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POLITICAL BARGAINING AND JUDICIAL INTERVENTION IN CONSTITUTIONAL AND ANTITRUST FEDERALISM

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ABSTRACT

Federal judicial deference to state and local regulation is at the center of contentious debates regarding the implementation of competition policy. This Article invokes a political process bargaining framework to develop a principled approach for addressing the appropriate level of judicial intervention under the dormant commerce clause and state-action immunity from antitrust enforcement. Using illustrations from network industries, it is argued that, at core, these two independent doctrines share a common concern with political (not only market) failure by focusing on the incentives faced by powerful stakeholders in state and local lawmaking. More important, they share the common purpose of deterring the adoption of regulations with adverse spillover effects for those who do not participate in the relevant lawmaking process. The Article illustrates how a political process bargaining approach to these doctrines differs in its recommendations from traditional formulations, with implications for the degree of deference courts afford state and local laws.

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INTRODUCTION

Defining the scope of state and local regulation is one of the most difficult questions public law confronts in the context of competition policy. Its implications take on particular significance as we partially “deregulate” (or, perhaps more politically correctly, “restructure”) industries such as electric power and telecommunications.¹ Given a strong tradition of state and local economic regulation, reinforced by partial federal jurisdiction over many regulatory problems, bargaining over the content of regulation is frequently left to the spheres of state and local politics.²

1. Along these lines, the use of “deregulation” in this Article is not intended to imply complete dismantling of regulation, but discarding certain features of traditional regulation, such as cost-of-service ratemaking. Frequently, partial regulation of industries such as electric power and telecommunications remain long after these industries are deregulated. Deregulation generally entails disentangling network characteristics of these industries from their competitive sectors, and regulation of networks by federal, state and local governments remains active, even in the most “deregulated” environments. As Alfred Kahn has stated, “[t]he decision to regulate never represents a clean break with competition.” 2 ALFRED E. KAHN, *THE ECONOMICS OF REGULATION* 113 (1988). So too, the decision to embrace competition in these industries never represents a clean break with regulation. See PAUL L. JOSKOW & RICHARD SCHMALENSSEE, *MARKETS FOR POWER: AN ANALYSIS OF ELECTRIC UTILITY DEREGULATION* 211–12 (1983) (concluding: “[o]ur analysis leads us to conclude that any sensible deregulation scheme will require continuing economic regulation of some segments of the electric power system.”); JEAN-JACQUES LAFFONT & JEAN TIROLE, *COMPETITION IN TELECOMMUNICATIONS* 272 (2000) (discussing the regulatory issues for deregulated telecommunications markets).

2. Regulation operates along both horizontal dimensions, in which different territories at the same hierarchical level assert jurisdiction vis-à-vis each other, and vertical dimensions, in which different hierarchical levels of government—federal, state, and local—lay claim to regulatory power. The classic formulation is to see federal–state jurisdictional issues through the lens of vertical power or bargaining conflicts. See William W. Buzbee, *Recognizing the Regulatory Commons: A Theory of Regulatory Gaps*, 89 IOWA L. REV. 1, 52–53 (2003); Jim Chen, *The Vertical Dimension of Cooperative Competition Policy*, 48 ANTITRUST BULL. 1005 (2003). For a broader discussion of the implications of such conceptualization for the enforcement of constitutional rights in public law, see Stephen Gardbaum, *The “Horizontal Effect” of Constitutional Rights*, 102 MICH. L. REV. 387 (2003). Gardbaum rejects the “vertical” conceptualization of constitutional rights enforcement under the state

The continued relevance of state and local politics leaves regulatory law in a schizophrenic balance. Given the tradition of active state regulation of natural monopoly in industries such as electric power and telecommunications (in the form of “public utility” regulation, which frequently involved the setting of rates),³ firms in newly restructured markets are regularly placed in situations in which there is a jurisdictional gap (i.e., no regulation of private conduct) or in which there is concurrent jurisdiction between federal and state agencies (i.e., two or more potential regulators).⁴ Several leading scholars argue that state and local regulation is fundamentally inconsistent with competitive interstate markets, and that perhaps courts should err on the side of expansive interpretation of federal regulatory authority to strengthen competition policies.⁵

This Article departs from such recommendations by looking inward at states, rather than outward to—and upward at—federal law.⁶ As this Article discusses, jurisdictional gaps and overlaps present private firms with many opportunities for strategic manipulation in bargaining for

action doctrine to conclude that “[p]rivate choices are always indirectly subject to the Constitution whenever an individual relies on the law to protect or enforce them, because the Constitution applies directly to that law.” *Id.* at 458–59.

3. See Joseph D. Kearney & Thomas W. Merrill, *The Great Transformation of Regulated Industries Law*, 98 COLUM. L. REV. 1323, 1363–64 (1998); see also Jim Chen, *The Nature of the Public Utility: Infrastructure, the Market, and the Law*, 98 NW. U. L. REV. 1617, 1679 (2004) (reviewing JOSE A. GOMEZ-IBANEZ, *REGULATING INFRASTRUCTURE: MONOPOLY, CONTRACTS, AND DISCRETION* (2003) (describing the history of rate regulation)).

4. See Buzbee, *supra* note 2 (focusing on the jurisdictional problem of federal–state overlaps, which he refers to as the “regulatory commons”).

5. See Richard D. Cudahy, *Full Circle in the Formerly Regulated Industries?*, 33 LOY. U. CHI. L.J. 767 (2002). Judge Richard Cudahy sees federal regulation of electric power transmission as “more or less inherent in the scheme of deregulation and competition, which depends for its functioning upon widespread access to the transmission network.” *Id.* at 778. Richard Pierce embraces expanded congressional authorization for the Federal Energy Regulatory Commission (FERC) to resolve transmission-siting disputes, noting the inevitable incentives states face to erect impediments to interstate commerce. Richard J. Pierce, Jr., *Environmental Regulation, Energy & Market Entry*, 15 DUKE ENVTL. L. & POL’Y FORUM (forthcoming 2005) [hereinafter Pierce, *Environmental Regulation*]. For more than a decade, Pierce has been arguing for the same basic congressional solution. See Richard J. Pierce, Jr., *The State of the Transition to Competitive Markets in Natural Gas and Electricity*, 15 ENERGY L.J. 323 (1994) [hereinafter Pierce, *Competitive Markets*]. Jim Chen advocates increased federal authority over telecommunications for similar reasons. Jim Chen, *Subsidized Rural Telephony and the Public Interest: A Case Study in Cooperative Federalism and Its Pitfalls*, 2 J. ON TELECOMM. & HIGH TECH. L. 307 (2003).

6. Hence, its analysis joins issue with those who wish to unpack the black box of state and local government. As the recent turn to focus on state and local governance chronicles, states are complex and nuanced regulatory systems whose governance features should not be ignored. See, e.g., Richard Briffault, *Our Localism: Part I—The Structure of Local Government Law*, 90 COLUM. L. REV. 1 (1990); Clayton P. Gillette, *In Partial Praise of Dillon’s Rule, or, Can Public Choice Theory Justify Local Government Law?*, 67 CHI.-KENT L. REV. 959 (1991).

regulation at the state and local levels.⁷ Rather than looking to federal preemption as a solution, I argue that legal doctrines focused on state and local lawmaking can improve competition policy in emerging markets. However, the response of public law to the opportunities faced by private firms in state and local lawmaking must be something more than the predominant judicial stance of deference to decentralized politics.

As James Madison recognized long ago in *Federalist No. 10*, the state political process is prone to abuses, particularly given the lower costs firms face in manipulating state and local, as opposed to federal, politics.⁸ If, for example, a state government has the authority to refuse imports from other jurisdictions, that state also has the power to influence an industry far beyond the state's own jurisdictional borders, shaping firm-specific structure, contracting, and other governance issues. Public law doctrines delineating the appropriate balance of powers between the state and federal spheres of regulation have significant implications for industry in the U.S., as well as for the law regarding competition policy.

These concerns are most significant in the doctrinal contexts of the dormant commerce clause of the U.S. Constitution and state-action immunity from antitrust enforcement.⁹ Part I of this Article presents a bargaining account of the dormant commerce clause, in which its primary purpose is understood as protecting against the imposition of spillover costs on those not afforded the opportunity to participate in state and local political processes. On the conventional understanding, barrier-free markets between the states form the core of dormant commerce clause jurisprudence.¹⁰ However, in contrast to this external market approach, Part I suggests that the dormant commerce clause is concerned with political, not only market, failure. The dormant commerce clause responds to a type of incompleteness in political bargaining—due to transaction costs, states may find it difficult to bargain with each other to ensure that

7. The account of regulation as bargaining is laid out more fully in JIM ROSSI, *REGULATORY BARGAINING AND PUBLIC LAW* (Cambridge University Press 2005). The effort focuses on developing a robust understanding of how bargaining and regulation interrelate, in a way that acknowledges incentives in the lawmaking process and the role of institutions. This account contrasts with the accounts presented by traditional progressives, who embrace the public interest as the animating goal of state regulation, and public-choice theorists, who are cynical about regulation generally, but especially suspicious of state and local regulation.

8. THE FEDERALIST NO. 10 (James Madison).

9. "State-action immunity," a judicially created antitrust defense, differs in purposes and origins from the "state action doctrine," which controls the extent to which constitutional-rights protections may be invoked against states or private actors. See Gardbaum, *supra* note 2.

10. See *infra* Part I.A (presenting the traditional neoclassical account of the dormant commerce clause, which protects the external competitive marketplace, and contrasting it with a political process understanding, which is more focused on cooperative bargaining).

trade barriers are not harmful to overall social welfare. An individual state's approach to monopoly regulation risks imposing spillover costs on other jurisdictions; by striking state legislation that is likely to impose such costs, the dormant commerce clause internalizes these spillover effects in order to improve the state political process. Part I illustrates the significance of this conception of the dormant commerce clause for competition policy in newly reconstituted industries, such as electric power and telecommunications.

Part II of the Article addresses state-action immunity—a common defense to antitrust enforcement where a state or local government actively regulates a firm. For example, price-regulated public utilities, including electric-power and telecommunications monopolies, have long escaped judicial antitrust scrutiny of their regulated activities. For most of the twentieth century, rate hearings before state and local regulatory commissions alone served to police the exercise of market power. Here, a tension with the dormant commerce clause seems apparent: While in spirit the dormant commerce clause is pro-competitive (and hence anti-protectionist), state-action immunity from antitrust enforcement is pro-regulation, a potential contrast in goal and approach.¹¹

But, as Herbert Hovenkamp has observed, “Regulation by state and local government is not only pervasive, but it is also probably more susceptible to political influences than federal regulation is.”¹² Part II of this Article advises that courts approach judicial gatekeeping in the antitrust context with extreme caution in emerging competitive markets. Once widely taken for granted by firms in the electric-power and telecommunications industries, state-action immunity should no longer automatically bar antitrust suits in utility industries. With deregulation, there is widespread recognition that antitrust laws may play an increasingly important role in deregulated industries, such as telecommunications, electric power, and natural gas.¹³ However, as Part II illustrates, courts embrace overbroad deference and have failed to take a principled approach to deciding when to intervene rather than grant state-action immunity in antitrust claims against utility industries. According to

11. Put another way, one doctrine is oriented towards free trade, while another favors—and may even encourage—state-sanctioned monopoly.

12. Herbert Hovenkamp, *Antitrust and the Regulatory Enterprise*, 2004 COLUM. BUS. L. REV. 335, 346.

13. See, e.g., Reza Dibadj, *Saving Antitrust*, 75 U. COLO. L. REV. 745, 748 (2004) (arguing that “as economic regulation has evolved it no longer makes sense to treat antitrust and regulation as separate bodies of doctrine—unified, they should form the building blocks of a new competition law.”).

a recent Federal Trade Commission (FTC) Office of Policy Planning task force report on the topic, “the state action doctrine has come to pose a serious impediment to achieving national competition policy goals.”¹⁴

Part III of this Article argues that a principled approach to state-action immunity would not embrace strong deference to decentralized lawmaking but would interpret this defense to antitrust enforcement in a manner similar to the political process bargaining account of the dormant commerce clause. However, the doctrinal convergence between the Constitution and antitrust federalism is not limited to pro-competitive policies that promote commercial exchange. A political process bargaining approach to these two doctrines illustrates their unified purpose of limiting the negative impact of interest-group capture of the state regulatory process, without completely prohibiting rent-seeking behavior. At their core, as Part III suggests, the fundamental goal of both doctrines is to protect a political process that facilitates regulatory bargaining by tempering self-interested interference that imposes spillover costs on non-participants in the relevant bargaining process. This has important implications for courts’ approaches to considering state-action immunity and, specifically, for the judicial inquiry into the nature of regulatory supervision at the state and local level.

As both constitutional and antitrust-federalism doctrines illustrate, in the context of economic regulation the judicial role requires something more than deference to decentralized politics. Public law, and in particular judicial review, should police private strategic manipulation of the political process in ways that are likely to impose spillover costs on non-participants in considering dormant commerce clause challenges to state and local lawmakers. For the same reason, courts must play an important gatekeeping role in policing antitrust enforcement by allowing the state-action-immunity defense only where adequate safeguards against welfare-reducing private conduct are in place.

I. A BARGAINING PROCESS ACCOUNT OF THE DORMANT COMMERCE CLAUSE

At its most general level, the dormant commerce clause limits the power of a state or local government to impair free trade.¹⁵ Derived from

14. OFFICE OF POLICY PLANNING, FED. TRADE COMM’N, REPORT OF THE STATE ACTION TASK FORCE 25 (2003), available at <http://www.ftc.gov/os/2003/09/stateactionreport.pdf> [hereinafter FTC STATE ACTION REPORT].

15. The evolution of the dormant commerce clause as a constitutional doctrine can be traced to

the Commerce Clause of the Constitution,¹⁶ the dormant commerce clause precludes a state from enacting barriers to interstate commerce that are blatantly discriminatory against out-of-state businesses, or which have the effect of bringing about such discrimination.¹⁷ As Oliver Wendell Holmes once remarked:

I do not think the United States would come to an end if we lost our power to declare an Act of Congress void. I do think the Union would be imperiled if we could not make that declaration as to the laws of the several States. For one in my place sees how often a local policy prevails with those who are not trained to national views and how often action is taken that embodies what the Commerce Clause was meant to end.¹⁸

Although it is not an express mandate of the text of the U.S. Constitution's Commerce Clause (hence its common reference as the "negative" commerce clause),¹⁹ the jurisprudence of the dormant commerce clause has long recognized this overall purpose. As Justice Cardozo famously remarked in striking down a New York law that set minimum prices all milk dealers were required to pay New York milk producers, the Commerce Clause prohibits a state law that burdens interstate commerce "when the avowed purpose of the [law], as well as its

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

16. The Commerce Clause provides that "[t]he Congress shall have Power . . . To regulate Commerce . . . among the several States." U.S. CONST. art. I, § 8, cls. 1, 3.

17. The "dormant" commerce clause embodies the notion that the grant of authority to Congress to regulate interstate commerce carries with it implied restrictions on the ability of states to initiate regulations affecting interstate commerce.

