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125 YEARS

SINCE THE INTERSTATE COMMERCE ACT: A Symposium in the Form of a Final Convocation

The Interstate Commerce Act is regarded as among the most important statutes ever adopted by Congress. Enacted in 1887 to address the "railroad problem," the Act did not merely create the Interstate Commerce Commission (ICC). It also heralded the general advent of independent agencies and, more broadly yet, the federal administrative state. It imposed a model of regulation—involving entry-and-exit controls, rate regulation, and cross-subsidized services—that would be replicated over the decades for purposes of regulating transportation, communications, and energy industries. Although the ICC itself was abolished a century later (in the mid-1990s), the Interstate Commerce Act had a major influence on the law and industry, and its effects continue to be felt (e.g., in debates concerning regulation of broadband).

In these circumstances, Marquette University Law School's Dean Joseph D. Kearney and Northwestern University School of Law's Professor James B. Speta recently published in the *Marquette Law Review* a symposium marking the Interstate Commerce Act's 125th anniversary. Their essays appear here as well (without footnotes), together with those of the other five participants, all longtime leading public-law scholars:

- Hon. Richard D. Cudahy of the U.S. Court of Appeals for the Seventh Circuit
- Paul Stephen Dempsey of McGill University
- James W. Ely, Jr., of Vanderbilt University
- Thomas W. Merrill of Columbia University
- Randal C. Picker of the University of Chicago.

Dean Kearney's essay, in the nature of a foreword (as well as a reminiscence), provides further context.

Illustrations by Stephanie Dalton Cowan
Illustration composites created from a series of historical documents and images gathered from various collections from within the Library of Congress, National Archives, and the Wisconsin Historical Society Archives.

THE LAST ASSEMBLY OF INTERSTATE COMMERCE ACT LAWYERS

Joseph D. Kearney

Dean and Professor of Law, Marquette University

I.

Upon graduating from law school in 1989 and completing a one-year clerkship, I began my career as a lawyer at Sidley & Austin in Chicago, a firm whose clients over the decades have included railroads, electric utilities, and telecommunications carriers. One of my first assignments involved a challenge to the emerging technology of "Caller ID." The Pennsylvania Public Utility Commission had cast doubt on the legality of the technology as proposed to be deployed by the local telephone company. As counsel for a long-distance carrier, American Telephone & Telegraph Co. (AT&T), we were less concerned about the particular ruling than by its implications for our own interstate service. I prepared a substantial brief on the matter, but among its legal arguments I can recall today only the one that, like the man upon the stair, was not there. For upon reading my draft, David W. Carpenter, an extraordinary lawyer and AT&T's primary outside counsel at the time, said something to this effect: "It omits the best argument." And what was that? "The filed rate doctrine," came the answer.

So began my introduction to a legal world that even then seemed as much of the railroads as of telephones. AT&T was required to file tariffs with the Federal Communications Commission (FCC), setting forth its rates and (necessarily) its services. Here is a succinct statement of this regime, frequently summarized as the filed rate doctrine: "Deviation from these tariffs is strictly prohibited under any circumstances, unless the regulatory commission concludes that the carrier's rates fail to meet the statutory requirement of being just, reasonable, and not unreasonably discriminatory." The model had been imported into the Communications Act of 1934 from the Interstate Commerce Act, whose great purpose upon its enactment in 1887 was to ensure that interstate railroads charged nondiscriminatory rates.

Carpenter had done some impressive things with the filed rate doctrine. In particular, in a series of cases involving electric utility companies, he (together with Rex E. Lee and others) had persuaded the Supreme Court that various state attempts to allocate or disallow certain costs were preempted by filings in the Federal Energy Regulatory Commission (because state regulators could not tread on federally filed tariffs). Indeed, at the same time as the Caller ID matter, we seemed to be on the cusp of another victory in the Supreme Court based on the filed rate doctrine.

In a sense, none of this was novel. The filed rate doctrine had been the law since 1895. It had proved powerful enough to oust the antitrust laws. And the same year as I learned of its existence, the Supreme Court rejected even the Interstate Commerce Commission's attempt to soften the effect of the doctrine. The agency had ruled that it was an unreasonable practice for a motor carrier to enforce a filed rate where the parties had explicitly negotiated a lower rate—that is, where there was a contract rate of the sort that typifies most business transactions. In *Maislin Industries, U.S., Inc. v. Primary Steel, Inc.* (1990), the Court struck down this policy because, by allowing deviations from tariffs, it offended the nondiscrimination regime at the heart of the system and the Act itself.

The effect of *Maislin* was that trustees in bankruptcy of motor carriers—there were many because of the deregulation and thus competition that the Motor Carrier Act of 1980 had engendered—proceeded against shippers who had entered into apparent contracts for lower rates and knew not of filed tariffs. To many, the filed rate doctrine seemed out of place in the world of the 1990s. The inequity of such shippers' fate after *Maislin* attracted even popular attention, with CBS's

60 Minutes running a story entitled "You're Kidding." Justice John Paul Stevens and Chief Justice William H. Rehnquist were among the critics in the legal world, the former writing for them both in a *Maislin* dissent that "[t]he 'filed rate doctrine' was developed in the nineteenth century as part of a program to regulate the ruthless exercise of monopoly power by the Nation's railroads" and that the Court "fail[ed] to appreciate the significance of the 'sea change' in the statutory scheme that has converted a regime of regulated monopoly pricing into a highly competitive market."

Even most of those forming the majority in *Maislin* seemed almost relieved a few years later, in *Reiter v. Cooper*, when shippers—now proceeding *within* the Interstate Commerce Act paradigm by asserting the traditional defense that the filed rates were unreasonable—cobbled together a different argument that might protect at least some of them against the invocation of the filed rate doctrine by trustees in bankruptcy of failed motor carriers.

The telecommunications legal world in which I was moving, during these years as a young lawyer, also struggled with the filed rate doctrine. The FCC wished to do without it. Indeed, the agency for years excused all long-distance carriers besides our client, AT&T, from the statutory obligation to file their rates: the agency claimed that its authority to "modify" the tariffing obligation gave it sufficient authority. In *MCI v. AT&T* (1994), Carpenter led a team of us who persuaded the Supreme Court to set the record straight, with Justice Antonin Scalia writing for the Court and quoting one of the greatest cases decided under the Interstate Commerce Act (the 1907 decision in *Texas & Pacific Ry. v. Abilene Cotton Oil Co.*):

> The tariff-filing requirement is . . . the heart of the common-carrier section of the Communications Act. In the context of the Interstate Commerce Act, which served as its model, this Court has repeatedly stressed that rate filing was Congress's chosen means of preventing unreasonableness and discrimination in charges: "There is not only a relation, but an indissoluble unity between the provision for the establishment and maintenance of rates until corrected in accordance with the statute and the prohibitions against preferences and discrimination."

Justice Stevens was left in dissent to make the same point as in *Maislin* had been true of trucking—that "[t]he communications industry has an unusually dynamic character"—and to decry "a rigid literalism that deprives the FCC of the flexibility Congress meant it to have in order to implement the core policies of the Act in rapidly changing conditions."

II.

My purpose in remembering a few aspects of my early career is less to recall the filed rate doctrine and more to evoke the spirit of the age, as is captured in the struggle over the doctrine. There seemed little doubt even then that we were nearing the end of an era. Events would soon confirm it. In 1995, I left Sidley & Austin for another clerkship; by the time I returned the next year, the legal landscape had changed unmistakably.

Most prominent was the new Telecommunications Act of 1996. The Act contained numerous provisions, including the termination of the Modification of Final Judgment—the Bell System consent decree that had formed one of the twin pillars of telecommunications regulation for more than a decade (the other pillar being the Communications Act of 1934) and that had provided

"One would imagine that, 25 years hence, the sesquicentennial will be marked. . . . Yet it will lack a substantial group of folks who can make some plausible claim to have grown up in the law, in some important sense, under the Interstate Commerce Act."

perhaps the bulk of my practice as a lawyer. Congress also gave the FCC the authority that it had so long sought and even claimed (unsuccessfully in the *MCI v. AT&T* case): specifically, it provided that the FCC could forbear from enforcing any regulation not necessary to accomplish the Communications Act's purposes—including the tariffing requirement.

