, or gas or oil transportation service.²² But mostly, regulators regulate sellers.

Understanding regulation as addressing the actions of actors avoids the confusion arising from talking about regulation in terms of inanimate objects. For if we say, “FERC regulates transmission,” we obscure a crucial legal fact: that both FERC and states regulate actions involving transmission facilities. What they regulate depends on the actor and the action. By focusing on nouns and verbs, we see that FERC regulates entities when they sell transmission service in interstate commerce; while states regulate entities when they construct transmission facilities and when they take private property to site those facilities.²³

19. See, e.g., *Cal. Elec. Power Co. v. FPC*, 199 F.2d 206, 209 (9th Cir. 1952) (“The entire thrust of Part II [of the Federal Power Act] is toward the seller at wholesale, not the buyer.”).

20. For a detailed explanation of electric utility acquisitions and a critique of their regulatory treatment by FERC and state commissions, see SCOTT HEMPLING, *REGULATING MERGERS AND ACQUISITIONS OF U.S. ELECTRIC UTILITIES*, *supra* note 15.

21. See Federal Power Act § 215, 16 U.S.C. § 824o (discussed in Chapter 3.B.4).

22. See 18 C.F.R. § 1c. For more on market manipulation, see Chapter 5.C.

23. Robert Gates, who served as Secretary of Defense under Presidents George W. Bush and Barack Obama, demanded comparable clarity. Told by an assistant, “The White House is calling,” he growled, “A building doesn’t make phone calls. Who the hell is it?” ROBERT GATES, *DUTY: MEMOIRS OF A SECRETARY AT WAR* (2014).

To deal with these actors and actions, to align their private actions with the public interest, legislatures and commissions have created substantive legal principles in four policy areas.

Market structure: Who has a right to sell which products and own which facilities? How easily can sellers enter and exit? Are customers served best, in terms of cost-effectiveness, customer responsiveness, reliability, efficiency, innovation and accountability, by a competitive market or a monopoly market? These questions of market structure are addressed in **Part One. Chapter 2** presents 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. The three ensuing chapters then describe how policymakers convert that traditional monopoly market structure into a competitive market structure. **Chapter 3** describes how policymakers *authorize* competition, allowing newcomers to sell services historically provided by the incumbent monopoly. **Chapter 4** describes a distinct, essential and difficult step: making authorized competition *effective* competition, by “unbundling” competitive from noncompetitive services and by reducing entry barriers so that no competitor has an unearned advantage. **Chapter 5** describes how regulators monitor the newly authorized competition to prevent the anticompetitive behaviors that undermine competition—behaviors like price squeeze, predatory pricing, tying and market manipulation.

Pricing: Prices set properly—that is, consistent with the statutory just-and-reasonable standard and the U.S. Constitution’s “just compensation” mandate—perform two roles: They compensate sellers consistent with their performance, and they induce customers to consume efficiently. **Part Two** explains the law of regulated pricing. **Chapter 6** addresses noncompetitive markets, where regulators set a utility’s rates based on some version of the utility’s reasonable cost (known as “cost-based pricing”). **Chapter 7** addresses pricing in regulated competitive markets, specifically wholesale electricity markets where the Federal Energy Regulatory Commission allows sellers to price at will (known as “market-based pricing”) but first screens and then monitors those sellers for market power—the ability to raise and sustain prices above effectively competitive levels. Then there are three longstanding restrictions on sellers’ pricing discretion: the ban on undue discrimination (**Chapter 8**); the filed rate doctrine, requiring a seller to charge only the “filed rate” (**Chapter 9**); and the prohibition against retroactive ratemaking (**Chapter 10**). A fourth feature of regulated rates is the *Mobile-Sierra* doctrine, an interpretation of the Federal Power Act and Natural Gas Act that defines when regulators may revise, or allow parties to revise, their contracts (**Chapter 11**).

Jurisdiction—federal, state and future: Our nation’s founders gave us two levels of sovereign government, federal and state. 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 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. We address those problems in **Part Three**. How federal and state decisionmakers share the same regulatory road, without burning brakes, grinding gears or colliding, is the subject of **Chapter 12**. The book concludes with **Chapter 13**, which identifies regulatory jurisdiction’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. Because of their scope and complexity, these matters require a separate book.²⁴

1.C.2. Sources

Decisions affecting market structure, pricing, corporate structure, control changes and financial structure are made by regulators and the entities whose actions they regulate. These decisions are authorized, directed, guided and confined by substantive statutory law and by constitutional law.

Substantive statutory law establishes (1) the regulator's duties and powers; (2) the sellers' and buyers' duties, 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 broad legal subjects like antitrust, tort, contract and property law.

Constitutional law, as applied to the regulatory context, protects regulated entities 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 limits states' powers to regulate, and discriminate against, interstate commerce. The Contract Clause restricts states' powers to impair existing contracts. The Takings Clause prohibits the federal government (and through the Due Process Clause, state governments) from "taking" private property without paying the owner "just compensation." The Supremacy Clause allows Congress, when acting under the Commerce Clause, to preempt states (or to authorize federal regulators to preempt states) from enacting or applying state laws in ways that interfere with federal policies. The Due Process Clause requires fair hearing procedures. 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.

Figure 1 displays the relationship among subjects, sources, decisionmakers, decisions, regulated actors and regulated actions. The citizenry's desire to involve regulators in market structure, sales and other matters leads to regulatory statutes. Regulatory statutes combine with preexisting general law and constitutional boundaries to create the body of law discussed in this book. That body of law, expressed through statutes, orders, rules and court decisions, governs the actions of regulated actors, as those actions and actors are specified by the regulatory decisions.

24. See SCOTT HEMPLING, REGULATING MERGERS AND ACQUISITIONS OF U.S. ELECTRIC UTILITIES, *supra* note 15.

Figure 1

Decisionmakers Use Law to Regulate Actors and Their Actions