18. OLIVER WENDELL HOLMES, COLLECTED LEGAL PAPERS 295–96 (1920).

19. Among skeptical textualists, such as Justices Scalia and Thomas, the doctrine is commonly referred to as the "negative" commerce clause, indicating the lack of express textual basis for it in the Constitution. See Jim Chen, *A Vision Softly Creeping: Congressional Acquiescence and the Dormant Commerce Clause*, 88 MINN. L. REV. 1764, 1765–66 (2004). Skeptics believe that the purposes of the dormant commerce clause can readily be served by other, more textually explicit, constitutional doctrines, such as the Import-Export Clause of Article I, Section 10 or the Privileges and Immunities Clause of Article IV, Section 2. These alternatives are not without their own critics. See, e.g., Brannon P. Denning, *Justice Thomas, The Import-Export Clause, and Camps Newfound/Owatonna v. Harrison*, 70 U. COL. L. REV. 155 (1999); Brannon P. Denning, *Why the Privileges and Immunities Clause of Article IV Cannot Replace the Dormant Commerce Clause Doctrine*, 88 MINN. L. REV. 384 (2003). However, for purposes of this Article, let it suffice to emphasize that the alternatives would make protections against interstate regulatory barriers much narrower.

necessary tendency, is to suppress or mitigate the consequences of competition between the states.”²⁰ This general principle was also invoked to strike a New York regulatory scheme that had been used to deny a license to an out-of-state milk-processing facility.²¹ Since the licensing provision had been enacted “solely [for] protection of local economic interests, such as supply for local consumption and limitation of competition,” it was found to be unconstitutional.²²

A. Bargaining, Spillover Costs, and Interstate Commerce

City of Philadelphia v. New Jersey,²³ a well-known case addressing how the dormant commerce clause limits state regulation of waste disposal, illustrates the modern doctrine courts apply to further the purpose of protecting the external market. New Jersey prohibited the importation of most “solid or liquid waste” originating out of state.²⁴ The statute was first challenged in state court, but the New Jersey Supreme Court upheld the law against a dormant commerce clause challenge, concluding that it “advanced vital health and environmental objectives.”²⁵ New Jersey, however, had failed to present any evidence that out-of-state garbage was more noxious than in-state garbage.²⁶ Writing for the majority, Justice Stewart asserted that “where simple economic protectionism is effected by state legislation, a virtually *per se* rule of invalidity has been erected.”²⁷ As the Court noted in *City of Philadelphia*, even if the New Jersey statute was not *per se* invalid, it would not necessarily withstand constitutional scrutiny under the Commerce Clause.²⁸ Instead, the Court would evaluate it under an alternative line of analysis: “Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.”²⁹ The Supreme Court struck down the New Jersey statute as a violation of the dormant commerce clause, but did not clearly

20. *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 522 (1935).

21. *H.P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 531–32 (1949).

22. *Id.* at 531.

23. 437 U.S. 617 (1978).

24. *Id.* at 618.

25. *Id.* at 620.

26. *Id.* at 629.

27. *Id.* at 624.

28. *Id.*

29. *City of Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978) (quoting *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970)).

state which of these two rules—per se invalidity or balancing—it applied.³⁰

While *City of Philadelphia* and earlier cases suggest a fairly aggressive level of judicial intervention in evaluating state and local laws under the Constitution,³¹ many of the most protectionist laws have avoided dormant commerce clause scrutiny altogether. In comparison to non-regulated industries, in which norms of competition prevail, dormant commerce clause jurisprudence played little historical role in defining the overall shape of heavily regulated industries, such as electric power and telecommunications.³² For instance, throughout the twentieth century, the electric power industry was dominated by cost-of-service regulated utilities.³³ Frequently, the sales jurisdiction of these firms was limited to specific state and local service territories.³⁴ Both retail and wholesale transactions were price regulated, based on the cost of service.³⁵ With such a regulatory framework in place, any notion of competition between suppliers is largely meaningless. Since a cost-of-service regulated industry is not in an open market in which competition can thrive, protecting interstate competition is of little concern. To the extent that there is any competition at all, it is largely limited to the political process of determining the applicability and scope of monopoly franchises.³⁶ Not surprisingly, dormant commerce clause challenges to public utility laws in the twentieth century were infrequent—nearly nonexistent.³⁷ When challenges were brought, federal courts typically deferred to state and local regulation.³⁸

30. *City of Philadelphia v. New Jersey*, 437 U.S. 617, 627–29 (1978).

31. In fact, recently the U.S. Supreme Court has followed the lead of lower courts, which embrace the dormant commerce clause to suggest that state laws banning direct shipment of wine from out-of-state distributors, but allowing in-state distributors to ship wine, present serious dormant commerce clause problems. See *Granholm v. Heald*, 125 S. Ct. 1885 (2005); see also *Beskind v. Easley*, 325 F.3d 506 (4th Cir. 2003); *Bainbridge v. Turner*, 311 F.3d 1104 (11th Cir. 2002); *Cooper v. McBeath*, 11 F.3d 547 (5th Cir. 1994); *Dickerson v. Bailey*, 212 F. Supp. 2d 673 (S.D. Tex. 2002); *Bolick v. Roberts*, 199 F. Supp. 2d 397 (E.D. Va. 2002).

32. To the extent there was no interstate trade in electric power subject to state jurisdiction, the opportunity for state regulators to interfere with interstate commerce was non-existent.

33. RICHARD F. HIRSCH, *THE ORIGINS OF DEREGULATION AND RESTRUCTURING IN THE AMERICAN ELECTRIC UTILITY INDUSTRY* 40–46 (1999).

34. *Id.* See also ROSSI, *supra* note 7, at 177.

35. See, e.g., JOSE A. GOMEZ-IBANEZ, *REGULATING INFRASTRUCTURE: MONOPOLY, CONTRACTS AND DISCRETION* (2003). See also Kearney & Merrill, *supra* note 3.

36. See Robert L. Bradley, Jr., *The Origins and Development of Electric Power Regulation, in THE END OF A NATURAL MONOPOLY: DEREGULATION AND COMPETITION IN THE ELECTRIC POWER INDUSTRY*, 43, 52–61 (Peter Z. Grossman & David M. Cole eds., 2003).

37. See *supra* notes 32–34 and accompanying text.

38. A classic precedent, which formed the basis for much of twentieth century state regulation of

However, as formerly regulated markets are deregulated, the introduction of competition changes the status quo, introducing a new vigor to dormant commerce clause challenges to public utility laws. For instance, since the Federal Energy Regulatory Commission (FERC) deregulated wholesale electric power markets in the 1990s,³⁹ interstate competition between firms in the power supply market has emerged.⁴⁰ Many states have further deregulated the retail side of electric power (California most famously, but other states such as Texas as well), but most states continue to depend on heavy state and local regulation of the industry.⁴¹ Against this backdrop, certain regulatory actions by a state or local government are constitutionally doubtful. For instance, if an individual state adopts a moratorium on the siting of new power plants or interstate transmission lines that are intended to provide service in wholesale (interstate) electric supply markets (as, in fact, several states have), this raises serious concerns under the dormant commerce clause.⁴² In addition, as other authors have noted, state-imposed subsidies and rebates designed to encourage renewable power or environmental conservation may also pose a problem under the dormant commerce clause in a deregulated environment.⁴³ For example, a tax that is imposed on all

public utilities, is *Munn v. Illinois*, 94 U.S. 113 (1876), which upheld legislative approval of joint price agreement by grain elevators in Chicago against a dormant commerce clause challenge, given concern with regulating a common carrier as a monopoly in the “public interest.” See also Saul Levmore, *Interstate Exploitation and Judicial Intervention*, 69 VA. L. REV. 563, 610 (1983) (“In examining local regulations, courts should be more suspicious of those imposing substantial costs out-of-state than those placing costs primarily within the legislating jurisdiction.”).

39. *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, 61 FED. REG. 21,540 (Apr. 24, 1996) (codified at 18 CFR pts. 35, 385) [hereinafter *Promoting Wholesale Competition*].

40. See DEPARTMENT OF ENERGY, ENERGY INFORMATION ADMINISTRATION, *THE CHANGING STRUCTURE OF THE ELECTRIC POWER INDUSTRY 2000: AN UPDATE*, ch. 7 (Oct. 2000), available at www.eia.doe.gov/cneaf/electricity/chg_stru_update/toc.html [hereinafter DEPARTMENT OF ENERGY UPDATE].

41. *Id.* ch. 8.

42. Of course, many state and local governments have adopted moratoria on economic development and growth generally, and these may raise some legitimate concerns under the dormant commerce clause, but power plant and transmission line siting moratoria pose a more specific problem. Concerned with their states becoming transmission superhighways or power plant siting grounds for others, many states have considered or adopted such moratoria. See, e.g., *Conn. Governor Signs Moratorium on Grid Projects, Keeping Cross Sound in Limbo*, POWER MARKETS WK., June 30, 2003, at 31 [hereinafter *Moratorium on Grid Projects*] (describing Connecticut’s moratorium on new transmission lines); *Florida County Imposes Power Plant Moratorium*, ELECTRICITY DAILY, July 2, 2001, at 1 (describing a Broward County, Florida, moratorium that stalled a 511 megawatt merchant power plant that had been approved by city officials in Deerfield Beach, Florida).

43. See Kristen H. Engel, *The Dormant Commerce Clause Threat to Market-Based Environmental Regulation: The Case of Electricity Deregulation*, 26 ECOLOGY L.Q. 243 (1999);

power sales in a state but redistributed to favor only in-state suppliers may present constitutional problems. Given these changes to regulation, courts need to reassess the scope of deference afforded to state and local regulation of network industries under the dormant commerce clause.

Since the 1980s, when deregulation took hold in a variety of industries, the Supreme Court has had several occasions to address the appropriate level of judicial deference under the dormant commerce clause. One of its cases on the topic, *General Motors Corp. v. Tracy*,⁴⁴ evaluated Ohio's differential tax burdens for in-state and out-of-state gas suppliers. Ohio had levied a five percent tax on all natural gas transactions except those involving local distribution companies (LDCs), which serve as an intermediary between end users and natural gas suppliers.⁴⁵ Under Ohio's natural gas tax, only in-state utilities qualified as tax-exempt LDCs, so Ohio's tax scheme effectively subjected in-state and out-of-state natural gas suppliers to different tax burdens.⁴⁶ The Court acknowledged that such a discriminatory scheme could violate the dormant commerce clause, but refused to find a violation of the dormant commerce clause on the particular facts that had been raised.⁴⁷ *General Motors*, which mounted a legal challenge to Ohio's differential tax, was a large enough customer to purchase its gas on the open market rather than bundled from a regulated LDC.⁴⁸ Absent competition between the LDC and the open market serving *General Motors*, the Court reasoned, "there can be no local preference, whether by express discrimination against interstate commerce or undue burden upon it, to which the dormant Commerce Clause may apply."⁴⁹

Other cases extend the reach of the dormant commerce clause beyond merely protecting external (interstate) markets. In *C&A Carbone, Inc. v. Town of Clarkstown*,⁵⁰ the Supreme Court invalidated a municipally-imposed monopoly over non-recyclable solid waste collected for processing and transfer. To guarantee a minimum stream of revenues for the project, the Town of Clarkstown, New York adopted a flow control ordinance, allowing the private operator of a transfer station to collect a fee of \$81 per ton—in excess of the disposal cost of solid waste in the

Steven Ferrey, *Renewable Subsidies in the Age of Deregulation*, PUB. UTIL. FORTNIGHTLY, Dec. 1997, at 22.

44. *General Motors Corp. v. Tracy*, 519 U.S. 278 (1997).

45. *Id.* at 281–82.

46. *Id.* at 282–83.

47. *Id.* at 310.

48. *Id.* at 301.

49. *Id.* at 300.

50. *C&A Carbone v. Town of Clarkstown*, 511 U.S. 383 (1994).

private market.⁵¹ C&A Carbone, Inc. processed solid waste and operated a recycling center, as it was permitted to do under the Clarkstown flow control ordinance.⁵² The flow control ordinance required companies like Carbone to bring nonrecyclable waste to the locally-franchised transfer station and to pay a fee, while prohibiting them from shipping the waste themselves.⁵³ “[A] financing measure,” the flow control ordinance ensured that “the town-sponsored facility will be profitable, so that the local contractor can build it and Clarkstown can buy it back at nominal cost in five years.”⁵⁴ The Court reasoned that the local law violates the dormant commerce clause because in “practical effect and design” it bars out-of-state sanitary landfill operators from participating in the local market for solid waste disposal.⁵⁵ In so reasoning, the majority drew from a 1925 case, written by Justice Brandeis, which held that a statute prohibiting “common carriers from using state highways over certain routes without a certificate” of convenience and necessity is unconstitutional.⁵⁶

If a municipal government itself were to create and own the facility, this would bring the monopoly within an exception to the dormant commerce clause known as the market-participant exception.⁵⁷ In creating monopolies, however, local governments frequently work with private firms, using the advantages of the state—subsidies, below-market interest rates from non-taxable bonds, bypassing state or local restrictions on use of municipal tax powers, etc.—to assist firms and create incentives for them to provide service. Since municipal governments often help to pay for even private infrastructure, such as waste disposal facilities, through the issuance of bonds, it is understandable that a local government might want to create a monopoly to ensure that its facility maintains sufficient revenues to cover its costs and to avoid jeopardizing the government’s

51. *Id.* at 386–87.

52. *Id.* at 387–88.

53. *Id.* at 388.

54. *Id.* at 393.

55. *Id.* at 389, 394.

56. *Id.* at 394 (quoting *Buck v. Kuykendall*, 267 U.S. 307, 315–16 (1925)). Justice Brandeis wrote for the Court:

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

Buck, 267 U.S. at 315–16.

57. See *Reeves, Inc. v. Stake*, 447 U.S. 429, 436–39 (1980); *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 808–10 (1976). For a survey of the academic literature on the market-participant exception, see Dan T. Coenen, *Untangling the Market-Participant Exemption to the Dormant Commerce Clause*, 88 MICH. L. REV. 395 (1989).

bond rating. Such facilities are allowed to collect charges, which serve the same basic function as a tax. If the government itself were to build, own and operate a facility, the political process would impose a general tax, but with private operations subsidized by a state- or locally-enforced monopoly, the tax implications of such projects are obscured. The Town of Clarkstown, New York, for example, guaranteed revenue for its solid waste transfer station—it promised a minimum of 120,000 tons of waste per year, allowing the firm to make more than \$9.7 million in annual revenue for five years—and agreed to buy it for \$1 at the end of the contract period.⁵⁸ One way of understanding the Court's rejection of the Clarkstown flow control ordinance is based on its concerns with impermissible government-assisted monopolies against the backdrop of interstate competition.⁵⁹

The basic touchstone guiding judicial intervention under the guise of the dormant commerce clause is commonly described as protecting the market against discrimination between in- and out-of-state competitors.⁶⁰ If recent decisions are taken at face value as supporting such a conception, the Supreme Court's dormant commerce clause jurisprudence might be said to embrace a pro-competition stance, consistent with the ideology and goals of the neoclassical economics framework, in which law sees its primary role as intervening to correct for market failure. In *Tracy*, for example, Justice Souter, writing for the Court, stated: "The dormant commerce clause protects markets and participants in markets, not taxpayers as such."⁶¹ He bolstered this vision of the dormant commerce clause by referencing the famous words of Justice Jackson:

Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his exports, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing

58. 511 U.S. at 387.