Less relevant to my practice and to the larger economy, but more symbolically notable, during this year Congress also eliminated the Interstate Commerce Commission. A new entity had to be created, the Surface Transportation Board (STB), but not with the same independent-agency status—or with the same building on Constitution Avenue. And the authority afforded the STB over rail carriers was slight.

To be sure, some vestiges of the past remained. I had the satisfaction (in *AT&T v. Central Office Telephone, Inc.* in 1998) of seeing a case in which I had been unsuccessfully involved in my first run at the law firm be overturned by the Supreme Court on the basis of the filed rate doctrine, more or less at the same time that even some well familiar with the doctrine were suggesting that the Court could no longer be counted on to have the stomach for it.

I made my own departure from this fading realm in becoming a law professor. In recalling my time as an Interstate Commerce Act lawyer (of a sort) and the era of which I was part, I am not here trying to tie together all these changes in any sort of synthetic way. Tom Merrill and I already sought to do this, in *The Great Transformation of Regulated Industries Law*, the article that bridged my transition from full-time practice to academe.

Instead, my motivation frankly is sentimental, although it is not nostalgic. By this, I mean that I do not consider myself (at least in this context) to be "of an older fashion," in the sense that "much that I love has been destroyed or sent into exile," to borrow a phrase from Chesterton. I hold no brief for filed tariffs over contracts in a competitive world. Yet, for the sentiment, the developing world of regulated industries law today rather resembles the larger culture, in that it has become fragmented. One could handle rather well, I should think, a negotiation of a content contract for a local exchange company, in the world defined largely by the Telecommunications Act of 1996, without any sense of the Hepburn Act, or the Mann–Elkins Act, or any number of other amendments to the Interstate Commerce Act. But less than a quarter century ago, as my own experience shows, a lawyer could not competently confront the new technology of Caller ID without some knowledge of the Interstate Commerce Act.

So for those of us who grew up at least partly in the old world, there is some pleasure in remembering. We hope that there is some value in the remembrance for others.

We expect that there is. The remembrance is not at the scale or scope of the law review symposia celebrating the 50th and 75th anniversaries of the Act—or even the rather more ambivalent observation of the 100th anniversary. Yet we have gathered an impressive collection of scholars. The following essays range from a recollection of the beginning, in the essay by James W. Ely, Jr., of Vanderbilt University, to the interplay between the Interstate Commerce Act and the antitrust law enacted only three years later (the Sherman Act), as explored by the University of Chicago's Randal C. Picker. Thomas W. Merrill, of Columbia University, discusses the unusual phenomenon of administered contracts in the Interstate Commerce Act's regulatory scheme, suggesting that the form of regulation was more impressive than the fact. McGill University's Paul Stephen Dempsey focuses on the Interstate Commerce Commission as an agency, taking us broadly from its creation to its demise. Judge Richard D. Cudahy of the Seventh Circuit points us to the future, sketching the possible relevance of the Interstate Commerce Act's paradigm for modern debates over regulation. James B. Speta, of Northwestern University, with whom it was my privilege to convene this group, concludes with an assessment of the Act's pertinence in an area with almost as much importance to the twenty-first century as railroads possessed in the nineteenth: namely, telecommunications.

There no doubt will be other remembrances of the Interstate Commerce Act in times to come. One would imagine that, 25 years hence, the sesquicentennial will be marked. Any such observance will have the benefit of greater critical distance. Yet it will lack a substantial group of folks who can make some plausible claim to have grown up in the law, in some important sense, under the Interstate Commerce Act.

In all events, we invite you to read these essays and to join us in remembering it.


FRISCO LINE
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GO
STOP
INTERSTATE COMMERCE COMMISSION

THE TROUBLED BEGINNING OF THE INTERSTATE COMMERCE ACT

James W. Ely, Jr.

Milton R. Underwood Professor of Law, Emeritus, and Professor of History, Emeritus, Vanderbilt University

From the time of their origin, railroads had been subject to regulation by the states. By the 1880s, however, there was broad agreement that piecemeal and inconsistent state controls were inadequate to deal with perceived difficulties and abuses arising from the interstate operations of railroads. Yet there was little agreement about the nature of the "railway problem," and still less any consensus as to how best to address the issue. Translating the amorphous public wish for rail regulation into concrete legislation was not an easy task. After years of inconclusive debate, Congress passed the Interstate Commerce Act in 1887. Despite this important step, the early years reveal an Act that made little difference. Congress itself waited nearly two decades to strengthen the powers granted to the Interstate Commerce Commission ("Commission" or "ICC").

An untidy compromise between quite different House and Senate bills, the Interstate Commerce Act was an amalgam of diverse and vague provisions. It created the ICC, the first important federal administrative agency, to oversee the Act. The five-member ICC had the authority to conduct hearings and issue orders to stop practices in violation of the statute. The Act declared that charges for interstate rail transportation should be "reasonable and just," but did not define this term or give the ICC the power to set rates. In addition, the Act banned rebates or preferential treatment for any shipper, and outlawed the pooling of traffic or earnings among carriers. The Act left unresolved a basic question: Was it intended to encourage competition among the carriers, or to stabilize the industry through cartelization? As with any novel measure, the effectiveness of the Act was open to question. Congress seemed primarily concerned to placate the public clamor to curb alleged railroad abuses, and was happy to leave unsettled policy issues to the ICC and the courts. "The entry of the national government into the realm of railroad regulation," historian Morton Keller aptly explained, "was a leap in the dark."

The early years of the ICC present a tale of frustration. The sheer size and complexity of the rail industry presented daunting challenges to the fledgling agency with its small staff. Moreover, the states retained jurisdiction over intrastate transportation, and state regulation had the potential to undermine ICC policy. The skepticism of the federal courts about administrative regulation of the economy also greatly contributed to the feeble nature of ICC supervision. Both the Supreme Court and the lower federal courts consistently placed a narrow construction on the Commission's authority. Two developments are particularly revealing.

First, the ICC had difficulty making its orders effective. Lacking the power to compel obedience to its orders, the agency was required to seek judicial enforcement of its mandates when railroad companies ignored adverse directives. This step, of course, created opportunities for delay when carriers disobeyed the ICC. More troublesome, however, was that federal courts from the outset refused to defer to agency findings of fact. Instead, the federal courts decided that factual matters should be reviewed de novo, and permitted the introduction of further evidence by either party. The findings by the ICC were treated as a sort of preliminary report. In *ICC v. Alabama Midland Railway* (1897), the Supreme Court affirmed this practice, ruling that the lower courts should give effect "to the findings of fact in the report of the Commission as *prima facie* evidence of the matters therein stated." It added that the courts "are not restricted to the evidence adduced before the Commission, [but] additional evidence may be put in by either party, and . . . the duty of the court is to decide, as a court of equity, upon the entire body of evidence."

Second, the ICC had difficulty establishing just and reasonable rates. The regulation of railroad rates was one of the most vexing, contested, and misunderstood issues facing lawmakers in the late nineteenth century. As common carriers, railroads had long been under an obligation to charge reasonable and nondiscriminatory prices. But the common law also allowed the carriers considerable latitude in setting rates. In the 1870s some states enacted so-called Granger laws, which empowered state commissions to prescribe maximum charges. Congress, however, stopped short of giving the ICC such authority. Under the 1887 Act, the agency could review rates and set aside those deemed unreasonable, but it could not fix rates. In time, however, the ICC asserted that the power to impose rates should be implied from the power to bar unreasonable rates.

