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# THE INTERSTATE COMMERCE ACT AS A MODEL OF REGULATION

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This anniversary of the Interstate Commerce Act (Act)<sup>1</sup> 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.”<sup>2</sup> 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,”<sup>3</sup> 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

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1. Ch. 104, 24 Stat. 379 (1887).

2. See Joseph D. Kearney & Thomas W. Merrill, *The Great Transformation of Regulated Industries Law*, 98 COLUM. L. REV. 1323, 1324–27 (1998).

3. *Munn v. Illinois*, 94 U.S. 113, 126, 130 (1877) (internal quotation marks omitted).

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).<sup>4</sup> 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.<sup>5</sup>

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,”<sup>6</sup>

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4. See *Maislin Indus., U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116, 119–21 (1990) (and authorities cited).

5. Ch. 3591, § 4, 34 Stat. 584, 589 (1906).

6. Kearney & Merrill, *supra* note 2, at 1397.

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<sup>7</sup> 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,<sup>8</sup> 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.<sup>9</sup> 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.<sup>10</sup> 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

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7. Ch. 601, 52 Stat. 973 (1938).

8. Airline Deregulation Act of 1978, Pub. L. 95-504, 92 Stat. 1705 (1978).

9. RICHARD WHITE, *RAILROADED: THE TRANSCONTINENTALS AND THE MAKING OF MODERN AMERICA* 355–65 (2011).

10. Preserving the Open Internet, 25 FCC Rcd. 17905, 17906 (2010).

predecessors in the 1880s, see discrimination, perhaps in the form of fees for assured access and priority, as a major threat to net neutrality.<sup>11</sup>

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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11. Theodore A. Livingston & Christian F. Binnig, *Net Neutrality: Point and Counterpoint*, INFRASTRUCTURE, Fall 2010, at 3, 3–5. The matter is further explored in the following (and concluding) essay in this remembrance of the Interstate Commerce Act upon the occasion of its 125th anniversary. James B. Speta, *Supervising Discrimination: Reflections of the Interstate Commerce Act in the Broadband Debate*, 95 MARQ. L. REV. 1195 (2012).