59. The market-participant exception does not preclude a Commerce Clause challenge to such a facility because the exception is limited and is not automatically available where the state could expand into the market. To avail itself of the market-participant exception, the state must establish that it is a market participant and may not use mere contractual privity to immunize downstream regulatory conduct in a market in which it is not a direct participant. See *S.-Cent. Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82 (1984).

60. Paul E. McGreal, *The Flawed Economics of the Dormant Commerce Clause*, 39 WM. & MARY L. REV. 1191, 1222–23 (1998).

61. *General Motors Corp. v. Tracy*, 519 U.S. 278, 300 (1997).

area in the Nation to protect him from exploitation by any. Such was the vision of the Founders; such has been the doctrine of this Court which has given it reality.⁶²

This neoclassical view of dormant commerce clause jurisprudence sees the role of federal courts as prohibiting states from interfering with the economic exchange of a free market economy.⁶³ On this view, the primary purpose of judicial intervention is to guard against state and local government balkanization by protecting free trade from state government interference in the external market.

However, it is misleading to read the dormant commerce clause as a constitutional mandate for competition, let alone deregulation. As dormant commerce clause jurisprudence itself recognizes, there are exceptions to the dormant commerce clause where the state itself takes on the role of market participant.⁶⁴ Further, the dormant commerce clause allows substantial state government intervention in the setting of prices, subsidies, and taxes, so long as a state does not engage in differential treatment in the same market in ways that burden interstate competition.⁶⁵ Moreover, since the dormant commerce clause is not derived from the express language of the U.S. Constitution, Congress retains the power to override it by adopting a national policy that preempts, or overrides, the competitive market between individual states.⁶⁶ For example, under the Commerce Clause, Congress has the express authority to establish an agency such as the Interstate Commerce Commission (ICC), giving it jurisdiction to regulate railroad rates previously left to individual states.⁶⁷ Congress also may authorize national ownership of infrastructure, as it did in creating the Tennessee Valley Authority (TVA) and countless other national firms, and may opt to preclude competition in an industry altogether.⁶⁸ “Our Constitution,” the late Julian Eule has written, “did not attempt to solve economic parochialism by an express prohibition against interference with

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

63. *See, e.g.*, Julian N. Eule, *Laying the Dormant Commerce Clause to Rest*, 91 YALE L.J. 425 (1982); Steven G. Gey, *The Political Economy of the Dormant Commerce Clause*, 17 N.Y.U. REV. L. & SOC. CHANGE 1 (1989–90); McGreal, *supra* note 60.

64. *See supra* notes 57 and 59.

65. *See supra* notes 44–62 and accompanying text.

66. *See* Chen, *supra* note 19.

67. For discussion, see HERBERT HOVENKAMP, *ENTERPRISE AND AMERICAN LAW: 1836–1937*, at 164–67 (1991).

68. For discussion, see Susan Rose-Ackerman & Jim Rossi, *Disentangling Deregulatory Takings*, 86 VA. L. REV. 1435, 1451–52 (2000).

free trade. Instead, it shifted legislative power over economic matters that affect more than one state to a single national body.”⁶⁹

To take a more modern example than the now-defunct ICC railroad regulation regime or TVA, Congress has created FERC, which has made a major policy choice to implement competitive regional wholesale power markets.⁷⁰ Congress has the power to override FERC’s decision, but despite concerns with state-led regulatory policies, as in California, no one has seriously proposed a congressional repeal of national deregulation policies in electric power. Alternatively, as others have proposed, Congress might expand FERC’s jurisdiction, taking some or all regulatory authority over retail markets away from state regulators.⁷¹ If Congress were to do so, by occupying the lawmaking field it might preclude states from enacting some laws that discriminate against out-of-state suppliers in deregulated wholesale markets. But—and this remains an important source of legitimacy for the dormant commerce clause—Congress has not done so.⁷² Congress’s inaction, however, does not mean that preemption plays no role in this context. In a sense, Congress’s acquiescence in FERC’s competitive policies preempts individual states from acting in ways that impair commerce between the states. Absent a change in federal policy, state efforts to curtail competition in wholesale electric power markets could be suspect under the dormant commerce clause to the extent that they undermine the interstate markets created by FERC.

While a federal preemption argument for interstate market norms is based in a positive legal source of congressional or federal agency enactments which preclude contrary state laws, preservation of the status quo under the dormant commerce clause also finds some source in the cooperative behavior between two or more states that have adopted a competitive norm of exchange in which Congress acquiesces. Many have suggested that the neoclassical account of the dormant commerce clause—as a legal source of free trade policies between the states—is flawed.⁷³ An alternative view understands judicial intervention under the dormant

69. Eule, *supra* note 63, at 430.

70. See *Promoting Wholesale Competition*, *supra* note 39.

71. See, e.g., Pierce, *Competitive Markets*, *supra* note 5 (proposing increased federal authority over transmission line siting).

72. As Jim Chen observes:

Congress’s persistent failure to repeal the dormant Commerce Clause is the singularly impressive feature of American constitutionalism’s approach to protecting free trade. Though it has failed to win academic support, congressional silence provides at least an adequate and perhaps even a persuasive case for preserving the dormant Commerce Clause.

Chen, *supra* note 19, at 1769.

73. See, e.g., sources cited *supra* note 63.

commerce clause not as inherently protecting competition itself, let alone free markets, but as protecting a political process that makes markets possible. On this view, the dormant commerce clause is as much about political failures as it is about market failure.

For instance, in *West Lynn Creamery, Inc. v. Healy*,⁷⁴ the Supreme Court struck down a Massachusetts tax and rebate scheme for milk that operated neutrally without regard to the milk's place of origin because the tax revenue went into a subsidy fund distributed solely to Massachusetts milk producers. In writing for the majority, Justice Stevens embraced a political process account of the dormant commerce clause, in which its role is seen as representative-enforcing in a manner similar to *United States v. Carolene Product*'s famous footnote four.⁷⁵ As Justice Stevens remarked in striking down the tax and subsidy regime in *West Lynn Creamery*:

Nondiscriminatory measures, like the evenhanded tax at issue here, are generally upheld, in spite of any adverse effects on interstate commerce, in part because "[t]he existence of major in-state interests adversely affected . . . is a powerful safeguard against legislative abuse." However, when a nondiscriminatory tax is coupled with a subsidy to one of the groups hurt by the tax, a State's political process can no longer be relied upon to prevent legislative abuse, because one of the in-state interests which would otherwise lobby against the tax has been mollified by the subsidy.⁷⁶

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

This political process account of the dormant commerce clause converges with a bargaining approach that understands lawmaking as a type of negotiated, but incomplete, contract. The Compact Clause of the Constitution prevents states from entering into bilateral or multilateral agreements absent congressional approval.⁷⁷ Even absent formal

74. 512 U.S. 186 (1994).

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

76. 512 U.S. at 200 (alterations in original) (citations and footnote omitted) (quoting *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 473 n.17 (1981)).

77. U.S. CONST., art. I, § 10, cl. 3 ("No State shall, without the Consent of Congress . . . enter

agreement under the Compact Clause, states may informally undertake a coordinated pro-commerce regime.⁷⁸ In this scenario, a single state—or powerful interest groups within a single state—may seek to appropriate rents by enacting legislation that is intended to defeat the coordinated regime.⁷⁹ The commons problems⁸⁰ created by jurisdictional overlaps between federal and state regulation create a need for gap-filling measures but also simultaneously provide the opportunity for powerful firms to influence the state lawmaking process to advance their self-interest. Individual state defectors can cause a divergence between *ex ante* and *ex post* expectations in maintaining the implicit cooperative norm between the states.

Drawing from this basic account of interstate coordination, Paul McGreal has argued that the dormant commerce clause is best understood as a solution to a Prisoner's Dilemma defection, where individual states (as well as the interest groups which demand state regulation) stand to gain by defecting rather than cooperating with market exchange norms.⁸¹ Maxwell Stearns takes this argument a step further, presenting the coordinated norm of competition as a Nash equilibrium, in order to account for why only certain kinds of rent seeking are condemned under the dormant commerce clause.⁸² A Nash equilibrium is a unique solution or set of available solutions that are stable, in the sense that they maximize payoffs for each player given the expected strategies of other players in the absence of formal cooperation.⁸³ An individual state's effort to enact regulations, tariffs, or subsidies that are designed to appropriate the gains of the pro-commerce regime is non-Nash. As Stearns argues, a court striking state legislation under the dormant commerce clause "facilitates a benign multiple Nash equilibrium game, one that presumptively takes strategies inducing a mixed-strategy equilibrium outcome off the table, but that also effectively ratifies the choice of the early movants followed by other states."⁸⁴ The Court's dormant commerce clause jurisprudence

into any Agreement or Compact with another State . . .").

78. See Maxell L. Stearns, *A Beautiful Mend: A Game Theoretical Analysis of the Dormant Commerce Clause Doctrine*, 45 WM. & MARY L. REV. 1 (2003).

79. See *id.*

80. See *id.*

81. McGreal, *supra* note 60, at 1245–79.

82. Stearns, *supra* note 78.

83. See ERIC RASMUSSEN, *GAMES AND INFORMATION: AN INTRODUCTION TO GAME THEORY* 23 (2d ed. 1994).

84. Stearns, *supra* note 78, at 12.

values commonality in market norms between the states over any individual state's particular regulatory choice.

In effect the Court tells the state whose law is under review that while the states are free to choose any of two or more available pure Nash equilibrium outcomes, individual states are not free, after a common regime is in place, to supplant other states' pure Nash equilibrium outcome with a mixed-strategy equilibrium, at least absent a sufficient demonstration that the nonconforming state's motivation is other than to disrupt a pure Nash equilibrium strategy.⁸⁵

On this account, the dormant commerce clause responds to an implicit bargaining failure in the market for inter-jurisdictional regulation. Its primary concern is with protecting interstate cooperation in lawmaking, not competition per se. In a world of low bargaining costs, the optimal level of interstate regulation might be expected to arise, but in actuality interstate bargaining for regulation is costly and rarely occurs. For example, it may be costly for a net wine-producing state, like California, to negotiate *ex ante* with a net wine-consuming state like New York for lower regulations or taxes and the low expected gains of such negotiation may not justify the costs of bargaining. A Coasean bargain for the optimal level of regulation can fail where there is imperfect information about preferences or the number of affected jurisdictions is large.⁸⁶ At the same time, if left to their own internal devices, states may face incentives from interest groups to pass regulations or taxes that impose spillover costs on producers or consumers in other jurisdictions. By internalizing spillover costs, the dormant commerce clause might be understood as restoring the conditions that make tacit cooperation, or implicit bargains, between states more likely.

B. Implications for Public Utility Regulation in New Markets

This is an important insight for regulatory law. Unlike the traditional public choice critique of regulation—which sees judicial intervention in public law as necessary to condemn rent seeking⁸⁷—the political process

85. *Id.*

86. *Id.*

87. On the economic theory of regulation, see Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J. ECON. 371 (1984); Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J.L. & ECON. 211 (1976); Richard A. Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 335 (1974); George J. Stigler, *The Theory of Economic*

account of the dormant commerce clause targets only those laws that restrain commerce pursuant to implicit or explicit contracts between other states. The U.S. Congress and states are allowed to adopt rent-seeking legislation, in the forms of regulation, subsidies, and taxes. However, an individual state cannot enact a law that undermines a desirable pro-commerce regime that has been put into place through the implicit or explicit cooperation of states, any more than it can undermine a pro-commerce regime adopted formally by Congress or a federal agency (under the preemption doctrine).

As an illustration, in the context of deregulated wholesale power markets, individual states frequently face strong incentives to defect in order to protect firms in their own internal market, such as local utilities. Several states have adopted moratoria on exempt wholesale generators (power plants that are not owned by incumbent utilities but will sell power in interstate commerce),⁸⁸ or have limited the siting of such plants to in-state utilities only.⁸⁹ Florida's Supreme Court, for example, has interpreted a state power plant siting statute to limit plant siting to those suppliers who are Florida utilities or who have contracts with Florida utilities.⁹⁰ Perhaps taking a cue from Florida's success in blocking the development of new wholesale power plants that do not directly serve in-state customers, other state and local governments, particularly in the Southern U.S., have imposed moratoria on merchant plants.⁹¹

States have also attempted to block the siting of merchant interstate transmission lines, necessary for reliable wholesale power supply markets. For example, regulatory officials in the state of Connecticut have strongly opposed the Cross Sound Cable, a 23-mile merchant transmission line that would allow Long Island Power Authority to import power to Brook Haven, New York from New Haven, Connecticut, leading to significant delays in the operation of the transmission line.⁹² The project was built in

Regulation, 2 BELL J. ECON. & MGMT. SCI. 3 (1971).

88. See *supra* note 42 (referencing state and local government moratoria).

89. See, e.g., Ashley C. Brown & Damon Daniels, *Vision Without Site; Site Without Vision*, ELECTRICITY J., Oct. 2003, at 23; Pierce, *Environmental Regulation*, *supra* note 5.

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

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

92. See *infra* notes 93-107 and accompanying text.

2002, following the FERC's approval of retail sales at negotiated transmission rates,⁹³ as well as permit approvals by the Army Corp of Engineers, the New York Public Service Commission, the Connecticut Siting Council, and the Connecticut Department of Environmental Protection.⁹⁴ It complied with all state siting and environmental statutes, except for a provision of its state-issued permit which required its lines to be buried at a certain depth. Expansion of transmission access to locations such as New York City would provide important capacity, and may have helped in absorbing some of the transmission shortages that exacerbated the Summer 2003 blackout.⁹⁵ In burying the transmission line, the project sponsor discovered hard sediments and bedrock protrusions along portions of the route. Some Connecticut officials cited environmental concerns in support of their opposition to the project, such as impacts on shellfish beds and dredging operations into the New Haven Harbor. The transmission line was built, however, and according to the project's CEO the line was "buried to the permit depth along 98 percent of the entire span, and over 90% of the route within the Federal Channel to an average of 50.7 feet below mean lower low water, well below the required level of minus 48 feet."⁹⁶

Nevertheless, a Connecticut official's vocal opposition kept the transmission line from becoming operational until 2004.⁹⁷ This may be a well-intended dispute over environmental regulation, but the line was not opposed only by environmental interests in the state of Connecticut. As often is the case when a regulatory body blocks a new entrant into a state's power industry, there is also an anti-competitive angle to opposition to the Cross Sound line. Northeast Utilities, a major investor-owned utility whose customers reside primarily in Connecticut (and which also services customers in Massachusetts and New Hampshire), owns an older, competing transmission line (the 1385 cable) that runs parallel to the Cross Sound Cable, and supports expanding that facility over the new

93. TransEnergie U.S., Ltd., 91 FERC ¶ 61,230 (2000).

94. See *Regional Energy Reliability and Security: DOE Authority to Energize the Cross Sound Cable: Hearing Before the Subcomm. on Energy and Air Quality of the House Comm. on Energy and Commerce*, 108th Cong. 55–56 (2004) (statement of Jeffrey A. Donahue, Chairman and CEO Cross Sound Cable Company, LLC) [hereinafter Donahue statement].