In *ICC v. Cincinnati, New Orleans and Texas Pacific Railway* (1897), the Supreme Court, in an opinion by Justice David Brewer, rejected this contention. It determined that, subject to the requirement that charges be reasonable and not discriminatory, the Interstate Commerce Act left the carriers free to adjust their rates to meet business conditions. In reaching this conclusion, the Court stressed the heavy investment in railroads and that rail transportation was carried on under diverse conditions in different parts of the country. Pointing out that administrative regulation of railroads was not new, the Court compared the language of the Act with that of state regulatory measures. A number of state laws clearly granted railroad commissions the power to fix rates, but such authority was not expressly given by Congress to the ICC. The authority to prescribe rates, the Court insisted, was "a power of supreme delicacy and importance," and could not be implied from "doubtful or uncertain" language. The Court disapproved of what it saw as an agency grab for power. The justices observed that "it would be strange if an administrative body could by any mere process of construction create for itself a power which Congress had not given to it." The Court left open, however, the possibility that Congress might confer ratemaking power on the ICC. Until that happened with the Hepburn Act of 1906, the ICC was compelled to abandon its efforts to set rates for the carriers.

By the early twentieth century, the ICC was largely toothless and spent much of its energy gathering statistics about the rail industry. In 1903 the ICC explained: "At present this Commission can investigate and report. It has no power to determine what rate is reasonable, and such orders as it can make have no binding effect." Nonetheless, the ICC served a vital political purpose. It satisfied the popular clamor for governmental control of railroads, even if the supervision was largely nominal.

Although the Interstate Commerce Act was important as the prototype for subsequent regulatory measures by Congress, the early history of the Act is a study in unresolved problems. Clearly the federal courts were dubious about an administrative body that was an uncertain fit in the constitutional system as traditionally understood. The modern norm of a deferential attitude toward administrative bodies was not the prevailing judicial view in the late nineteenth century. Indeed, implicit in the Supreme Court decisions narrowly construing the authority of the ICC was the premise that Congress, not the Commission, was the proper policymaking body. The Supreme Court of the 1890s was disposed toward private economic ordering, but the responsibility for the feeble power of the ICC rests ultimately with Congress, not the Court. It is far from clear that Congress was very serious about regulating the carriers. Revealingly, Congress appeared untroubled about Court rulings adverse to the ICC, and made no move to strengthen the agency for years. In fact, the ICC remained passive for a decade after the 1897 decisions.

"The regulation of railroad rates was one of the most vexing, contested, and misunderstood issues facing lawmakers in the late nineteenth century."

THE INTERSTATE COMMERCE ACT AND THE SHERMAN ACT: PLAYING RAILROAD TYCOON

Randal C. Picker

Paul and Theo Leffmann Professor of Commercial Law, The University of Chicago Law School, and Senior Fellow, The Computation Institute of The University of Chicago and Argonne National Laboratory

I start my antitrust class each year with the Supreme Court's classic 1897 decision in *United States v. Trans-Missouri Freight Association*. It is hard to imagine a better place to start. The case sits at the intersection of the two great late-nineteenth-century business law statutes: the Interstate Commerce Act (ICA) passed in 1887 and the Sherman Act passed in 1890. And how often do you get to open a class with the question, "How would you run a railroad cartel?"

In the era leading up to the ICA and the Sherman Act, railroad pools and traffic associations were commonplace. No federal law sat as a barrier to a private agreement to establish the rules of competition among the members of the pool or association. Cartels today are forced to sneak around, and, one suspects, this means that the understanding of the cartel is rarely committed to paper by thoughtful lawyers. But the pools and associations of the second half of the nineteenth century were discussed openly and reported in newspapers as the ordinary affairs of business. Consider the report in the *New York Times*, on July 10, 1878, of the most recent gathering at Saratoga, New York, of the Vanderbilt family and business interests. The prospects for a pool organized around the New York Central Railroad were an active part of the discussions: "Some of the railroaders believe that a general pool will ruin the business, and about as many others say that a pool, if well adhered to, would bring things up wonderfully. Few believe, however, even if a general pooling arrangement should be made by the trunk lines, that it would be generally adhered to."

This was the central problem of these arrangements. There is an incentive to cheat within cartels, and even though the agreements could be set out in great detail and often were, the agreements themselves weren't enforceable in court. It is one thing to stop short of condemning these agreements and something else to bring the force of the legal system to bear in enforcing them.

And yet the railroads continued to try. At the time that the ICA was passed, according to the agency that it established, there were 11 substantial traffic associations in place, covering the entire competitive railroad traffic in the United States. The post-Civil War period had seen an explosion in track miles from roughly 30,000 miles in 1860 to about 70,000 miles in 1873. The structure of competition quite literally embedded in the ground had shifted, and the railroads were struggling to create an institutional structure that matched it.

On March 15, 1889, the railroads that would comprise the Trans-Missouri Freight Association set out their agreement. Section 5 of the ICA had barred one institutional arrangement, the railroad pool. The pool was an effort to enforce cartel arrangements by requiring the sharing of revenues or profits. How much traffic a railroad received didn't really matter under a pool. What mattered was money, and if profits were split, competitive discipline would follow. The ICA took pools off of the table but was understood to have left room for other types of contractual arrangements, such as agreements on rates. Controlling those rates was the chief topic of the association agreement for the Trans-Missouri group.

The Trans-Missouri agreement was to go in effect on April 1, 1889, but with the passage of the Sherman Act on July 2, 1890, circumstances changed dramatically. By the standards of modern statutes, the Sherman Act was a little nothing, barely a page-and-a-half in the Statutes at Large. (The ICA itself ran nearly nine pages.) But within two years, the federal government challenged the very existence of the freight association as a violation of Section 1 of the Sherman Act.

Of course, a central concern of the Interstate Commerce Act was rates. All charges were to be "reasonable and just," and if that wasn't sufficiently clear, the Act turned around and "prohibited and declared to be unlawful" "every unjust and unreasonable charge." The Act barred unjust discrimination in rates and undue or unreasonable preferences and, in case it wasn't already covered, specifically condemned short-haul/long-haul discrimination. The Sherman Act itself didn't address rates directly at all, and antitrust's own version of an anti-discrimination regime wouldn't show up until 1914 in the Clayton Act (and then even more so in 1936 in the Robinson–Patman Act). All that Section 1 of the Sherman Act forbade was contracts in restraint of trade, and it said nothing about the reasonableness or unreasonableness of those restraints.

But what exactly was the mechanism by which the ICA's not-too-hot, not-too-cold pricing regime was to emerge? In an industry populated by small firms, we expect atomistic competition to result in prices equal to average costs. Faced with monopoly, we can expect high prices and deadweight losses, but the railroads sat in that uncomfortable middle ground. The railroads knew—and argued to the Court in *Trans-Missouri*—that the competitive structure of railroads was perverse and needed something more than purely unbridled competition to sustain a healthy industry. Railroads were a special-use property. They couldn't easily be turned into something else if the railroad business turned out to be oppressively competitive. The railroads sought the opportunity to prove that their rates were reasonable—as required by the ICA—and that the association agreement was the mechanism to produce reasonable rates.

In the Supreme Court, the Trans-Missouri association argued that the railroad business had to be understood as exempt from the Sherman Act—that the much more specific Interstate Commerce Act, designed for railroads, had to control over the more general terms of the Sherman Act. Alternatively, assuming that the Sherman Act did indeed apply to them, the railroads wanted to contend that their restraints were acceptable under the Sherman Act given that they were necessary to produce the reasonable charges required under the ICA. Certainly, suggested the association, the Sherman Act didn't forbid all contracts in restraint of trade but just those that unreasonably restrained trade.

In a 5–4 decision, the Supreme Court rejected both propositions. The Sherman Act was passed more than three years after the ICA, so it would have been easy enough for Congress to carve out the railroads from the new antitrust statute, but nothing like that had been done. And, in similar fashion, it would have been easy enough for Congress to expressly limit Section 1 of the Sherman Act to bar only unreasonable restraints of trade. Had this been done, the Court seemed to suggest, then the railroads would have been given the chance to prove that their agreement would "only keep rates up to a reasonable price." But Section 1 barred all restraints of trade, both reasonable and unreasonable, and the agreement of the Trans-Missouri Freight Association was found to violate the Sherman Act.

> "And how often do you get to open a class with the question, 'How would you run a railroad cartel?'"

What were the railroads to do? Railroad pools had been the preferred method for enforcing railroad cartels, but those were expressly barred by the ICA. Railroads had countered with the rate associations, which seemed to sidestep the ICA but were now condemned by the Sherman Act. The answer took two forms: seek more legislation and continue their practices much as they had before, notwithstanding the decision in *Trans-Missouri*.

As to legislation, the ICC reported in its 12th annual report, dated January 11, 1899, that the railroads were seeking new legislation that they hoped would solve the problems that they had faced for the last half century. The railroads didn't want merely an exemption from the Sherman Act or a repeal of the anti-pooling provisions of the ICA. Instead, the railroads wanted the power to enter into rate and pooling agreements that would be enforceable in court—agreements with teeth.

In the meantime, the railroads tried to operate as they had before. The 1902 annual report of the Interstate Commerce Commission explained the realities of railroad life:

> It is not the business of this Commission to enforce the antitrust act, and we express no opinion as to the legality of the means adopted by these associations. We simply call attention to the fact that the decision of the United States Supreme Court in the Trans-Missouri case and the Joint Traffic Association case has produced no practical effect upon the railway operations of the country. Such associations, in fact, exist now as they did before those decisions, and with the same general effect. In justice to all parties we ought probably to add that it is difficult to see how our interstate railways could be operated, with due regard to the interests of the shipper and the railway, without concerted action of the kind afforded through these associations.

This was the first decade or so of the Interstate Commerce Act. How would the rate provisions of the Act be implemented? The Act itself was understood not to give direct rate-setting authority to the Interstate Commerce Commission. The railroads themselves tried to set rates through the traffic associations, much as they had tried to do with the pooling arrangements that had preceded the ICA. The result in *Trans-Missouri* seemed to bar those arrangements under the Sherman Act.

The path forward from there was complex and with many fits and starts. Legislation was proposed to amend the Sherman Act to limit Section 1 to barring unreasonable restraints of trade, but the Supreme Court itself rendered that unnecessary in 1911 in its "reinterpretation" of Section 1 in the *Standard Oil* case. On the railroad side, the 1920 Transportation Act finally gave the ICC rate-setting authority (even beyond the authority to determine maximum rates that the 1906 Hepburn Act provided). In 1948, with the passage of the Reed–Bulwinkle Act, the intersection of the ICA and the Sherman Act was finally dovetailed: The ICC was given the authority to approve carriers' private agreements on rates, and that approval in turn conferred antitrust immunity on those arrangements.

This was in many ways the path forward seen by the Interstate Commerce Commission as early as 1899. The commission both was familiar with life for railroads as it had been before the two great business acts and then had seen how those acts had worked together for a decade culminating in the *Trans-Missouri* case in 1897 and the *Joint-Traffic Association* case in 1898. The commission noted that "many thoughtful persons" believed that "unrestricted competition was inconsistent with the purposes aimed at" by the Interstate Commerce Act, and the commission was inclined to agree with them. The commission further noted that there was "no great nation at the present time which endeavors to enforce competition between its railways, although in many cases that method has been tried and abandoned." Competition needed to be restricted and railroads needed to be allowed to accomplish this through agreement but subject to oversight by the commission to protect the public interest. Five decades later, the early vision of the commission was fulfilled. Of course, whether that was a good result is a question for another day.

"Cartels today are forced to sneak around, and, one suspects, this means that the understanding of the cartel is rarely committed to paper by thoughtful lawyers."


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THE INTERSTATE COMMERCE ACT, ADMINISTERED CONTRACTS, AND THE ILLUSION OF COMPREHENSIVE REGULATION

Thomas W. Merrill
Charles Evans Hughes Professor, Columbia Law School

The 125th anniversary of the Interstate Commerce Act invites reflection on what it has contributed to our understanding of public regulation. Perhaps the most important and enduring idea associated with the Act is what we may call the administered contract. At common law, transportation services, like other goods and services, were governed by ordinary contracts between customer and carrier. Building on innovations in English and state railroad legislation, the Interstate Commerce Act developed a different form of contracting. Contracts for transportation services became public acts, understood to have the openness, generality, and binding force of public law. This concept of the administered contract soon spread to other public transportation and utility services. It remains a feature today of what we loosely call public utility law. Ironically, rail transportation, where it all began, has reverted to ordinary contracting. This aspect of the history of the Interstate Commerce Act—the rise and fall of the administered contract—tells us much about why the Interstate Commerce Act, despite all its flaws, was so widely emulated. It also sheds important light on the appropriate domain of private and public law in the provision of services to customers.

Ordinary contracts are obligations based on mutual assent between identified persons. They are private undertakings in two senses. First, they see the light of day only under special circumstances, such as a litigated dispute or public recordation to perfect a security interest. Second, the obligations that such contracts create are personal to the parties and ordinarily do not extend to third parties, except in unusual circumstances such as third-party-beneficiary contracts. Ordinary contracts are enforced by courts and arbitrators, seeking to identify the parties' agreement and to enforce it by its terms. Courts and arbitrators typically do not consider questions of social welfare or regard themselves as free to rewrite contracts in order to achieve a different outcome from the one agreed upon by the parties.

Administered contracts, like ordinary contracts, are grounded in mutual assent. A service provider offers service on stated terms and conditions; if a customer agrees, this creates an obligation binding both parties. Nevertheless, administered contracts differ from ordinary contracts on many dimensions. Unlike ordinary contracts, administered contracts are public undertakings. They are filed in "tariffs" or "schedules" with an administrative body, and these tariffs must be posted in public places or otherwise made available for public inspection. Administered contracts are public in a second sense as well: They are regarded as offers open to any member of the public. Although an offer of service may be designed to meet the needs of a single customer, once the proposal is filed as a tariff, any person is free to avail himself of the service on the same terms and conditions.

Perhaps most significantly, administered contracts are understood to be public obligations. Some of this is inherent in the preceding point: Once a service provider agrees to offer service on stated terms and conditions, and these are filed in a public tariff, the service provider is obligated to provide the service if it is requested. Indeed, failure to provide the service when requested is a violation of law. But even more strikingly, enforcement of the contract is not given to courts, at least not exclusively, but is subject to oversight and modification by a public administrative body. Such an agency typically has the power to review tariffs before they take effect for compliance with general legal requirements and to reject or modify tariffs found to be noncompliant. The agency can also bring civil enforcement actions and even initiate criminal proceedings against persons who provide services without a publicly filed tariff or who provide services or pay rates that deviate from the publicly filed tariff.

Finally, administered contracts are public obligations in the sense that they preempt contrary state law. This feature of administered contracts is called the "filed rate doctrine." The service provider and the customer may not mutually agree to deviate from the tariff on any dimension—that is, they are prohibited from modifying the tariff by an ordinary contract. And the customer may not bring an action in tort to recover for any loss or damage that has been disclaimed by the tariff. This feature highlights the degree to which administered contracts function as an alternative to private ordering through the common law.

The concept of the administered contract emerged from the central purpose of the Interstate Commerce Act, which was to prevent "discrimination" in the provision of rail service. The principal cause of complaint against railroads was the perception that some customers were getting better deals than others for what were perceived to be similar services. Specifically, high-volume, well-connected customers, such as the oil and steel trusts, were getting breaks that were denied to ordinary folks. The disparity in rates was endemic to the railroad industry, with its mixture of competitive and monopolistic routes. The central problem was how to allocate large fixed costs—such as roadbed, terminal expenses, and administrative overhead—to individual movements. There was no clear answer to this problem. Railroads naturally sought to allocate a higher proportion of fixed costs to shippers on monopolistic routes, like rural grain elevators, which had little ability to resist higher prices. Railroads sought to allocate a smaller proportion of fixed costs to high-volume shippers like the oil and steel trusts, which typically had access to multiple transportation alternatives and could take their business elsewhere if rates got too high.