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

96. Donahue statement, *supra* note 94, at 56.

97. Bruce W. Radford, *Cross-Sound Cable Puts Feds on the Spot*, FORTNIGHTLY'S SPARK, June 2004, at 1, available at <http://www.pur.com/pubs/spark/jun04.pdf>.

transmission line.⁹⁸ Northeast Utilities favored updating its line over approving the Cross Sound line, with which it would compete, and has requested FERC to use its authority under Section 210 of the FPA to order New York to assist in replacing the 1385 cable.⁹⁹

After the Cross Sound transmission line was built, Connecticut passed a moratorium on the siting of new or expanded transmission lines across Long Island Sound,¹⁰⁰ effectively limiting the ability of the project's sponsors to make the project comply with Connecticut's understanding of the permits.¹⁰¹ The Cross Sound Cable was authorized to operate under an emergency order issued by the U.S. Secretary of Energy following the August 2003 blackout, but that order was lifted in early 2004, leaving the Cross Sound line without permission to go live.¹⁰² So, effectively, the Cross Sound Cable was completed in 2002, but remained dormant as a permanent transmission alternative until Summer 2004, due to a regulatory impasse between the state of Connecticut, on the one hand, and the Cross Sound project's investors and the state of New York, on the other. As FERC Chairman Pat Wood indicated before Congress in May 2004, federal regulators lack authority to resolve the issue, given state and local jurisdiction over transmission-line siting.¹⁰³ FERC has embraced wholesale deregulation, but FERC has lacked the authority to preempt the state environmental siting process over the transmission line.¹⁰⁴ Connecticut's Attorney General, backed by environmental interest groups and Northeast Utilities, threatened litigation if the Cross Sound line is allowed to go live again, instead favoring expansion of the existing transmission line, owned by Northeast Utilities.¹⁰⁵ Only when FERC threatened to approve expansion of the 1385 cable was FERC able to force the parties to the bargaining table.¹⁰⁶ FERC could not preempt the states and mandate operation of the Cross Sound transmission line, but the threat

98. *Id.* at 11.

99. Donahue statement, *supra* note 94, at 56.

100. *Moratorium on Grid Projects*, *supra* note 42.

101. *Id.*

102. Under Section 202(c) of the FPA, the U.S. Secretary of Energy can mandate operation of a transmission line over objections of state regulators, but only in the context of an emergency—not where it is merely found to be in the public interest. 16 U.S.C. § 824a(c) (2005).

103. *Regional Energy Reliability and Security: DOE Authority to Energize the Cross Sound Cable: Hearing Before the Subcomm. on Energy and Air Quality of the House Comm. on Energy and Commerce*, 108th Cong. 40–42 (2004) (statement of Patrick Wood, III, Chairman FERC).

104. In the Energy Policy Act of 2005, Congress extended to FERC “back stop” authority to preempt state transmission line siting procedures in limited circumstances.

105. Radford, *supra* note 97, at 1.

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

of it making a decision elsewhere led stakeholders to negotiate a settlement, allowing the line to operate.¹⁰⁷

As in the context of the Connecticut transmission line dispute, to the extent that transmission remains entirely within the control of state, rather than federal, regulators, states may have strong incentives to protect their own incumbent firms or citizens, rather than supporting cooperative efforts to expand transmission. Indeed, Suffolk County, New York sued the state of Connecticut, claiming that its moratorium and other efforts to block the new transmission line violate the Commerce Clause of the U.S. Constitution.¹⁰⁸ A political process account of the dormant commerce clause would suggest that judicial deference to Connecticut's claim of state environmental benefits is inappropriate. In a dormant commerce clause challenge to the Connecticut siting dispute, federal courts would need to carefully scrutinize the claims of environmental protection. Given that the project was already built, concerns with allowing the line to become operational seem highly suspect. By defecting from the norm of interstate cooperation in supporting the growth of transmission infrastructure to serve the national market, Connecticut was disrupting the cooperative equilibrium that exists among states (here a cooperative equilibrium that supports increased competition).

To be sure, some rent transfers are permissible, if not desirable, in the state political process. For example, rent-seeking in the form of a neutral corporate tax exemption for utilities, or rent-seeking in the setting of utility rates to favor industrial growth, is likely permissible, and subject only to the safeguards of the state political process. However, rent-seeking in the form of exclusionary regulation that limits access to the interstate market is more suspect as an economic matter where market exchange is the cooperative background norm. Florida's Supreme Court rejected a dormant commerce clause challenge to the use of the state's restrictive power plant siting statute to restrict the building of new plants by out-of-state suppliers.¹⁰⁹ However, since the dormant commerce clause challenge was only litigated before the Florida Supreme Court,¹¹⁰ the inadequacy of

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

108. See *N.Y. County Sues Connecticut, Says Blocking Merchant Line Violates Commerce Clause*, POWER MARKETS WK., May 31, 2004, at 23. Given that, in Summer 2004, a settlement allowed the line to go operational, this suit was withdrawn.

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

110. Below, the Florida Public Service Commission allowed siting of the power plant, and in

a state court record establishing discrimination against out-of-state suppliers probably made this argument less compelling than it could have been. At a minimum, dormant commerce clause jurisprudence would require states to explain how legislation restricting power supply in the wholesale market or transmission expansion might serve benign purposes of environmental or consumer protection.

It is more difficult to assess the constitutional status of state- or local-franchised monopolies under the dormant commerce clause. On the political process account, the Town of Clarkstown, New York violated the dormant commerce clause by granting a monopoly that imposed a veiled tax on users of waste disposal outside of the locally-sponsored facility, including outside the state.¹¹¹ Its monopoly franchise was invalidated. In *Carbone*, Justice Souter wrote a dissent, joined by Chief Justice Rehnquist and Justice Blackmun, arguing that the majority had ignored the distinction between private and public enterprise and that the flow control ordinance monopoly is easily distinguished from the “entrepreneurial favoritism [the Court has] previously defined and condemned as protectionist.”¹¹² On the traditional account of judicial intervention, it is unclear what distinguishes this monopoly from a constitutionally permissible state or local monopoly.

A political process bargaining account of judicial intervention under the dormant commerce clause would suggest why electric, natural gas, and telecommunications monopolies will not necessarily fail constitutional evaluation if they refuse to open their service territories and network facilities to competitors. The historical lack of a background norm of competition excuses many historical monopolies from the constitutional reach of the dormant commerce clause: If there is no interstate market, a state or locally imposed monopoly cannot discriminate against out-of-state commerce. With the development of interstate markets in telecommunications and electric power, however, more difficult questions emerge. For example, it might be unconstitutional for a utility to impose a surcharge on all users of distribution service, regardless of whether they purchase their power from local or out-of-state suppliers.

doing so made no specific findings of discrimination in violation of the Commerce Clause. *Id.* at 431–32.

111. *See supra* notes 50–59 and accompanying text.

112. *C&A Carbone v. Town of Clarkstown*, 511 U.S. 383, 416 (Souter, J., dissenting). According to Justice Souter’s dissent, “[t]he Commerce Clause was not passed to save the citizens of Clarkstown from themselves.” *Id.* at 430. Thus, the dissent rejects extending the political process account beyond scenarios that discriminate between local and out-of-town participants.

If a municipality, such as the Town of Clarkstown, operates a government-owned monopoly over telecommunications or electric distribution service, the market-participant exception shields its conduct from the reach of the dormant commerce clause.¹¹³ Franchised private utilities—such as investor-owned utilities—pose a potential problem but are not necessarily unconstitutional, even under the political process account of the dormant commerce clause. The political process account, however, warns state and local governments to approach the financing of such operations with care. In *Carbone*, the Town of Clarkstown promised to make up losses from operating the transfer facility at competitive rates, presumably by taking these losses out of its general revenues.¹¹⁴ What the dormant commerce clause seems to prohibit is a local government explicitly indemnifying a private monopoly out of the public fisc, even where it imposes the same monopoly and fees on both in- and out-of-state providers of service. The Takings Clause does not require governments to take on such obligations,¹¹⁵ but the dormant commerce clause may prohibit them if they are the result of rent seeking that imposes burdens on interstate cooperation regarding the optimal level of regulation.¹¹⁶ Further, as in *Carbone*, authorizing above-market fees solely for purposes of maintaining the monopoly may be constitutionally suspect. As we move from local to state monopoly franchises, concerns with a single firm capturing the political process are weaker—a single firm that dominates municipal politics may have little power in state-wide regulatory and political processes—so state-franchised monopolies may be more likely to pass constitutional muster. But even neutral financing arrangements may be suspect if they favor local enterprise and have the “practical effect and design”¹¹⁷ of impeding the evolution of cooperative interstate lawmaking.¹¹⁸

If, however, one state approves retail competition while adjacent states do not, the political process bargaining account does not advise judicial intervention. While a handful of states may “defect” from interstate cooperation by embracing competitive mechanisms (such as “retail wheeling”),¹¹⁹ this is not the type of uncooperative state lawmaking that

113. See sources cited *supra* note 57.

114. See *supra* note 54 and accompanying text.

115. Instead, the Takings Clause serves to prohibit governmental overreaching.

116. See *supra* notes 77–85 and accompanying text (summarizing the argument based on interstate cooperation).

117. *Carbone*, 511 U.S. at 394.

118. See, e.g., sources cited *supra* note 43.

119. See Kelly A. Karn, Note, *State Electric Restructuring: Are Retail Wheeling and Reciprocity*

requires judicial intervention to protect against spillover effects for non-participants. Powerful incumbent in-state monopolies could be expected to oppose such measures in the state political process, so nothing would be gained by judicial intervention to safeguard against such laws.

II. JUDICIAL GATEKEEPING AND STATE-ACTION IMMUNITY FROM ANTITRUST ENFORCEMENT

While the dormant commerce clause is an affirmative restriction on state power to act derived from the Constitution, state-action immunity serves as a defense from antitrust enforcement. State-action immunity suspends federal antitrust enforcement under the Sherman and Clayton Acts¹²⁰—statutes designed to enhance competition and free trade norms—where a state actively supervises the private activity.¹²¹ This judicially-created antitrust defense originated when the Supreme Court rejected a Sherman Act challenge to a California marketing program brought by a grower because the program “derived its authority and its efficacy from the legislative command of the state.”¹²² By serving as a “filter” (or “gatekeeper”) for judicial scrutiny of private conduct,¹²³ such immunity serves the federalism purpose of facilitating participation in the state regulatory process¹²⁴ which lends legitimacy to the development of regulation.¹²⁵

Provisions Constitutional?, 33 IND. L. REV. 631 (2000) (arguing that state laws that allow retail wheeling with out-of-state suppliers only on conditions of reciprocity would fail to withstand dormant commerce clause scrutiny).

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

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

122. *Parker*, 317 U.S. at 350.

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

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

125. State-action immunity also may serve a judicial-avoidance purpose, providing federal courts a way of disposing of complex and technical issues, especially in ways that have a binding impact on state law. However, other legal doctrines, such as abstention (which advises federal courts to abstain from exercising jurisdiction out of comity) adequately avoid the precedent-creating risk of federal court review of state regulation. Abstention can be invoked where a federal court is making a decision that has a binding effect on state law. By contrast, with antitrust litigation courts are not normally passing judgments on the lawfulness of state regulation, but are focused on the merits of private conduct under federal law.

The impact of a court making a decision not to apply state-action immunity is not to invalidate a state or local regulation, but to subject private conduct that complies with (or is envisioned by) regulation to antitrust scrutiny. Thus, courts evaluating state or local regulation in the context of state-action immunity should be expected to be less, not more, deferential to decentralized politics. In addition, to the extent a finding of state-action immunity provides private firms engaging in certain types of conduct an absolute defense from antitrust liability, it encourages the formation of state monopolies, or monopolistic conduct, where states intend to take private conduct outside of the pale of antitrust enforcement. Given this, state-action immunity presents a particularly compelling case for careful judicial scrutiny of state and local regulation. However, courts are almost oblivious to such concerns and frequently embrace overbroad judicial deference in the state-action-immunity context.¹²⁶

A. Midcal and Other Smoke Signals from the Supreme Court

In applying state-action immunity, the Supreme Court has adopted a two-part test to determine which state regulation is exempt from antitrust enforcement: "First, the challenged restraint must be 'one clearly articulated and affirmatively expressed as state policy'; second, the policy must be 'actively supervised' by the State itself."¹²⁷ This test seems simple enough. Only if a state law expressly envisions monopolistic conduct and if the state actively supervises such conduct, will the conduct escape antitrust enforcement. In application, though, courts have struggled in applying state-action immunity, often because different bodies within a state take on the regulatory role and because the nature of regulation varies so much from industry to industry. While state-action immunity might be intended to create a safe harbor for state and local politics, judicial decisions invoking it are hardly consistent or principled. The Supreme Court's current approach to state-action immunity also seems to ignore how judicial deference in this context can create incentives in the state and local lawmaking process that are harmful to social welfare.

Application of state-action immunity to local governments, such as municipal bodies, as opposed to states, has presented a difficult challenge for courts.¹²⁸ Local government lawmaking perhaps provides the most

126. See FTC STATE ACTION REPORT, *supra* note 14.

127. Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc. 445 U.S. 97, 105 (1980) (citation omitted).

128. Commentary on the applicability of state action immunity to local governments is abundant.

salient opportunity for extension of the political process insights of dormant commerce clause jurisprudence to the state-action-immunity context in antitrust law. In a short-lived line of cases, the Supreme Court read state-action immunity narrowly in the context of municipal (as opposed to state) regulation. *Community Communications Co. v. City of Boulder, Colorado*,¹²⁹ for example, subjected municipal governments to antitrust enforcement for monopolistic conduct. Speaking for the majority, Justice Brennan distinguished between states regulating as states—entitled to the state action defense under a federalism rationale—and as political subdivisions—exempt from antitrust enforcement only insofar as they are implementing state policy, but not when they are acting as municipal governments only.¹³⁰ The City of Boulder's moratorium on cable television expansion was thus subject to antitrust challenge because Colorado, at the state level, had not clearly expressed a policy to regulate cable television; in fact, Justice Brennan thought it apparent that Colorado had no state-wide policy at all—that there was a gap in state regulation.¹³¹

This rationale for narrowing the availability of the state action defense for municipal governments is striking in its similarity to the political process account of dormant commerce clause jurisprudence. Like the constitutionally suspect municipally franchised monopoly in *Carbone*, which the Court believed to impair external market competition, the City of Boulder's moratorium on cable effectuates a tax on its citizens that goes too far. This impairs competition in the internal (intrastate) market, as well as perhaps in the external (interstate) market. As such, a certain convergence between the dormant commerce clause and state-action immunity informs the Court's skepticism about local regulation in this line of cases. To the extent that both the dormant commerce clause and state-action immunity emphasize the incentives private firms face in bargaining in the law-making process with state and local governments, a narrow

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

129. *Cmty. Communications Co. v. City of Boulder*, 455 U.S. 40 (1982).

130. *Id.* at 52–56.

131. *Id.* at 54–55. Justice Brennan was clear that “mere neutrality” by the state regarding municipal regulation does not suffice. Instead, a “clear articulation and affirmative expression” to replace antitrust enforcement with regulation is necessary. *Id.* at 55.

reading of state-action immunity from antitrust enforcement against private firms is justified in the municipal context for the very same reasons that the political process account of the dormant commerce clause makes sense.¹³²

A more recent line of cases, however, departs from the municipal-state distinction in antitrust immunity that Justice Brennan laid down in the context of cable television regulation.¹³³ In *Town of Hallie v. City of Eau Claire*,¹³⁴ the Court abandoned the clear-articulation requirement in assessing municipal state-action immunity. Instead, Justice Powell reasoned in his majority opinion, as long as a state confers permissive authority in general terms for a municipality to deal with a matter within the municipal government's discretion, this is sufficient to exclude the conduct from antitrust enforcement.¹³⁵ Thus, when the state of Wisconsin granted municipalities the authority to establish sewage treatment plants, this impliedly granted municipal government the power to make decisions about who would be served. Justice Powell recognized that municipalities may exercise "purely parochial public interests" which, at some level, could be subject to antitrust enforcement.¹³⁶ In his view, however, a state delegation to a municipal government is sufficient to meet the clearly expressed and fully articulated criterion of the state-action immunity test, which reading exempts from antitrust enforcement a large range of municipal regulation.¹³⁷ Under this approach, an "express mention" by a legislature of an intent to displace competition is not necessary (although perhaps it would be sufficient); instead, the Court suggests, what matters is that the allegedly anticompetitive conduct is a "foreseeable result" of the state policy.¹³⁸

In addition, at least in the original *Midcal* formulation, state-action immunity requires courts to determine how active and involved a regulatory scheme must be for purposes of deeming it "active

132. Reacting to the prospect of liability created by *City of Boulder*, Congress abolished money damage liability under the antitrust laws for municipalities, their officials, and private persons acting under the direction of local governments and their officials in the Local Government Antitrust Act of 1984. See H.R. REP. NO. 98-965, at 18-19 (1984), reprinted in 1984 U.S.C.C.A.N. 4602, 4619-20. Congress continued, however, to authorize antitrust liability for private conduct that is sanctioned or authorized by municipal governments.

133. See *infra* notes 134-38 and accompanying text.

134. *Town of Hallie v. City of Eau Claire*, 471 U.S. 34 (1985).

135. *Id.* at 46.

136. *Id.* at 47.

137. *Id.*

138. *Id.* at 41-42.

supervision.”¹³⁹ In *Hallie*, however, the Supreme Court effectively abandoned the requirement of active state supervision, at least insofar as it applies to municipalities.¹⁴⁰ In so holding, the Court explained that the purpose of state supervision is to ensure that regulatory policies are pursued for public purposes and not to enrich private actors. According to the Court, “Where a private party is engaging in the anticompetitive activity, there is a real danger that he is acting to further his own interests, rather than the governmental interests of the State.”¹⁴¹ But, if a state has clearly authorized a municipality to act, the Court reasoned that there is no such problem. Instead, the “only real danger is that it will seek to further purely parochial public interests at the expense of more overriding state goals.”¹⁴² Thus, if it is clear that state authorization exists, either expressly or by virtue of foreseeable results, the Court held that there is no need to make a finding that the state actively supervises the municipality’s regulation of the private activity.¹⁴³

While this approach envisions an inquiry into the “foreseeable results” of policy adopted by a state legislative body, it does not define what the inquiry would entail.¹⁴⁴ Appellate courts following this approach invoke state-action immunity based almost exclusively on a clear legislative purpose, or a clear statement to displace competition or antitrust enforcement by courts.¹⁴⁵ Beyond this, however, they generally engage in judicial restraint, deferring to state regulation of public utility monopolies under the antitrust laws.¹⁴⁶ Deference has its appeal in a complex regulatory environment, but the Court’s relaxation of a state supervision requirement for municipalities is counterintuitive if not incoherent. The premise that municipal regulation is not likely to be captured by private interests at the expense of the public good ignores the high risk of interest group capture at the local level, where the incentives for *ex ante* lobbying of the regulator are perhaps strongest. At the local level, the costs to firms of organizing and lobbying regulators are much lower than at the state

139. Cal. Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc., 445 U.S. 97, 106 (1980).

140. Town of Hallie v. City of Eau Claire, 471 U.S. 34, 46–47 (1985).

141. *Id.* at 47.

142. *Id.*

143. *Id.*

144. For a discussion of this aspect of *Hallie*, see Elizabeth Trujillo, *The Hidden Prong of the Midcal Test: A New Look at State Action as the Pendulum Shifts Towards Deregulation of the Electrical Markets*, 83 DENV. L. REV. (forthcoming 2005).

145. See *supra* notes 134–43 and accompanying text.

146. *Id.* See also Town of Hallie v. City of Eau Claire, 471 U.S. 34, 47 (1985) (“Once it is clear that state authorization exists, there is no need to require the state to supervise activity the municipality’s execution of what is a properly delegated function.”).

level.¹⁴⁷ Although the Court seems to embrace a federalism-based formalism as a rationale for deference to municipal regulation, this account of federalism proves too much. Such a stance can result in state delegation to municipal governments with no strings attached, insulating private behavior at the local level from almost all antitrust enforcement. Further, it places focus on the mere formalistic articulation of state goals by a state body, without addressing their purpose. States, as well as municipal governments, sometimes regulate in ways that allow private interests to place their own economic well-being ahead of the public good. Allowing the law to insulate such private conduct from antitrust scrutiny may have serious consequences in deregulated markets.

The Court's state-action immunity cases in the context of municipal regulation seem to view the clear-articulation and active-supervision requirements as one and the same, or as collapsing into a one-step foreseeability test.¹⁴⁸ In a more recent case on the topic, however, the Court has made it clear that the active-supervision requirement is alive and well as an independent criterion where the conduct of state, as opposed to municipal, regulators is at issue.¹⁴⁹ The Court's decision nonetheless raises many questions about the scope of application of this test to many private arrangements in deregulated markets. In *FTC v. Ticor Title Insurance Co.*,¹⁵⁰ the Court addressed the application of state-action immunity to the rate-setting activities of title insurance companies in several states. Most of the states regulating the title insurance defendants permitted private insurers to jointly file rates, which state officials could reject or allow to remain in effect.¹⁵¹ The record of the case suggested that no significant review of the rates actually took place by these states.¹⁵² The FTC had conceded that the state statutes authorizing the acceptance of jointly filed rates met the clear-articulation requirement,¹⁵³ but the Court found the agency's review did not constitute active supervision and thus failed the

147. One would expect a powerful firm at the local level to hold more influence over elected officials than at the state level.

148. See Trujillo, *supra* note 144.

149. See *infra* notes 150–55 and accompanying text.

150. *FTC v. Ticor Title Ins. Co.*, 504 U.S. 621 (1992).

151. *Id.* at 629–31.

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

153. *Id.* at 631. In the decision below, the Third Circuit, following a First Circuit decision, held that the existence of a funded and authorized state program met the active-supervision requirement. *Ticor Title Ins. Co. v. FTC*, 922 F.2d 1122, 1136 (3d Cir. 1991) (following *New Eng. Motor Rate Bureau, Inc. v. FTC*, 908 F.2d 1064, 1071 (1st Cir. 1990)).

second step of *Midcal*.¹⁵⁴ Hence, the Court concluded, the allegedly anticompetitive acts of the insurers could be challenged.¹⁵⁵

B. Hazy Signals from Appellate Courts in Restructured Markets

Since state-action immunity serves a gatekeeping function for antitrust enforcement, the defense will increasingly play an important role as formerly regulated firms are deregulated.¹⁵⁶ Yet, according to most appellate courts, the gates of antitrust enforcement remain closed, allowing the conduct of many private firms to escape antitrust scrutiny altogether in emerging competitive markets. Despite *Ticor's* signal that the active supervision requirement is alive and well, lower courts—especially the Eighth, Tenth and Eleventh Circuits—generally have continued to take a deferential approach to state-action immunity in reviewing state regulation in deregulated markets. Even where state, not local, regulation is at issue and even where competitive markets for service are emerging, these courts are not inclined to allow the Sherman Act to apply to private conduct in formerly regulated industries where there is some state regulatory scheme, however incomplete it is.

Illustrating this deferential and narrowing approach to judicial intervention, the Tenth Circuit has embraced particularly broad antitrust immunity for electric utilities, despite the introduction of competition into large segments of the industry. For example, the Tenth Circuit extended antitrust immunity to Oklahoma Gas and Electric Company's (OG&E) conduct based on evidence that the state regulatory agency had "general supervision" authority over the utility, "including the power to fix all of OG&E's rates for electricity and to promulgate all the rules and regulations that affect OG&E's services, operation, and management."¹⁵⁷ The Tenth Circuit deemed a state agency's power to engage in review alone as sufficient for applying state-action immunity, effectively rendering the active-supervision requirement meaningless.¹⁵⁸ While the court cited a previous case which "found that the use of similar authority over an electric utility satisfied the active supervision requirement"¹⁵⁹ as a

154. *FTC v. Ticor Title Ins. Co.*, 504 U.S. 621, 640 (1992).

155. *Id.* at 647.

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

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

158. *Id.*

159. *Id.* (citing *Lease Lights, Inc. v. Pub. Serv. Co. of Okla.*, 849 F.2d 1330, 1334 (10th Cir.

basis for this conclusion, it made no effort whatsoever to discern evidence of the affirmative use of such authority by the regulator with respect to the utility whose conduct was at issue.¹⁶⁰

The Eighth Circuit has taken a similarly deferential approach to state-action immunity.¹⁶¹ *North Star Steel*, a customer located within the exclusive service territory of MidAmerican, an electric utility in Iowa, sought to purchase competitively priced electricity and requested that MidAmerican wheel power to it.¹⁶² MidAmerican refused, and North Star sued, alleging that the utility violated the antitrust laws by refusing to allow access to its transmission lines.¹⁶³ The court found that active supervision of the utility's conduct existed due to the fact that by statute in Iowa new customers were assigned to exclusive service providers and, in the event there was a conflict over which provider was in control of a given area, the regulator determined which provider should "occupy" the area.¹⁶⁴ The court found that Iowa's legislature "affirmatively expressed" a policy of displacing competition in the market for retail electric service.¹⁶⁵ The court refused, however, to explore the substantive basis for the agency's regulatory determinations in defining exclusive service territories.¹⁶⁶ For instance, even though the state had experimented with limited "pilot" retail wheeling programs,¹⁶⁷ the court did not evaluate whether the state agency's efforts to promote competition in power supply might coexist with maintaining exclusive service territories over transmission and distribution, effectively deferring to state regulators on all of these issues.¹⁶⁸ In fact, the only regulatory action that was discussed by the court related to the definition of distribution service territories, not

1988)).

160. *Okla. Gas & Elec. Co.*, 244 F.3d 1220. The case presents a notable contrast to a later Tenth Circuit case, in which the court refused to extend state action immunity to unilateral activity which was "neither mandated, nor authorized, nor reviewed, nor even known about" by the state regulator. *Telecor Communications, Inc. v. Southwestern Bell Tel. Co.*, 305 F.3d 1124, 1140 (10th Cir. 2002). This case is also too narrow in its construction of state action immunity. As is discussed *infra*, state action immunity should not be limited to purely "unilateral" activity, but should also extend to bilateral activity in which the regulator plays a passive role.

161. *N. Star Steel Co. v. MidAmerican Energy Holdings Co.*, 184 F.3d 732 (8th Cir. 1999).

162. *Id.* at 734.

163. *Id.*

164. *Id.* at 738-39.

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

166. The court did not, for example, review how service territories were determined.

167. *N. Star Steel Co. v. MidAmerican Energy Holdings Co.*, 184 F.3d 732, 736 (8th Cir. 1999).

168. *Id.*

the allocation of power supply or generation.¹⁶⁹ The court also reasoned that “less pervasive regulatory regimes have been held to satisfy the active supervision prong.”¹⁷⁰

One of these “less pervasive” regulatory regimes is blanket state prohibitions—by statute or regulation—on certain types of pro-competitive conduct.¹⁷¹ For example, according to Florida’s regulators and courts, Florida has adopted a statutory prohibition on retail electric competition, outside of self-wheeling arrangements (i.e., a supplier transmitting power over the utility’s lines for the supplier’s own use).¹⁷² Although Florida does not have a clear legislative statement regarding the issue, Florida’s Public Service Commission (PSC) had adopted a regulation which prohibits retail wheeling to provide access to competitive power supply outside of self-wheeling arrangements.¹⁷³ A Florida Supreme Court case had previously interpreted this regulation to preclude cogenerators from selling their power in the retail market.¹⁷⁴ Accepting both the regulation and the Florida Supreme Court’s characterization of the regulation, the Eleventh Circuit applied state-action immunity to preclude an antitrust action by a cogeneration facility against a utility which refused to wheel power at a competitive rate.¹⁷⁵ The court reasoned that “the doors to the PSC were open to all with standing to complain,”¹⁷⁶ but nowhere did the court identify how a private cogenerator might raise such issues before the Florida PSC.¹⁷⁷ Arguably, it could not, other than by directly challenging the state agency regulation authorizing the allegedly anticompetitive conduct.

A way of understanding the antitrust claim before the Eleventh Circuit is as a collateral attack on the state agency rule based on a substantive violation of federal antitrust law. The decision echoes a previous Eleventh Circuit case, in which it was found that state-action immunity protects a regulated electric utility’s division of service territories in the county in which a customer is located from Sherman Act restraint-of-trade claims.¹⁷⁸ Taken together, these Eleventh Circuit opinions seem to suggest that the

169. *Id.*

170. *Id.* at 739.

171. Many states limit competition not through active regulation of the industry but by prohibiting certain basic market exchanges or sales.

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

173. *Id.*

174. *Id.*

175. *TEC Cogeneration Inc. v. Fla. Power & Light Co.*, 76 F.3d 1560 (11th Cir. 1996).

176. *Id.* at 1570.

177. *Id.*

178. *Praxair, Inc. v. Fla. Power & Light Co.*, 64 F.3d 609 (11th Cir. 1995).

existence of an agency rule authorizing anticompetitive conduct is enough to trigger active supervision.¹⁷⁹ If this holds, however, private conduct can be insulated from antitrust liability not only by the actions of a state legislature, but also a unilaterally adopted agency rule, even if this rule prohibits pro-competitive conduct with little or no agency oversight.

This deferential approach to gatekeeping in antitrust enforcement has serious implications for the enforcement of the antitrust laws in deregulated markets. In California's deregulated electric power market, wholesale power suppliers possessing market power have allegedly engaged in tacit collusion to withhold supply and to thus artificially inflate their prices.¹⁸⁰ Of course, both federal and state regulation continued, even in the context of California's failed regulation plan.¹⁸¹ FERC made its own determinations that individual firms lacked market power and had approved several market-based tariffs, allowing deregulation in the wholesale market.¹⁸² As to California's retail market, state agencies as well had approved the sale of power by these suppliers through the state-sanctioned market exchange.¹⁸³ To the extent that the behavior of any private firms operating in this market raised a plausible Section 1 (or even a Section 2) antitrust claim under the Sherman Act, the mere existence of a state-sanctioned and -supervised market should not give rise to state-action immunity.