One strategy the Interstate Commerce Act took against this perceived inequity was to attack the problem directly, in the form of anti-discrimination obligations, long-haul/short-haul provisions (which forbade charging more for short-distance shipments than for otherwise identical long-distance shipments over the same route), and a general prohibition on unreasonable rates and practices. Enforcement of these substantive constraints, however, was difficult. It was expensive to file a complaint charging a carrier with a violation of these provisions, or to persuade Interstate Commerce Commission ("Commission" or "ICC") staff to commence an investigation. Once commenced, proceedings quickly bogged down in complicated evidentiary questions about cost accounting. When courts began to recognize defenses based on "meeting competition," success became increasingly hard to achieve.

"The concept of the administered contract emerged from the central purpose of the Interstate Commerce Act, which was to prevent 'discrimination' in the provision of rail service."

A second strategy was the adoption of administered contracts. If railroad service could be procured only through published contracts, these contracts were available to all, and deviations were strictly prohibited, then favoritism would become much more difficult. The regime of administered contracts turned out to be much easier to implement and enforce than the substantive prohibitions against discrimination. The courts, at the urging of the Commission, soon held that any provision of service without a tariff, any failure to file and publish a tariff before providing service, or any deviation from a tariff once it became effective was a per se violation of the Interstate Commerce Act. Railroad employees, shippers, agency officials, and courts could easily understand these rules and the consequences of violating them. Administered contracts did not end differential treatment. Carriers quickly learned to file tariffs tailored to specific endpoints, goods, and volumes, and so could continue to engage in differential pricing based on different competitive circumstances. But at

> "Administered contracts did not end differential treatment. . . . But at least the plague of secret rebates, kickbacks, and preferences, which was so disturbing to the public in the late nineteenth century, was brought to an end."

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The idea of the administered contract was wildly successful. Within the transportation sector, the idea spread from railroads to motor carriers, intercity buses, river barges, and airlines. It leaped to other industries as various as stockyards, telephony, natural gas distribution, and electricity distribution. It prevailed in a variety of federal regulatory schemes and was adopted by nearly all states as well.

Explaining why the idea of administered contracts was so successful is more difficult. Although the idea got its start in an industry characterized by a mixture of competitive and monopolistic routes, where differential pricing (i.e., "discrimination") was rampant, it proved to be equally popular in regulation of both industries with natural monopoly characteristics (electricity, natural gas distribution, and local telephony) and industries that were inherently competitive and were regulated largely to protect some other industry from competition (motor carriers and river barges). So the administered contract was not a regulatory response to any specific industry structure.

Without doubt, administered contracts had some benefits. The device was critical in stamping out the more blatant forms of favoritism, such as secret rebates, and this may have contributed in some measure to public confidence in the fairness of a rapidly industrializing capitalist system. They made it marginally easier to initiate claims of discrimination, since all tariffs were theoretically available for inspection through the agency's public documents room. The reality, as I have suggested, is that even with this better access to evidence, claims of discrimination or long-haul/short-haul violations were very hard to win. Administered contracts made it possible to protest rate increases before they took effect, and to seek a stay from the Commission pending investigation. This probably provided customers somewhat more leverage than they had under a regime that allowed only reparations for rates already put into effect and later deemed unlawful. But whether this had any widespread or permanent effect on the level of prices is questionable. Overall, it is hard to pinpoint any significant tangible benefit associated with the widespread use of administered contracts relative to ordinary contracts.

This is my theory: The regime of administered contracts created the illusion of comprehensive regulation without its associated costs. Forcing regulated firms to file and adhere strictly to tariffs satisfied the public's demand that the government "do something" about abusive practices in various critical network industries. Every firm had to publicize every service offering in advance, and had to wait patiently for a short period (e.g., 30 days) to see if any customer would protest or the agency would suspend and investigate. The public was thus led to believe that the government was on top of the industry. The reality was that all but a tiny percentage of tariff filings piled up, unread, in agency offices and later in warehouses. Meanwhile, the administered-contract regime imposed a small deadweight loss on regulated firms, but preserved their autonomy to determine what services they would offer at what prices. Administered contracts created the appearance of regulation while leaving the significant decisions unregulated, except in the most extreme cases. In so doing, they avoided the sclerosis and inefficiency that would have accompanied any effort to nationalize these industries and run them as state bureaucracies, as happened in most other industrial democracies.

The regime of administered contracts under the Interstate Commerce Act came to an end fairly rapidly in a 20-year period from the mid-1970s to the mid-1990s. Using "letters of understanding," railroads began soliciting business from major shippers, such as utilities that burn coal provided by continuous-cycle unit trains running from mine head to power plant. When disputes arose in which railroads attempted to argue that such letters were not binding because they were not filed as tariffs, courts were not amused. The ICC soon decided that such letters of understanding were presumptive evidence of reasonable rates and had to be reflected in tariff filings. Administered contracts were effectively subordinated to ordinary contracts. The Staggers Rail Act of 1980 expressly authorized the use of carrier–customer contracts, which quickly became the standard mode of doing business in the industry. When the ICC was formally abolished on January 1, 1996, tariff filing ended and rail service contracts were by statute returned to state courts to be treated like ordinary contracts.

What caused the demise of the administered contract in the context of the Interstate Commerce Act? President Eisenhower's interstate highway system may have been the most important cause, with the growth of the air transportation network playing a supporting role. The convenience of the new highway system and the emergence of air travel quickly reduced intercity rail passenger transportation to a detail. The railroads happily turned over all intercity operations to Amtrak, a federally subsidized corporation, in 1970. The vast growth in the transport of goods by motor carriers, along with the development of commercial air freight, meant that most shippers of commercial goods had competitive alternatives to rail transportation, even if, as before, the shippers were served by only one rail carrier. The primary exception consisted of shippers of bulk commodities such as coal, but these sorts of shippers were precisely the types of firms that could negotiate long-term contracts with rail carriers, and there was no reason to believe that administered contracts would provide them with better protection than ordinary contracts.

In short, the administered contract disappeared once widespread dependency on rail transportation disappeared. When the Interstate Commerce Act was adopted 125 years ago, multitudes of agricultural producers and small manufacturers were completely dependent on rail transportation to connect with the outside world, and fear of exploitation by railroads was rampant. The regime of administered contracts helped to tamp down this anxiety, at least to a degree. Once new transportation alternatives—car, motor carrier, and airplane—opened up, the sense of dependency on railroads faded away. It was only a matter of time before the ritual of tariff filing, publication, and worrying about strict compliance with tariff terms came to be seen as an unnecessary regulatory burden, adding to the cost of rail transport with little or no offsetting benefit.

If this analysis is correct, it suggests that the proper domain of administered contracts should be determined by economic dependency, even though, as noted, administered contracts were sometimes imposed without regard to such dependency. The economic concepts of monopoly or market dominance are a relevant part of the inquiry. But so is a more contextual understanding of vulnerability. Someone is economically dependent on a service when that service is a necessity of economic life and is provided by a single firm or a single dominant firm. Railroads fit this description when the Interstate Commerce Act was adopted. They do not, at least not for the vast majority of economic actors, today. It is thus fitting and proper that the idea of administered contracts, which emerged under the Interstate Commerce Act, has today disappeared from the industry in which it was born. ▸▸

"This is my theory: The regime of administered contracts created the illusion of comprehensive regulation without its associated costs."

THE RISE AND FALL OF THE INTERSTATE COMMERCE COMMISSION: THE TORTUOUS PATH FROM REGULATION TO DEREGULATION OF AMERICA'S INFRASTRUCTURE

Paul Stephen Dempsey

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This is an excerpt from the conclusion of Professor Dempsey's article.

The transportation industry has undergone a remarkable metamorphosis—from horses and wagons, to steamships, to railroads, to trucks and automobiles, to aircraft and spacecraft—a transformation that is far from over. The evolution of technology, of America's economy, and indeed, of economic theory and political ideology all has contributed to the relationship between government and this important infrastructure industry, one which today accounts for approximately 16 percent of the gross national product.

Few industries play as broad or vital a role in the economy as transportation. Throughout American history, a network of roads, canals, railroads, and airways has spurred growth by making possible the movement of goods from one market to another. Transportation has historically been identified as an industry "affected with a public interest." The common carrier obligation—the principle that service be open to all upon reasonable request and on fair and nondiscriminatory terms—has been imposed upon commercial transportation providers since the Middle Ages. So regulatory oversight of the surface transportation industry has long been considered necessary and justified to protect the public's interest in having adequate transportation available on reasonable terms.

More affirmatively, perhaps, federal, state, and local governments in the United States have a long history of building, financing, subsidizing, and promoting transportation. The land grants and government subsidies helped build the railroads; the nationalization of rail passenger service helped restore the health of the freight railroads. Government carries the mail. It builds the roads, highways, transit lines, airports, and seaports. It does all this because it understands the profound positive social and economic externalities that transportation potentially offers. Whenever possible, the provision of transportation services in the United States has been left to private firms (a/k/a common carriers). When it has not been economically feasible, as with airports, air traffic control and the airways, urban transit, small community air service, and intercity passenger rail service, the government has assumed responsibility; that is, federal, state, and local governments have subsidized or provided these services.

Across this time (or since 1887, at any rate), federal regulation of the transportation sector of the United States' economy has served various purposes: to remedy market deficiencies (such as the lack of effective competition or the existence of destructive competition), to override the market to achieve broader social purposes, and to ensure uniformity in the face of regulatory efforts by the states. These purposes and the manner in which regulation has been implemented to achieve them affect not only the performance of the companies and industries in this sector, but also the ability of the United States to lead the global economy.

In 1887, Congress passed the Interstate Commerce Act to protect the shipping public from the monopoly power of the rail industry, and created the Interstate Commerce Commission to carry out that regulatory charge. In 1935, the Commission's regulatory authority was extended to include the nascent interstate trucking and bus operations. Other sectors of surface transportation—pipelines, domestic water carriers, and freight forwarders—were subjected to economic regulation in 1910, 1940, and 1942, respectively. Airlines were regulated in the same fashion beginning in 1938.

Federal economic regulation of transportation developed into a comprehensive web of governmental oversight of entry and exit, rates, consolidations, and service quality. Regulation reached its high-water mark in the 1950s and 1960s.

In the late 1970s and early 1980s, Congress began to pare and refine federal transportation regulation to reflect contemporary industry conditions and evolving ideological attitudes. The result was to reduce significantly the federal presence in the interstate transportation industry. Perceived successes in transportation deregulation became the political catalyst for comprehensive deregulation across many infrastructure industry sectors.

Today, railroads have consolidated into four major lines; the bus industry has one large survivor; and several hundred airlines and trucking companies have gone bankrupt. Ironically, the only major airline to support deregulation, United Airlines, ended up in the largest bankruptcy in aviation history. Former American Airlines CEO Bob Crandall observed:

> Our airlines, once world leaders, are now laggards in every category, including fleet age, service quality and international reputation.
>
> . . . [T]he financial health of the industry, and of the individual carriers, has become ever more precarious. Most have been through the bankruptcy process at least once, and some have passed through on multiple occasions.
>
> . . . .
>
> . . . I feel little need to argue that deregulation has worked poorly in the airline industry. Three decades of deregulation have demonstrated that airlines have special characteristics incompatible with a completely unregulated environment. To put things bluntly, experience has established that market forces alone cannot and will not produce a satisfactory airline industry, which clearly needs some help to solve its pricing, cost and operating problems.

The effects have been widespread. Deregulation of the power industry unleashed Enron to wreak havoc on consumers and investors. Deregulation of the telecommunications industry has led to financial instability. Deregulation of the financial industry resulted in a trillion-dollar bailout of the savings and loan industry, followed years later by the subprime mortgage crisis, which resulted in the housing industry meltdown and several trillions more in taxpayer liability in propping up the largely deregulated banking and financial industry.

The cumulative weight of these events triggered the most serious economic collapse in American history since the Great Depression, saddling our generation and

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the next with unprecedented debt. Deregulation of trade has transformed the United States, the wealthiest nation on the planet, into a debtor nation, in which middle-class industrial jobs have located offshore, leaving Americans to retrain as greeters in Wal-Mart, full of goods produced abroad. The economists tell us this is beneficial for "consumer welfare," irrespective of the fact that a consumer needs a job to buy the cheap imported goods. It is said of economists that they know the price of everything and the value of nothing. They have led this stampede toward free and unregulated markets, and working-class Americans pay the price for their myopic adventurism.

Despite the economic crisis of contemporary America, the politicians and the public remain in denial that deregulation had anything to do with the disintegration of the American economy. This is perhaps because, unlike the 1930s, the collapse of the twenty-first century did not result in the collapse of the banking industry, leaving the country penniless and unemployed. Today, instead, the banks are solvent, subprime housing has been repossessed, and the American economy has been transformed into lower-paying service-sector jobs. America remains in this trap so long as the prevailing wisdom is that market can do no wrong and government can do no good. We have not learned from the wisdom of George Santayana: those who forget the lessons of history are doomed to repeat it. Judge Richard Cudahy has observed:

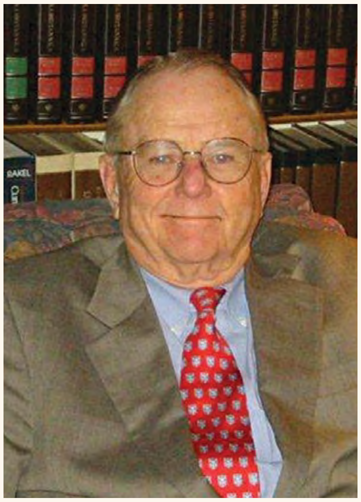
> Economic activity and its political analogues are inherently cyclical, and regulatory institutions must be attuned to the cyclical nature of things. A good deal of the time, competition advances innovation and growth, but there is indeed sometimes such a thing as destructive competition. We have apparently known destructive competition, linked to predatory pricing, in the airline industry and may continue to know it. Competition in this industry has been destructive because on balance wealth has been destroyed and both tangible and intangible values have been undermined. Competition itself has been weakened, and for that reason a return to some form of regulation is likely.

In the nineteenth century, market failure gave birth to transport regulation. The public interest in transportation was deemed paramount. Nearly a century after economic regulation was born, an inflationary economy, coupled with a perceived failure of the regulatory mechanism, gave birth to deregulation. Undoubtedly, the pendulum of American public policy will swing again. Like transportation itself, public policy in this vital infrastructure industry is in perpetual motion.

THE INTERSTATE COMMERCE ACT AS A MODEL OF REGULATION

Richard D. Cudahy

Senior Judge, U.S. Court of Appeals for the Seventh Circuit



This anniversary of the Interstate Commerce Act reminds us that this historic statute—corrective of notorious railroad abuses in the nineteenth century—is the model for "direct" regulation of business at both the state and federal level. In recent decades, this model, or "original paradigm," of regulation has been widely supplanted by a "new paradigm," as Kearney and Merrill termed it in *The Great Transformation of Regulated Industries Law*. The new paradigm is characterized by a narrowed application of direct regulation to bottlenecks or areas of monopoly power, as opposed to areas where competition in a relevant market is arguably adequate to maximize consumer welfare, induce efficiency, and adequately discipline the economic process without government intervention.