These appellate court decisions, however, send mixed signals at best. At worst, these decisions invite private manipulation of state and local

179. *Id.* at 613 (“An agency’s interpretation of its own regulations must be given controlling weight unless that interpretation is plainly erroneous or inconsistent with the regulation.”). In an earlier case, the Eleventh Circuit relied entirely on the clear-articulation requirement to find state-action immunity. See *Mun. Utils. Bd. of Albertville v. Ala. Power Co.*, 934 F.2d 1493 (11th Cir. 1991). This seems to completely take state-action immunity outside of the two part *Midcal* test, turning it into a one-step clear-articulation requirement. In *S. Motor Carriers Rate Conference, Inc. v. United States*, 471 U.S. 48, 60 (1985), the Court stated: “The federal antitrust laws do not forbid the States to adopt policies that permit, but do not compel, anticompetitive conduct by *regulated* private parties. As long as the State clearly articulates its intent to adopt a permissive policy, the first prong of the *Midcal* test is satisfied.” The Court made it clear that the presence or absence of compulsion is not the “*sine qua non* to state-action immunity.” *Id.*

180. See Darren Bush & Carrie Mayne, *In (Reluctant) Defense of Enron: Why Bad Regulation is to Blame for California’s Power Woes (or Why Antitrust Law Fails to Protect Against Market Power When the Market Rules Encourage Its Use)*, 83 OR. L. REV. 207 (2004); Robert B. Martin, III, *Sherman Shorts Out: The Dimming of Antitrust Enforcement in the California Electricity Crisis*, 55 HASTINGS L.J. 271 (2003).

181. California, for instance, retained a complicated system of state regulation.

182. See DEPARTMENT OF ENERGY UPDATE, *supra* note 40, ch. 7.

183. For discussion of this regulatory framework, see Jim Rossi, *The Electric Deregulation Fiasco: Looking to Regulatory Federalism to Promote a Balance Between Markets and the Provision of Public Goods*, 100 MICH. L. REV. 1768 (2002) (book review).

regulators to create antitrust immunity. Particularly as state and local governments engage in lawmaking in partially deregulated markets, the risks of private manipulation of lawmaking are high. Given this, courts could improve the functioning of deregulated markets, as well as the political process, if they could devise a more principled way of exercising their gatekeeping function in the state-action immunity context.

III. REASSESSING JUDICIAL DEFERENCE IN ANTITRUST FEDERALISM

Since *Hallie*, the Supreme Court has abandoned the political-process-informed municipal-state distinction in assessing state-action immunity from antitrust enforcement. In place of this, federal courts assume a highly deferential stance in reviewing both state and local regulation as they apply state-action immunity to antitrust challenges to allegedly anticompetitive conduct. If a state regulates an activity, courts reviewing private conduct under complex regulatory schemes are increasingly likely to imply a regulatory policy—sometimes even absent a clear articulation of regulatory purpose by the state.¹⁸⁴ This indicates a strong judicial preference for deference—and against judicial intervention—in applying state-action immunity as an antitrust defense.

The active-supervision prong of state-action immunity is also judicially implied in many recent cases involving deregulated electric power markets, especially in the Eighth, Tenth and Eleventh circuits.¹⁸⁵ These courts fail to evaluate the degree of scrutiny provided by state or local regulators, as well as whether the purpose of this supervision overlaps with the pro-competitive goals of the Sherman Act.¹⁸⁶ Their approach evinces a serious lapse of judicial gatekeeping in the consideration of antitrust challenges to private conduct in restructured industries, such as electric power and telecommunications. Without a judicial safeguard, overbroad judicial endorsement of state-action immunity allows allegedly anticompetitive private conduct to escape scrutiny altogether and risks undermining the goals of competition law, particularly as national markets in these industries develop.

184. Courts do so by making a determination that the allegedly anticompetitive conduct was either explicitly envisioned by, or foreseeable to, state legislators. *See supra* text accompanying notes 134–44 (referencing the foreseeability approach).

185. *See supra* notes 156–83 and accompanying text.

186. *Id.*

A. Deference, Incentives, and Spillover Costs in State-Action Immunity

Merrick Garland, now a judge of the U.S. Court of Appeals for the District of Columbia, has been one of the strongest defenders of this deferential approach to state-action immunity in considering the relevance of state regulation.¹⁸⁷ In a leading article on state-action immunity, he argues that there is no principled basis for distinguishing between municipalities and states for federal antitrust law purposes.¹⁸⁸ Put simply, his view is that state and local legislation should not be assessed by the federal courts for either their efficiency or rent-seeking effects in antitrust cases.¹⁸⁹

Several scholars depart from this strong deference approach to state-action immunity by proposing efficiency criteria for courts to use in evaluating state regulation in antitrust federalism. Responding to *Hallie*, John Shepard Wiley proposes that courts directly address the efficiency, and in particular public choice, implications of state and local legislation in deciding whether to invoke state-action immunity.¹⁹⁰ According to Wiley, if anticompetitive legislation is inefficient and the result of producer-interest lobbying, state-action immunity should not shield conduct authorized under the legislation from scrutiny under the Sherman Act.¹⁹¹ In similar spirit, Matthew Spitzer argues that federal courts should intervene in evaluating antitrust claims notwithstanding state or local legislation if the legislation is inefficient or transfers wealth from consumers to producers.¹⁹² John Cirace argues that courts should employ an efficiency test to evaluate the effects of state and local legislation on claims under the Sherman Act.¹⁹³ Others, such as Steven Semeraro, find the efficiency and public choice focus of these scholars incomplete, but this does not lead him to recommend strong deference; instead, Semeraro argues for rigorous review of state and local regulation on public-interest-oriented grounds.¹⁹⁴

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

188. *Id.* at 502–07.

189. *Id.* at 519.

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

191. *Id.* at 788–89.

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

193. Cirace, *supra* note 128.

194. Steven Semeraro, *Demystifying Antitrust State Action Doctrine*, 34 *HARV. J.L. & PUB. POL'Y* 203, 212–13 (2000) (arguing that, based on a “status choice” approach, courts should inquire “whether

In contrast, defenders of judicial deference in antitrust federalism see judicial review of state and local laws for efficiency, rent-seeking, or public interest goals as tantamount to federal courts returning to substantive due process review of state and local regulation, which encroaches on decentralized lawmaking in the economic regulation context.¹⁹⁵ Like advocates of deregulatory takings in public utility law attempt to reinvigorate *Lochner v. New York*¹⁹⁶ in determining government liability for regulatory transitions,¹⁹⁷ strong deference advocates are concerned that judicial intervention in the context of state-action immunity will necessarily lead courts to a *Lochner*-type review of regulation.¹⁹⁸ Garland, for example, favors exempting from judicial review under the Sherman Act all regulatory actions by state and local governments except for delegations to private parties of the power to restrain the market to private parties.¹⁹⁹

However, it has been a hundred years since *Lochner* was decided and more than sixty years since it reigned supreme in utility law,²⁰⁰ and no one seriously wishes to invoke its ghost.²⁰¹ Indeed, if judicial review of decentralized lawmaking is approached in a principled and cautious manner, a deferential stance to antitrust immunity certainly is not necessary to limit the scope of judicial review. As Daniel Gifford has argued, federal courts have the capacity to review state and local legislation without directly addressing their substantive efficiency effects.²⁰² Gifford suggests that courts apply the same “free market” approach in the state-action-immunity context that they apply under the dormant commerce clause by recognizing two markets.²⁰³ State-action

a government actor’s conception of the public interest is being furthered by the anticompetitive restraint”).

195. See Garland, *supra* note 187.

196. *Lochner v. New York*, 198 U.S. 45 (1905).

197. See J. GREGORY SIDAK & DANIEL F. SPULBER, *DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT: THE COMPETITIVE TRANSFORMATION OF NETWORK INDUSTRIES IN THE UNITED STATES* (1997). For criticism, see Jim Chen, *The Second Coming of Smyth v. Ames*, 77 TEX. L. REV. 1535 (1999) (book review); Herbert Hovenkamp, *The Takings Clause and Improvident Regulatory Bargains*, 108 YALE L.J. 801 (1999) (book review); Rose-Ackerman & Rossi, *supra* note 68, at 1460–63; Jim Rossi, *The Irony of Deregulatory Takings*, 77 TEX. L. REV. 297 (1998) (book review).

198. Garland, *supra* note 187, at 488 (making an explicit comparison to *Lochner*).

199. *Id.* at 506.

200. See *Fed. Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) (abandoning substantive review of utility rates).

201. See Chen, *supra* note 197, at 1568.

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

203. *Id.*

immunity would protect the internal (intra-state) market from trade restraints, while the dormant commerce clause extends to the external (inter-state) market.²⁰⁴

Gifford's "two markets" approach has some appeal, but the bargaining process account²⁰⁵ illustrates that judicial review in both constitutional law and antitrust federalism contexts could entail something more than judicial endorsement of free markets at differing vertical levels. Put simply, a private markets theme, focused exclusively on market failure, has too much horsepower to serve as a useful test for courts in reviewing state and local regulation. Of course, both federal and state-local regulators can make choices to regulate in the public interest, or even to take ownership of a firm's resources.²⁰⁶ Thus, neither doctrine really requires private competitive markets at either the federal or state level.

In contrast, a political process bargaining account illustrates how both doctrines are primarily concerned with failures in cooperation, rather than market competition. So understood, state-action immunity from antitrust enforcement serves purposes similar to those the political process account of the dormant commerce clause embraces. Apart from Gifford, courts and commentators have only explicitly recognized the connection between the two doctrines on rare occasions,²⁰⁷ let alone considered whether both doctrines share political process concerns.

Although they do not discuss the similarities between the doctrines, Robert Inman and Daniel Rubinfeld have perhaps made the most strident political-process-based argument in the antitrust federalism context, arguing that state-action immunity should only be invoked where regulation imposes substantial spillover costs on out-of-state interests.²⁰⁸ On their view, state-action immunity would not remove from antitrust enforcement all private monopolies, but only those which are actively supervised by the state for purposes of limiting the harms that flow from unregulated monopoly.²⁰⁹ The active-supervision prong of state-action immunity is not inherently anti-commerce, but recognizes the necessity for regulation to correct for certain market failures where the public interest demands it. On this understanding, for state-action immunity to make

204. *Id.*

205. *See supra* Part I.A.

206. *See supra* notes 67–69 and accompanying text (discussing the ICC and TVA).

207. One of those rare occasions is a classic case that created state action immunity. *Parker v. Brown* raised both dormant commerce clause and antitrust challenges to the California raisin marketing program. *Parker v. Brown*, 317 U.S. 341 (1943).

208. Inman & Rubinfeld, *supra* note 124.

209. *Id.*

sense in its application, enforcement of pro-commerce norms is necessary where the federalism-based value of participation comes into conflict with efficiency, as may occur if state regulation creates spillover costs for those who do not participate in the relevant regulatory process. In this respect, the process bargaining account of dormant commerce clause jurisprudence also might inform the judicial approach to state-action immunity.

To the extent that this account is correct, courts must set a relatively high threshold before invoking gatekeeping presumptions, as they do in determining when state-action immunity precludes antitrust enforcement. However, recent cases involving utility restructuring illustrate the problem of the low state-action-immunity threshold many lower courts currently embrace.²¹⁰ Especially in a process of restructuring or deregulation—which gives birth to the norms of competition—private firms face strong incentives to use the regulatory process to enact partial regulatory schemes for purposes of establishing immunity from the antitrust laws. As states have begun to deregulate industries such as telecommunications and electric power, the nature of state regulation has changed. Rather than regulating utilities through rate and traditional certificate-of-need proceedings,²¹¹ increasingly regulators are laying down general structural rules or approving structural, rather than pricing, tariffs.²¹² Most agree that, with the rise of competitive markets, antitrust law plays a more—not less—important role than under traditional rate regulation.²¹³ As one Department of Justice lawyer has recognized in the context of antitrust enforcement in emerging competitive electric power markets, “If a state opens its retail market to competition, then the state action doctrine would not apply to conduct that relates directly to retail competition.”²¹⁴ The

210. See *supra* Part II.B.

211. See *supra* notes 33–36 and accompanying text.

212. Order 888 is an example. See DEPARTMENT OF ENERGY UPDATE, *supra* note 40, ch. 8.

213. See Dibadj, *supra* note 13. See also Ray S. Bolze et al., *Antitrust Law Regulation: A New Focus for a Competitive Energy Industry*, 21 ENERGY L.J. 79 (2000); Jade Alice Eaton, *Recent United States Department of Justice Actions in the Electric Utility Industry*, 9 CONN. J. INT’L L. 857 (1994); Craig A. Glazer & M. Bryan Little, *The Roles of Antitrust Law and Regulatory Oversight in the Restructured Electricity Industry*, 12 ELECTRICITY J. 21 (May 1999); William J. Kolasky, *Network Effects: A Contrarian View*, 7 GEO. MASON L. REV. 577 (1999); John Burrit McArthur, *Anti-trust in the New [De]Regulated Natural Gas Industry*, 18 ENERGY L.J. 1 (1997); Thomas A. Piraino, Jr., *A Proposed Antitrust Analysis of Telecommunications Joint Ventures*, 1997 WIS. L. REV. 639; William Baer, *FTC Perspectives on Competition Policy and Enforcement Initiatives in Electric Power*, *Address Before the Conference on the New Rules of the Game for Electric Power: Antitrust and Anticompetitive Behavior* (Dec. 4, 1997), at <http://www.ftc.gov/speeches/other/elec1204.htm>; Robert Pitofsky, *Competition Policy in Communications Industries: New Antitrust Approaches*, *Address Before the Glasser LegalWorks Seminar on Competitive Policy in Communications Industries: New Antitrust Approaches* (Mar. 10, 1997), at <http://www.ftc.gov/speeches/pitofsky/newcomm.htm>.

214. Joseph F. Schuler, Jr., *State Action Doctrine Losing Relevance*, *Department of Justice*

reality of separating regulated from unregulated conduct for antitrust federalism purposes is hardly simple, however, as states frequently endorse competition in some, but not all, aspects of formerly regulated industries, such as electric power and telecommunications.²¹⁵

A political process bargaining framework is consistent with the overall goal of protecting markets, in both the internal and external contexts, but advises a different emphasis for state-action immunity than previous efforts, such as Gifford's, which allow consistency with free market principles to drive both dormant commerce clause jurisprudence and state-action immunity.²¹⁶ Understanding state and local legislation as based in bargaining focuses on the process that leads to lawmaking, rather than on unregulated markets themselves. Between states, bargaining frequently fails, and may be costly to achieve, given the Compact Clause.²¹⁷ The dormant commerce clause serves as a safeguard to this concern.