So the world has changed. Whereas the original paradigm was held to be applicable (as a constitutional matter) to businesses characterized as "affected with a public interest," today the regulation of these same enterprises, which include public utilities, is usually said to depend (as an economic matter) on finding them to be capital-intensive "natural monopolies," in which marginal cost remains below average cost over a full range of output and a sole provider is more efficient than competition. For example, state public service commissions traditionally regulated the electric power industry, but under the new paradigm, transmission and distribution are directly regulated, while generation is treated as workably competitive and spared government economic surveillance.

But the original paradigm is still useful. Direct regulation, as in the Interstate Commerce Act, generally involves principles of public interest applied by a regulatory authority (usually a commission) to commercial enterprises so as to combine the supposed efficiency of private enterprise with social needs supposedly democratically derived. This permits, the theory goes, surveillance of service as well as price, but we also know now that it is arguably less effective and more open to improper influence than free and fair competition in a market, as prevails in the economy generally. In these circumstances, in evaluating the nature of regulatory measures, one must attach appropriate importance to the evils sought to be corrected by regulation.

As all concede, in the case of the Act, the prime evil was discrimination in price and in other respects, highlighted by railroad rate favoritism to the Standard Oil Company, greatly enhancing its dominance. There was also acute concern about geographic discrimination disadvantaging certain agricultural areas and crops and giving rise to the undue favoring of long hauls over short. So it is not surprising that the Act not only moved sweepingly against discrimination (for its primary substantive end) but also deployed a uniform filed rate at the expense of a contract rate established in a competitive market (for its procedural means). As a further measure strongly advancing uniformity, totally destructive of competition, and also adverse to discrimination, the Act as amended authorized rate bureaus for collective rate-making.

As modified by subsequent legislation, the Act empowered the commission that it created to fix maximum railroad rates based on reasonableness and justice. This was a model for public-utility rate-setting, which usually involved establishment of a rate base reflecting invested capital and a rate structure generating revenues sufficient to cover expenses plus a return on the rate base sufficient to attract capital. The rate structure was then to distribute revenues to services generally in accordance with costs.

After the advent of the new paradigm, by contrast, there are still strictures against discrimination, but with less blunt tools than uniform rates on public file. Instead, the paradigm relies on competition, which (in a puzzling parallel) also involves price discrimination, although these price differences are presumably justified by cost. Perhaps the main reason for moving from the original paradigm to the market model was ideological, part of what has been called the "capitalist revolution," which has been dominant since the 1980s, but which has been shaken by the recent financial crisis and economic downturn.

The move to the market paradigm from a regime of direct government regulation has been most unquestioned in industries, such as motor carriers and airlines, having no natural monopoly characteristics. But at least in the case of the airlines, deregulation has not been free of apparently fundamental problems. Economic regulation of the airlines by the Civil Aeronautics Act of 1938 was introduced not primarily to protect consumers but to make the industry viable and capable of being financed. The period of direct regulation, ended in 1978, has been the only one during which airlines have been profitable and apparently viable for the long term. Destructive competition—nonexistent in theory but a practical reality—is without any clear solution but seems to be leading to ever-more-massive consolidation within the industry—not a favorable omen for workable competition.

The Interstate Commerce Act, adopted in 1887, was a long time in gestation and at various times attracted some industry support, based in part on its potential for various sorts of joint ratemaking. But it was more beginning than end. The contest that the Act signaled between the advocates of government regulation and exclusive reliance on natural forces and the market continues today.

This contest is prominent, for example, in the debate about "net neutrality" in the world of communications and the Internet. Net neutrality essentially means the historic openness of the Internet and the principles necessary to protect and promote it. The Federal Communications Commission recently approved net neutrality rules, in an effort to increase Internet service provider transparency; to prevent the blocking of access to any legal services, applications, and content; and to prohibit wired providers from "unreasonable discrimination" of content or services. Opponents of such regulation argue that Internet communication has developed historically through the action of market forces free of regulation and giving maximum scope to innovation and creativity—and that future progress is threatened by regulation. Advocates of regulation, on the other hand, not unlike their predecessors in the 1880s, see discrimination, perhaps in the form of fees for assured access and priority, as a major threat to net neutrality.

The Interstate Commerce Commission may be gone. However, the larger battle goes on as to whether regulation controls the abuses of freedom or obstructs the creative process springing from unregulated freedom—or at least as to which of these functions is dominant.

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Congress of the United States of America;
At the Second Session,
Begun and held at the City of Washington on Monday, the sixth day of December, one thousand eight hundred and eighty-six
AN ACT
To regulate Commerce.
Classification
No. 21.
lines of the following-named Express Companies:
cartels
Newfoundland Express Company
New York & Boston Despatch Express Company
Northern Express Company
Southern Express Company
United States Express Company
Wells Fargo & Company Express
Western Express Company
Concurring Carriers:
Halifax & Southwestern Railway (Express Department)
United States and between any point in the
between any point in the United States and
within the United States on business

SUPERVISING DISCRIMINATION: REFLECTIONS OF THE INTERSTATE COMMERCE ACT IN THE BROADBAND DEBATE

James B. Speta
Professor, Northwestern University School of Law

"The forms of action we have buried, but they still rule us from their graves." For a telecoms lawyer asked to reflect on the 125th anniversary of the Interstate Commerce Act, F.W. Maitland's famous line concerning common law procedure leaps to mind. The 1887 Interstate Commerce Act (ICA) continues to exert an outsize influence on the world of telecommunications—despite changes in both the ICA and telecoms. The ICA's original commitments of just and reasonable rates, nondiscriminatory service, and supervision by an administrative agency were, as is well-known, copied from the railroad statute into numerous other federal regulatory regimes—including the Communications Act of 1934. And while the ICA's structure steadily changed in the 1970s and 1980s, leading to the Interstate Commerce Commission's eventual demise in 1996, the Communications Act remains the controlling statute for an enormous, and increasingly important, segment of the American economy—notwithstanding that telephones, telegraphs, and broadcasting (the objects of that Act) are no longer the important services.

In fact, the most persistent issue for the Federal Communications Commission (FCC) in recent times has been—and remains—in the realm of broadband services: specifically, the application of "nondiscrimination" rules to the Internet. Both the FCC and commentators discuss this issue as if it were, in part, simply the extension of nondiscrimination obligations codified in 1887 and 1934 and behave as if nondiscrimination notions under those statutes might illuminate the modern debate. I have done the same, and perhaps even worse by reaching back to the common law of common carriage, and there is at least some purchase to be had in all this, because, as the literature says, "non-discrimination was unquestionably the overriding goal of the Interstate Commerce Act, taking precedence even over the 'just and reasonable' [rate] requirement."

But, as important as the nondiscrimination obligation was to the regulatory model initiated by the ICA, much of the current telecoms (or broadband) debate forgets that nondiscrimination was merely one aspect of a regulatory system in which all aspects of a carrier's services were supervised. And under that supervision, discrimination was frequently allowed—after all, the statute forbade only "unjust discrimination," which gave the regulators considerable flexibility. Moreover, discrimination was frequently *required* in this regulatory model, in the name of universal service. This richer history should allow a better consideration of the modern, broadband problem.

I. "NONDISCRIMINATION" IN THE CURRENT TELECOMS DEBATE

One influential commentator in the debate over the proper rules for broadband regulation (Tim Wu) has made the pitch that "in coming decades . . . the main point of the telecommunications law should be as an anti-discrimination regime, and that the main challenge for regulators will be getting the anti-discrimination rules right." He is hardly alone. And the FCC's only significant foray into Internet regulation has been to impose nondiscrimination rules on Internet access providers, first issuing a (since-vacated) cease-and-desist order against one provider and following more recently with generally applicable rules providing that "[f]ixed broadband providers may not unreasonably discriminate in transmitting lawful network traffic." Virtually no one calls for the other economic elements of the original regulatory paradigm, such as renewed restrictions on entry and exit, or the return of rate-regulation. And while few call for the FCC to be abolished, everyone (including the FCC) agrees that its touch should be lighter, more ex post, more deferential to private companies. The FCC itself describes the Open Internet rules as "high level," indicating that they will be applied case-by-case through private negotiation, private standard-setting, and, only as necessary, complaint and enforcement actions through the agency.

Those pushing for modern, Internet nondiscrimination rules frequently invoke their statutory history—from the ICA through the original Communications Act. The FCC invoked the Interstate Commerce Act when it forbade "unreasonable discrimination" by broadband carriers, although the reference came in rejecting calls for stronger nondiscrimination rules. More recently, in setting up his project for broadband anti-discrimination rules, Tim Wu argued that "[a]s an anti-discrimination regime, common-carriage is important both historically and conceptually." Similarly, Susan Crawford has said that modern market conditions require returning to the old ways—that "[w]e need to return to the basic notion of a non-discriminatory network underlying communications. . . . [T]he old paradigm of regulation is new again—with a few changes." The foresighted work of Ithiel de Sola Pool expressly argued for common carrier rules for new electronic networks, where monopoly conditions warranted. Even the opponents of network neutrality rules make the connection between those rules and the historic nondiscrimination regime of the Interstate Commerce Act. For example, Bruce Owen, intending no compliment, has written that "[p]roponents of net neutrality may recognize their own fears and goals . . . [in] the legislative history of the first modern attempt by the federal government to regulate directly the behavior of large firms, in this case railroads. The result was the 1887 Act to Regulate Commerce."

II. THE SHIFTING NORMS OF NONDISCRIMINATION UNDER ICA STATUTES

A call for broadband nondiscrimination rules as an extension of the nondiscrimination requirement of the ICA and of the Communications Act misses two important pieces of the history of those regimes. As already noted, the statutory text forbade only "unjust" (or "unreasonable") discrimination, and the regulators sometimes used that discretion to approve discriminatory rates. More importantly, the goal of universal service, especially in the Communications Act, meant that the regulators affirmatively valued discrimination—discrimination that helped maintain artificially low prices for some services while ensuring that the carrier met its total revenue needs.

The common law did not impose a strict non-discrimination duty on common carriers—so long as rates were reasonable, they did not have to be equal. The ICA was undoubtedly meant to do more. Specific provisions forbade much long- and short-haul discrimination, and the statute generally forbade unreasonable discrimination. It is sometimes said of the Interstate Commerce Act (this is the D.C. Circuit in *Sea-Land Service, Inc. v. ICC* in 1984) that "[t]he core concern in the nondiscrimination area has been to maintain equality of pricing for shipments subject to substantially similar costs and competitive conditions, while permitting carriers to introduce differential pricing where dissimilarities in those key variables exist."

But introducing the idea that the tariffed rate may respond to competitive conditions—that discounts can be approved (*Sea-Land* again) "on grounds of reduced costs and the need to meet intermodal competition"—

"The 1887 Interstate Commerce Act . . . continues to exert an outsize influence on the world of telecommunications—despite changes in both the ICA and telecoms."

> "The FCC and advocates for broadband nondiscrimination may take one part of a system and not others, but should acknowledge—and explain—their selectivity."

eliminates any need for "costs" to serve as the basis of a nondiscrimination requirement. Moreover, the Interstate Commerce Commission early implemented "value-of-service pricing," under which high-priced commodities were charged more (regardless of cost of transport). And even further deviations from nondiscrimination were permitted: "The Hoch–Smith Resolution, passed by Congress in 1925, explicitly required the ICC to give consideration to the relationship between agricultural freight rates and agricultural incomes and has been interpreted as giving clear legislative sanction to the maintenance of the value-of-service rate structure" (Friedlaender & Spady, 1980). These practices had economic and noneconomic explanations. Economically, value-of-service pricing "may have been a roughly adequate method of concentrating the fixed costs of railroad service on those customers whose demands for rail transportation were least elastic" (Richard Posner, 1971), and permitting rate concessions upon the development of intermodal competition allowed the railroad to keep the traffic at some rate (maintaining at least a marginal contribution to fixed costs). Non-economically, low prices for agricultural commodities no doubt were popular.

That did not mean that nondiscrimination was a dead letter, to be sure. Formal nondiscrimination requirements persisted. Even when the ICC and later the FCC (and the courts) approved contract rates, the law required that a carrier offer the rate to any party that could meet the exact terms of the rate. Extreme formalism came in the Communications Act context, when the FCC approved what were known as "contract tariffs"—service packages that, while tariffed, in most cases could be met by only one potential customer. Moreover, substantive nondiscrimination cases did occur, and the regulators did, from time to time, hold that tariffs for similar services were discriminatory.

The point, though, is that nondiscrimination, while an important rule, was very much applied based on the overall context, and that context was part economic and part noneconomic. Economically, railroads had high fixed costs, which needed to be recovered. Non-economically, the Interstate Commerce Act's politics excluded recovery of those fixed costs against the most captive customers (the short-haul, agricultural customers). As competition developed, further concessions from the traditional modes of proceeding, including non-discrimination, were required. Consider the D.C. Circuit's statement in one of the telecommunications contract tariff cases: "We have the impression that there is a certain air of unreality about this case. The FCC (one way or another) will undoubtedly permit AT&T to compete effectively against its competitors . . . ."

Little need be added about universal service, for the point is now clear. Regulators wanted universal service (and, in the case of railroads, cheap agricultural service, and, in the case of telephones, cheap local residential service). This meant cross-subsidies, some of which necessarily violated any notion of cost-based non-discrimination. In telephony, business rates were higher than residential rates, even if the business and the residence shared the same address. Long-distance rates were made uniform, even though the costs were higher on lightly used trunk routes.

III. LESSONS

What does this mean for the debate over broadband nondiscrimination rules? Without doubt it means that one cannot simply say that the Interstate Commerce Act and the Communications Act adopted nondiscrimination rules for essential services, and therefore such non-discrimination rules should now be adopted for broadband carriers (because broadband service is becoming essential). And one also cannot say that nondiscrimination rules are the response to broadband monopoly, for of course the monopoly is incomplete. The business access market is likely more robustly competitive (as it was in traditional telephony in the 1990s) than the residential market. Under the traditional scheme's permission of rate discounts to respond to competition, the result would be to allow carriers to charge businesses less than residential customers. But, of course, the universal service imperative of the traditional regime would *not* in fact have permitted that result, for what were largely noneconomic (or at least distributional) grounds.

These conflicting forces have always been conflicting, but they could be resolved by a traditional regulator such as the ICC or the FCC in a system in which entry was legally and practically limited, and in which the regulator had the tools to ensure that carriers would receive adequate overall returns. Applying nondiscrimination rules while attempting to maintain the essentially unregulated nature of Internet carriers is a much trickier enterprise, and it is not clear how the new system can adapt to balance these concerns. On the one hand, the FCC's recent foray attempts to meet this concern by only stating a high-level principle of nondiscrimination and promising to adjudicate disputes. Adjudication may allow the FCC to forbid only particularly problematic practices, minimizing its intrusion into the business practices of the carriers, and to consider any legitimate business justifications offered by the carriers for specific services. On the other hand, the FCC has rejected the notion that discrimination is only a concern when it can be expressly linked with anticompetitive foreclosure (which would be an instance in which the carrier is making *more than* normal profits). As a result, the Open Internet Rules have the potential to impose important business restrictions on the carriers, while the FCC no longer comprehensively supervises them and assures the adequacy of their revenues.

In short, while the Interstate Commerce Act's nondiscrimination requirement provides something of a model for the broadband world, the rule was part of a system—a system in which nondiscrimination was never absolute and that allowed compensation for its costs. The FCC and advocates for broadband nondiscrimination may take one part of a system and not others, but should acknowledge—and explain—their selectivity. ■

Downtown Milwaukee ca. 1900 (right) and in 1912 (immediately below). *Wisconsin Historical Society (WHi 24987 and 4690).*