Within a state, as in other lawmaking processes, private interest groups frequently face incentives to lobby lawmakers to secure benefits, and may prefer open-ended regulatory schemes which leave details to be worked out by an agency firm-by-firm. The more local the lawmaking process, the less costly it is for powerful interest groups to organize and influence the process, but lawmaking can have serious spillover effects for non-participants. At the local level, capture may be more visible, but it also may be more stable, given ability to capture the political as well as the regulatory process. Thus, if courts are to focus on the quality of the political process leading to enactment of a market restraint, the now-defunct municipal-state distinction is sensible. It would require courts to apply more scrutiny to local, as opposed to state, regulations in restraint of trade. Instead of protecting markets per se, state-action immunity (like the dormant commerce clause) can be understood as representation-reinforcing. The main difference is that, in the Sherman Act context, Congress has already declared an overriding purpose of competition, so

Attorney Says, PUB. UTILS. FORTNIGHTLY, May 15, 1999, at 70 (quoting Milton A. Marquis, attorney with U.S. Department of Justice antitrust division).

215. See DEPARTMENT OF ENERGY UPDATE, *supra* note 40, ch. 8.

216. See *supra* notes 202–04 and accompanying text. Others draw on this approach, but do not fully develop its implications for network and other regulated industries. See, e.g., Easterbrook, *supra* note 128 (focusing on interstate market effects of regulation); Levmore, *supra* note 38, at 626–29 (arguing state action immunity should be reformulated to focus on the effects of regulation in interstate markets).

217. See *supra* note 77.

the primary source of the competitive norm is legislative, not based on an implicit norm of cooperation between the states.²¹⁸

This account also has implications for the judicial approach in applying state-action immunity to lawmaking at the state level, as courts frequently are asked to do in deregulated electric power and telecommunications markets. As Frank Easterbrook has suggested, legal presumptions can play an important role in antitrust law, particularly where they serve as gatekeeping filters for judicial consideration of antitrust claims.²¹⁹ If state-action-immunity doctrine is approached as providing default rules to guide judicial intervention, such presumptions could set positive incentives in the bargaining process of state lawmaking.

First, as to the clear-articulation requirement, courts could clarify that this is a type of a clear-statement rule designed to promote more democratic decisionmaking at the state level. State-action immunity, implied from the Sherman Act, affords immunity for purposes of promoting federalism—valued because of the democratic legitimacy it affords, not because state decisions in and of themselves are sacrosanct. Clear-statement rules skew decisionmaking toward the political process.²²⁰ If the state legislature adopts a clear statement, or expressly articulates policy to regulate in restraint of trade, courts may decline to interfere under the first prong of the *Midcal* test. As William Page has argued in some of the leading articles on state-action immunity, such a clear statement heightens the visibility of legislation, encouraging participants in the political process to acquire information about and to debate policies.²²¹ Absent such a statement, private conduct that is consistent with or authorized by broad delegations to municipal governments or regulatory agencies would be subject to review under the Sherman Act.

Dillon's Rule, a canon that only broadly applied in states to invalidate broad state delegations to municipalities (most states have moved away from this with the growth of "home rule"), may serve the same overall goal of providing a higher level of supervision for municipal lawmaking.²²² The effect of the clear-articulation requirement, however, is

218. See *supra* note 19.

219. Easterbrook, *supra* note 123.

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

221. William H. Page, *Antitrust, Federalism, and the Regulatory Process: A Reconstruction and Critique of the State Action Exemption After Midcal Aluminum*, 61 B.U. L. REV. 1099 (1981); William H. Page, *Interest Groups, Antitrust, and State Regulation: Parker v. Brown in the Economic Theory of Legislation*, 1987 DUKE L.J. 618.

222. See Gillette, *supra* note 6.

not to create a federally-enforced version of Dillon's Rule. Dillon's Rule invalidates delegations to municipalities absent express approval by the state legislature.²²³ In contrast to Dillon's Rule, which automatically invalidates the delegation, the clear-articulation requirement would subject the delegation to scrutiny under the Sherman Act, but might still allow it to stand if it did not unlawfully restrain trade or was not otherwise anticompetitive.

Yet, traditional clear-statement rules have their limits, as they assume that a legislature itself speaks with a single purpose and voice. As Kenneth Shepsle and many others before and after him have put it, a legislature is a "they," not an "it."²²⁴ A clear-statement rule is a hermeneutic effort to get at legislative intent—to pay fidelity to past preferences, which are a judicially constructed fiction—but a legislature will rarely have a clear intent on an issue of complex economic regulation. Courts can readily abuse clear-statement rules to the extent that judges use judicially-implied clear statements as a backdoor means to impose a constitutional design—"judicial modesty cloaking judicial activism."²²⁵ Moreover, a clear statement rule assumes that the major problem is the legislature, not the interest groups which interact with lawmaking bodies.

By contrast, a different type of interpretive canon—"preference-eliciting default rules"—provides a better way of conceptualizing the clear-articulation requirement in state-action immunity.²²⁶ Einer Elhauge has recently argued for a "penalty default rules" in judicial interpretation of statutes: Where a court interpreting a statute is unsure of Congress's intent, the court adopts the interpretation of the statute that is most unfavorable to the interest group which is most capable of persuading Congress to reverse the interpretation.²²⁷ Much as penalty default rules in contract law are designed to elicit better information in future contracting,²²⁸ such a penalty-enhancing approach encourages a different type of private behavior in future lawmaking processes. Specifically, Elhauge envisions a preference-eliciting approach as influencing private behavior to procure more explicit legislative action in the future, which

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

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

225. Eskridge & Frickey, *supra* note 220, at 646.

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

227. *Id.*

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

will increase the accountability of the political process.²²⁹ The clear-articulation requirement in state-action immunity serves a similar purpose. Understood as a penalty-enhancing default rule, a clear-articulation requirement does not give rise to automatic state-action immunity where a legislature could merely foresee some regulatory activity. Instead, a penalty-default clear-statement rule would assign ambiguity a result that the interest groups most likely to reverse the interpretation (i.e., those with monopoly power in an industry) would disfavor—here, antitrust enforcement. Interest groups may be successful in persuading state lawmakers to adopt an antitrust exemption for industries, but lawmakers should be required to use clear and unmistakable language in supplanting antitrust laws with delegations to local governments or regulatory agencies.

A preference-eliciting penalty-default rule is only a partial solution to the problem created by regulatory incompleteness in state lawmaking. A clear articulation of purpose is necessary, and does a lot of the heavy lifting in state-action-immunity analysis, but it is not a sufficient basis for suspending judicial review of market conduct under the Sherman Act. Some evaluation of how the state engaged in regulatory oversight is also necessary to guard against private abuse of a regulatory gap. The active-supervision prong of *Midcal* provides this, and as *Ticor* would suggest, it is incumbent on federal courts to take this prong seriously.

The Ninth Circuit has recognized the importance of active supervision in restructured network industries by applying *Midcal* in a way that contrasts markedly with the approaches of the Eighth, Tenth and Eleventh circuits. *Columbia Steel Casting, Inc. v. Portland General Electric Co.*,²³⁰ a leading Ninth Circuit case on the topic, embraces a skeptical stance to a state-action-immunity claim in a partially deregulated electric power market. There, the state of Oregon had clearly expressed a legislative policy to remove market competition by authorizing regulators to approve allocations of service territories.²³¹ However, *Midcal* and *Ticor* suggest that, in considering antitrust claims, judicial gatekeepers examine not only the legislature's clarity in delegating to the regulator, but also what the regulator does in exercising its discretion.²³² Recognizing this, the Ninth Circuit properly refused to extend state-action immunity to a utility's purported anticompetitive conduct in dividing Portland into exclusive

229. Elhauge, *supra* note 226.

230. 111 F.3d 1427 (9th Cir. 1996).

231. *Id.* at 1433 n.2.

232. See *supra* notes 127, 150–55 and accompanying text.

service territories, given that regulators had not made firm-specific decisions to displace competition with regulation.²³³ Although the utility claimed that its conduct was consistent with previous contracts and orders agreed to under generally delegated ratemaking authority, the only way the regulator could have mandated service territories was pursuant to a statute under which the regulator had not acted.²³⁴ “[M]ere ‘state authorization, approval, encouragement, or participation in restrictive private conduct confers no antitrust immunity,’”²³⁵ the Ninth Circuit explained.

If a clear articulation of purpose alone were sufficient to provide a shield from the Sherman Act, this would create perverse incentives for interest groups in the state and local lawmaking process. It would allow select, powerful private interests to lobby lawmakers for a delegation under clear statutory language (however broad) and then engage in conduct that completely escapes the scrutiny of both agency regulators and courts—even where the conduct would otherwise be anticompetitive under the Sherman Act. If courts reduce state-action immunity to foreseeability under *Hallie*, based on implied legislative intent,²³⁶ state-action immunity has the same potential result. By encouraging firms to lobby for antitrust exclusion in state legislation, state-action immunity can have harmful forum selection effects. For example, a state restructuring plan that envisions a scheme of competitive restructuring as displacing antitrust enforcement could eviscerate the competitive norms of the antitrust laws, regardless of how such a scheme actually organizes the industry and monitors firm behavior. Antitrust federalism allows positive regulation by decentralized governmental bodies, but it does not authorize raw state repeal of federal antitrust law through ambiguous delegations or even through plain language overrides of the Sherman Act.²³⁷ Thus, to the extent the preference-eliciting default-rule interpretation of state-action immunity eviscerates the active scrutiny requirement, it concedes too much. This result is not required by judicial deference or antitrust federalism, and may prove harmful to social welfare.

233. *Id.* at 1441–42.

234. *See id.* at 1442.

235. *Id.* at 1440 (quoting *Phonetele, Inc. v. Am. Tel. & Tel. Co.*, 664 F.2d 716, 736 (9th Cir. 1981)).

236. *See supra* notes 134–43 and accompanying text.

237. William H. Page & John E. Lopatka, *State Regulation in the Shadow of Antitrust: FTC v. Tigor Title Insurance Co.*, 3 SUPREME CT. ECON. REV. 189 (1993).

B. The Need for an Active-Supervision Inquiry

As the U.S. Supreme Court stated in *Ticor*, and the Ninth Circuit embraced in *Columbia Steel Casting*, active supervision of state regulators' conduct, as well as a clear statement of purpose, is required in order to trigger state-action immunity from antitrust enforcement.²³⁸ However, many appellate courts remain astonishingly deferential to regulators in applying the active-supervision prong of the *Midcal* test.²³⁹ Consistent with the Supreme Court's pronouncements in the context of municipal regulation, these appellate courts effectively read out of state-action-immunity analysis any serious scrutiny of regulatory supervision, focusing instead on whether a decentralized legislative body has delegated authority to supervise private conduct to an agency. In most cases, *potential* supervision of conduct alone has been sufficient to trigger state-action immunity from enforcement of the antitrust laws.²⁴⁰

However, judicial deference to regulatory power, or the potential for regulation, without more invites interest group manipulation of the regulatory forum for enforcement of competition law. For example, in the context of electric power restructuring debates at the state level, firms seeking immunity from the antitrust laws might lobby for delegation of decisions regarding competitive access to essential facilities, as well as pricing, to the regulator. It does not follow from a legislative delegation, however, that the regulator has in fact exercised authority in ways that are consistent with the pro-competitive goals of the Sherman Act. Allowing state-action immunity to preclude antitrust enforcement in such circumstances creates strong incentives for delegation to state regulators with little or no guarantee that such authority is exercised in ways that promote federalism or social welfare, let alone competition.

If anticompetitive conduct warrants any scrutiny under antitrust federalism, appellate courts must depart from their current and past practice of ignoring, or diluting, the active-supervision requirement. A preference-eliciting default-rule approach is also useful in addressing this aspect of *Midcal*.²⁴¹ Rather than implying active supervision from the historical fact of delegation, as most courts do, a general presumption against active supervision would force litigants to present evidence of a

238. See *supra* notes 150–55, 230–31 and accompanying text.

239. See *supra* Part II.B (discussing Eighth, Tenth and Eleventh Circuits).

240. For example, potential regulation by a utility commission was found by the Tenth Circuit to be sufficient in *Trigen*, discussed *supra* notes 157–60 and accompanying text.

241. See Elhauge, *supra* note 226.

pattern or regulatory activity and would elicit more explicit future lobbying of regulators by monopolies. Put simply, an opportunity for regulation is not the same as active supervision—although courts seem to consistently reach this conclusion.²⁴² The opportunity for regulation is a first step of the active-supervision analysis, but it hardly concludes it.²⁴³ A preference-eliciting default-rule approach also requires courts to assess how frequently, and under what circumstances, supervisory authority is exercised by regulators.

For example, the Second Circuit recently refused to extend state-action immunity to an output cartel permitted by New York legislation implementing a tobacco settlement.²⁴⁴ The legislation was clear and express in its purpose to implement market share allocations in the sale of cigarettes, but the Second Circuit criticized the state for failing to articulate either a competitive or anticompetitive rationale for the policy.²⁴⁵ Regardless of whether the clear-articulation requirement had been met, and whether the cartel was foreseeable under *Hallie*, the Second Circuit refused to extend state-action immunity due to a lack of active supervision, as is required by the second prong of *Midcal*.²⁴⁶ As the court observed, neither the New York statutes, the settlement, nor any other regulation envisioned active supervision of pricing under the cartel.²⁴⁷ Given “no mechanism” for reviewing the reasonableness of pricing decisions or monitoring market conditions,²⁴⁸ the court concluded “New York has failed to provide for any state supervision, much less active supervision, of the pricing conduct of cigarette manufacturers under the anticompetitive market structure.”²⁴⁹ It further observed, “Absent such a program of supervision, there is no realistic assurance that a private party’s

242. See *supra* Part II.

243. Raising a similar concern, the FTC Report of the State Action Task Force states, “One recurring problem involves the failure to distinguish between authorizing classes of activity and forming state policy to displace competition.” FTC STATE ACTION REPORT, *supra* note 14, at 26.

244. *Freedom Holdings, Inc. v. Spitzer*, 357 F.3d 205 (2d Cir. 2004).

245. *Id.* at 229–30. The court was not convinced by the health benefit claims made by the state in the course of litigation, and observed that the only public discussion of the effect of the market-share provisions was to increase prices and to discourage young people from smoking—the precise type of cartel that the Sherman Act condemns. *Id.* at 230. In an order on rehearing, the court clarified: “the court must find under this [clear-articulation] prong that the state did not inadvertently include anticompetitive activities in some larger scheme. For this reason, it is important that a state enunciate its intent to displace competition when it means to do so.” *Freedom Holdings, Inc. v. Spitzer*, 363 F.3d 149, 156 (2d Cir. 2004) (order on rehearing).

246. *Id.*

247. *Id.*

248. *Freedom Holdings, Inc.*, 357 F.3d at 231.

249. *Id.* at 232.

anticompetitive conduct promotes state policy, rather than merely the party's individual interests."²⁵⁰

Recognizing the important role an active-supervision inquiry plays in antitrust federalism, the Ninth Circuit has also refused to find state-action immunity on this ground in the context of deregulated electric power markets. The court allowed Snake River Valley Electric Association, an electrical cooperative, to sue an investor-owned utility for anticompetitive denial of access to essential transmission facilities, rejecting the utility's claim to state-action immunity.²⁵¹ The utility argued that the state regulatory scheme clearly envisioned the utility refusing to wheel—to the extent the state had adopted a clear policy to displace competition among electric suppliers—but the Ninth Circuit did not allow this to trigger antitrust immunity.²⁵² Under Idaho state law, the utility could decline the customer's wheeling request without the substantive review of a state agency or state courts, but the court reasoned that “[t]his is the type of private regulatory power that the active-supervision prong of *Midcal* is supposed to prevent.”²⁵³ Thus, the Ninth Circuit reasoned, while a self-policing regulatory scheme may qualify for state-action immunity without active supervision,²⁵⁴ where the regulator has discretion to exercise active supervision it is an appropriate object of inquiry for a court. Similarly, perhaps signaling a departure from the deferential approach it previously had embraced in the electric power context,²⁵⁵ the Tenth Circuit refused to extend state-action immunity to lock up telephone contracts procured by Southwestern Bell that were “neither mandated, nor authorized, nor reviewed, nor even known about by” state regulators.²⁵⁶

Cognizant of the potential gap that a low active-supervision threshold can create, some lower courts recognize that active supervision “would be satisfied if the state or state agencies held ratemaking hearings on a consistent basis.”²⁵⁷ This is a good starting point for judicial analysis of the application of antitrust laws in a restructured network environment. Courts have a long history of allowing the existence of consistent ratemaking

250. *Id.* (quoting *Patrick v. Burget*, 486 U.S. 94, 101 (1988)).

251. *Snake River Valley Elec. Ass'n v. PacifiCorp*, 238 F.3d 1189 (9th Cir. 2001).

252. *Id.*

253. *Id.* at 1194.

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

255. *See supra* notes 157–60 and accompanying text.

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

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

hearings at the state or local level to give rise to state-action immunity. In *Ticor*, for instance, the Supreme Court found it relevant that the Wisconsin state regulatory body had not held rate hearings prior to approving a jointly filed insurance rate.²⁵⁸ Thus, extending a presumption of state-action immunity, and against judicial intervention, in the context of rate hearings is appropriate.

Mere private contracts, however, do not meet this standard. For example, an agency-approved contract provision prohibiting a customer from entering into the electricity market as a competitor in the future, offered by a utility in exchange for a discounted rate, is not protected by state-action immunity.²⁵⁹ For similar reasons, mere private filings of contracts or tariffs with a regulatory agency, without active regulatory scrutiny or oversight, would not meet the active-supervision requirement. Without meaningful agency review of the specific private conduct at issue, state-action immunity can be abused by private firms in a deregulatory environment.²⁶⁰ The factors that should guide courts in identifying active supervision include how frequently agencies monitor private activities, whether agencies have authority to enforce standards through the imposition of penalties, and whether agencies have adequate resources to engage in meaningful monitoring and enforcement. When in doubt, if a regulatory system risks the imposition of spillover effects on non-participants, the presumption should be against invoking state-action immunity.

In interpreting the active-supervision requirement, courts must be true to the overall federalism purposes of state-action immunity. Fidelity to federalism would not limit assessment of supervision to state regulation only, but would also include other regulatory bodies, such as municipalities. In addition, fidelity to federalism would require some attention to the process which gives rise to regulatory supervision. If the purposes of regulatory action overlap with the overall consumer welfare goals of the Sherman Act, perhaps some degree of deference to supervision by the state or local regulator is appropriate. However, if the purpose is blatantly protectionist, in ways that do not even arguably

258. *FTC v. Ticor Title Ins. Co.*, 504 U.S. 621, 630 (1992).

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

260. As the *FTC Report of the State Action Task Force* observes:

Active supervision requires the state to examine individual private conduct, pursuant to that [clearly-articulated] regulatory regime, to ensure that it comports with that stated criterion. Only then can the underlying conduct accurately be deemed that of the state itself, and political responsibility for the conduct fairly be placed with the state.

FTC STATE ACTION REPORT, *supra* note 14, at 54.

improve consumer welfare and that impose spillover costs on those in other jurisdictions who have not participated in the process leading to the adoption of regulation, intervention of the antitrust laws is entirely appropriate. A preference-eliciting default rule would align private incentives to ensure more explicit procurement of state-action immunity via legislation and regulatory activity.

In contrast to the Eighth, Tenth and Eleventh Circuits, the Ninth Circuit correctly makes an affirmative finding of active supervision by the regulator a predicate to any finding of state-action immunity, even in deregulated markets. However, a more recent Ninth Circuit case addressing state-action immunity in the very same antitrust claim illustrates how readily the active-supervision prong will be undermined if courts allow it to hinge entirely on the nature of the regulatory program approved by a state legislature rather than on what regulators do in implementing that program.²⁶¹ On the heels of the court's recognition that there was no state-action immunity in the first Snake River Valley Electric Association case,²⁶² the Ninth Circuit extended state-action immunity to the same allegedly anticompetitive conduct.²⁶³ Following the first judicial finding of no state-action immunity, which allowed antitrust litigation to go forward, the Idaho legislature intervened by amending its Electric Supplier Stabilization Act, under which the utility had previously declined a wheeling request absent agency review.²⁶⁴ The amendments allowed an electric supplier to refuse to wheel power if the requested wheeling "results in retail wheeling and/or a sham wholesale transaction," subject to review of the state regulatory agency.²⁶⁵ In addition, the Idaho legislature prohibited competing suppliers from serving customers or former customers of other electric suppliers unless the competing supplier petitions the Idaho regulator and the regulator issues an order allowing the service.²⁶⁶

In reviewing this legislative intervention, the Ninth Circuit held that, unlike the previous statutory arrangement, which left the decision not to wheel entirely to private choice, the amended statute "has not left unregulated a private preserve without competition" and thus meets the

261. See *infra* notes 263–68 and accompanying text.

262. See *supra* notes 251–54 and accompanying text.

263. Snake River Valley Elec. Ass'n v. PacifiCorp (*Snake River Valley II*), 357 F.3d 1042, 1048–51 (9th Cir. 2004).

264. *Id.* at 1048.

265. IDAHO CODE § 61-322D(1) (2002).

266. IDAHO CODE § 61-334B (2002).

active-supervision requirement for state-action immunity.²⁶⁷ The Ninth Circuit emphasized that the Idaho statute precluded a private utility from wheeling without a contrary decision by the state regulator.²⁶⁸ The result of this ruling is that statutes and regulations that prohibit competitive conduct can eviscerate any active-supervision requirement.²⁶⁹ On this approach, if a private firm is successful in lobbying for a statute that prohibits it from engaging in competitive conduct, it would be immune from antitrust challenge, even if that legislation occurs in the context of a pending antitrust challenge. However, as the analysis of this Article suggests, a court should not take a law prohibiting access to a network facility at face value, but should carefully evaluate the scope of the regulator's discretion to override any private choice to engage in anticompetitive behavior, including the criteria the regulator is to apply in making such a decision.

Revival of the active-supervision portion of judicial review as a type of preference-eliciting default rule in state-action-immunity analysis does not imply that courts should subject state and local regulation to strict scrutiny review, as advocates of deference seem to imply. Rather, to make the connection explicit, the type of judicial review called for in evaluating state-action immunity is more akin to what courts provide under the political process account of the dormant commerce clause. A focus on agency monitoring and enforcement, along with the prospect of negative spillover effects on non-participants, makes it more likely that these will be taken into account in the state or local political process. Perhaps mindful of the connection between these two legal doctrines—but without drawing any explicit connection between them—the FTC's *Report of the State Action Task Force* recommends “judicial recognition of the problems associated with overwhelming interstate spillovers, and consider such spillovers as a factor in case and *amicus*/advocacy selection.”²⁷⁰

In terms of remedy, a failure to apply state-action immunity has less significant consequences than other judicial review of legislation or regulation. It does not result in condemning public conduct or necessarily striking legislation but instead merely subjects private conduct to review under the antitrust laws. If the type of regulation does not present veiled wealth transfers—benign rent-seeking would not impair the political

267. *Snake River Valley II*, 357 F.3d at 1049.

268. *Id.* at 1050.

269. This was allowed by the Eleventh Circuit in *TEC Cogeneration*. See *supra* notes 175–77 and accompanying text.

270. FTC STATE ACTION REPORT, *supra* note 14, at 56.

process—private conduct that is supervised by the regulator generally would be shielded from the scope of the Sherman Act. Rent-seeking that thwarts the representative political process, however, would not be used by private firms as a strategy to escape judicial review under the antitrust standards of the Sherman Act. Such an approach preserves federalism values by protecting the type of democratic participation that forms the core of federalism. It also reduces the incentive for private interest groups to quietly lobby state and local regulators in ways that allow state-action immunity to become a private strategy for opting out of antitrust enforcement in ways that impose spillover costs for those within a state or local government who are not part of the lawmaking process.

CONCLUSION

More than two decades ago, a classic exchange between (now Judge) Merrick Garland and Cass Sunstein debated the merits of courts engaging in “hard look” review of agency decisions to deregulate industries.²⁷¹ Judicial deference has an undeniably important place in public law generally, including in the law of economic regulation. Under the *Chevron* doctrine, which federal courts frequently invoke to defer to reasonable agency interpretations of law,²⁷² a federal agency’s construction of its jurisdictional statutes is generally upheld. Because deference to a federal agency leads to national uniformity, judicial deference in reviewing regulations involving federalism issues implicitly adopts a national supremacy understanding of federalism. Courts have a general preference for a federal supremacy approach to the resolution of jurisdictional battles and for uniformity in their legal resolution.²⁷³ Most discussions of deference in regulatory law focus on horizontal allocations of power, between courts and regulatory agencies at the same hierarchical level. Certainly, however, vertical deference issues implicate a different set of concerns, as constitutional law and antitrust federalism illustrate, and may be at odds with the uniformity values promoted by horizontal deference.

271. See Merrick B. Garland, *Deregulation and Judicial Review*, 98 HARV. L. REV. 505 (1985) (criticizing “hard look” review of agency decisionmaking); Cass R. Sunstein, *Deregulation and the Hard-Look Doctrine*, 1983 SUP. CT. REV. 177.

272. *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). As the Supreme Court stated in *Chevron*, “an agency to which Congress has delegated policymaking responsibilities may, within the limits of that delegation, properly rely upon the incumbent administration’s views of wise policy to inform its judgments.” *Id.* at 865.

273. See Peter L. Strauss, *One Hundred Fifty Cases Per Year: Some Implications of the Supreme Court’s Limited Resources for Judicial Review of Agency Action*, 87 COLUM. L. REV. 1093 (1987).

Public law has not adequately addressed the different *kinds* of judicial deference at work in implementing competition policy. Restructuring of network industries not only concerns the explicit choices of agency regulators, but also the implicit opportunities the political and regulatory processes provide for strategic private choices to manipulate public regulation. Elsewhere, I have argued that judicial deference to private firm rate filings, even involving federal agencies, does not enhance the goals of competition and regulatory law absent judicial safeguards to protect against strategic private tariffing.²⁷⁴ Due to the regulatory-enforcement void presented by gaps and concurrent jurisdiction, the “filed rate doctrine” (a defense to private claims against utilities) did encourage private firms to add terms to the regulatory contract that suit their private interests, leading to particularly worrisome forum selection behavior where regulators do not actively evaluate the content of tariffs. Strategic forum shopping in tariff filing threatens to undermine competitive electric power and telecommunications markets.²⁷⁵ For this reason, it may be necessary for courts to evaluate the public interest in selection of an enforcement forum in applying the filed tariff doctrine, rather than leave this decision entirely within the realm of private choice.²⁷⁶

As this Article’s analysis of the dormant commerce clause and state-action immunity suggests, though, the bargaining problems presented by gaps and concurrent jurisdiction are much broader than the issue presented by tariffs and other private filings with regulatory agencies. Blanket deference to state and local politics also fails to promote the goals of regulatory law or competition policy. The temptation for judicial avoidance, and judicial deference, is strong where complex technical issues are under review, as in the context of electric power and telecommunications regulation.²⁷⁷ A strong judicial deference stance converges with the overall trend towards decentralization, popular among many free market advocates,²⁷⁸ and punting an issue back to the state and

274. Jim Rossi, *Lowering the Filed Tariff Shield: Judicial Enforcement for a Deregulatory Era*, 56 VAND. L. REV. 1591 (2003) (arguing that courts should not embrace a broad presumption in favor of the filed tariff doctrine).

275. *Id.*

276. *Id.* at 1658–59. See also Jim Rossi, *Debilitating Doctrine*, PUB. UTIL. FORTNIGHTLY, Nov. 2004, at 16 (discussing problems with the filed-rate doctrine in the context of Texas’s deregulated electric power market).

277. See Garland, *supra* note 187; Richard J. Pierce, Jr., *The Unintended Effects of Judicial Review of Agency Rules: How Federal Courts Have Contributed to the Electricity Crisis of the 1990s*, 43 ADMIN. L. REV. 7 (1991).

278. Although, as is noted *supra* note 5, many leading scholars are skeptical of the ability of decentralized regulatory processes to adequately sustain competitive interstate markets. While I do not

local political process appeals to advocates of the new federalism. However, as this Article argues, federal court deference to state and local political processes results in seriously harmful effects for competitive markets.

A bargaining-centered approach to economic regulation recognizes an important role for state and local regulation, even in deregulated markets. At the same time, due to the possibility of strategic private manipulation of vertical (federal-state) bargaining space, blanket judicial deference to state and local regulation in the contexts of the dormant commerce clause and in the judicial gatekeeping function of applying state-action immunity to antitrust claims ignores private incentives in decentralized lawmaking. Further, as a focus on bargaining suggests, these two independent judicial doctrines hold promise to improve the lawmaking process at the state and local level if they are approached with similar goals in mind, rather than as in tension. At their core, both doctrines share the goal of promoting bargaining in the lawmaking process while minimizing private incentives in state and local lawmaking that lead to overall reductions in social welfare in the form of the imposition of spillover costs on those who do not participate in the relevant lawmaking process.

In a leading article on the transformation of the law of regulated industries, Joseph Kearney and Thomas Merrill predict that the courts will play a fundamental role as economic regulation and competition policies are reformulated.²⁷⁹ We need not relive the mistakes of the failed *Lochner* era, but parallels in the dormant commerce clause and state-action immunity lay seed for a common principle for courts to look to in reviewing state and local regulations. Whether courts are invalidating legislation, as in the context of the dormant commerce clause, or serving as a gatekeeper for antitrust scrutiny, as in the context of state-action immunity, the purpose in reviewing state or local political processes is the same—to improve democratic lawmaking among and within the states. Without such improvement, it is foolhardy to think that competitive markets will thrive as formerly regulated markets are restructured at the state and local, as well as the federal, levels of government.

disagree, I also am not optimistic that Congress can solve all of these problems on its own through some sort of national legislation that preempts all state and local regulation. Given the likely failure of Congress to act in a comprehensive and preemptive manner, public law has an important role to play in improving decentralized lawmaking for competitive markets.

279. Kearney & Merrill, *supra* note 3, at 1369 (“Although lacking the same policymaking authority as Congress and regulatory commissions, the courts affect the pace, extent, or manner of regulatory change each time they decide a case involving legislative or administrative regulatory policies—whether they ratify, overturn, or require the government to reconsider a particular policy.”).

