THE TELECOMMUNICATIONS ACT OF 1996, THE TAKINGS CLAUSE, AND TENSIONS IN PROPERTY THEORY

Eric R. Claeys*

INTRODUCTION

This Article draws on general property scholarship about takings law to evaluate the telecommunications law and scholarship to date on takings challenges to the local-exchange provisions of the Telecommunications Act of 1996 ("the Act," or "the 1996 Act").[1] In 1996, the Federal Communications Commission implemented regulations to execute these local-exchange provisions. These statutory provisions and regulations require the Baby Bells and other local-exchange carriers ("the incumbents") to interconnect their exchanges to the facilities of competing local-service providers ("the competitors").[2] The incumbents have challenged these laws and regulations on several fronts, particularly for failing adequately to compensate the incumbents for their historical costs, the costs they have invested in building or maintaining the physical infrastructure that constitutes the local exchanges. In the 2002 decision *Verizon Corp. v. FCC*,[3] the U.S. Supreme Court broadly upheld these regulations against statutory and administrative-law challenge, but largely declined to review the incumbents' constitutional claims under the Takings Clause.[4] Those takings claims promise to raise particularly difficult issues of policy and constitutional law as they proceed to trial in different jurisdictions.

This Article takes a modest step toward clarifying the grounds of debate about these takings claims Before proceeding, I hasten to warn that many of the most relevant policy issues are beyond the scope of this Article. These issues raise serious questions about the economics and business of the telecommunications industry, but I am neither an economist nor a telecommunications specialist. Rather, in the spirit of this Symposium, I hope to use some of the tensions in and lessons from general property theory to shed light on the more industry-specific and policy-oriented issues raised by the local-exchange provisions of the 1996 Act.

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* Assistant Professor of Law, St. Louis University. I am grateful to Douglas Lichtman and Michael Heller for comments on earlier drafts of this Article. Work on this Article was supported by financial and research assistance from Verizon Communications.

[1] See especially 47 U.S.C. §§ 251-52 (2000 & 2004 Supp.).

[2] See Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, First Report and Order, 11 F.C.C.R. 15499 (1996).

[3] 535 U.S. 467 (2002); *see id.* at 527-28.

[4] U.S. Const. amend. V ("[N]or shall private property be taken for public use, without just compensation.").

This Article examines the use and abuse of takings property theory in the specialized telecommunications law and scholarship about local-exchange takings claims. In particular, it examines a puzzling phenomenon about this law and scholarship: Virtually all the authorities contend that the takings issues are quite simple and admit of only one answer, and yet the authorities split surprisingly evenly into three separate camps about how those issues should be resolved. In *Verizon*, the Supreme Court assumed that the incumbents' constitutional claims raised questions within the framework of ratemaking doctrine, which guarantees to regulated utilities the power to recover their capital and a minimum reasonable rate of return on it.[5] This approach has also been endorsed by William Baumol and Thomas Merrill[6] and, more recently, by Jim Chen.[7] Daniel Spulber, first with J. Gregory Sidak[8] and then with Christopher Yoo,[9] has suggested that when the Act requires incumbents to interconnect their competitors to local exchanges, it renders "classic physical taking[s]," which *per se* entitle the incumbents to just compensation worth the going market value of the physical infrastructure and access rights that have been taken.[10] A few courts and commentators have suggested that the FCC's rate regulations are as innocuous as rent-control laws and other laws that courts have upheld under strongly deferential "regulatory takings" principles associated with the Supreme Court decision *Penn Central Transportation Co. v. City of New York*.[11] Those three frameworks—rate-of-return law, *per se* rules, and *ad hoc* interest balancing—exhaust all the important possibilities in takings law. It is strange that all the authorities seem so certain that the legal issues are easy to settle and yet so widely divided on how to settle them.

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[5] *See Verizon*, 535 U.S. at 523-24.

[6] William J. Baumol & Thomas W. Merrill, Deregulatory Takings, Breach of the Regulatory Contract, and the Telecommunications Act of 1996, 72 N.Y.U. L. Rev. 1037 (1997).

[7] Jim Chen, The Nature of the Public Utility: Infrastructure, the Market, and the Law, 98 Nw. U. L. Rev. 1617, 1685 (2004) (book review of Gosé A. Gómez-Ibáňez, Regulating Infrastructure: Monopoly, Contracts, and Discretion (2003))

[8] J. Gregory Sidak and Daniel F. Spulber regard Priest's descriptions as setting the context for phone regulation in *Deregulatory Takings and Breach of the Regulatory Contract*, 71 N.Y.U. L. Rev. 851, 878-79 (1996).

[9] Daniel F. Spulber & Christopher S. Yoo, *Access to Networks: Economic and Constitutional Connections*, 88 Corn. L. Rev. 885 (2003).

[10] *Id.* at 978.

[11] 438 U.S. 104 (1978). For examples of these authorities, consider Texas Office of Public Utility Counsel v. FCC, 183 F.3d 393, 429 (5th Cir. 1999) (suggesting, in dicta relating to a company's takings challenge to the 1996 Act, that the claim lacked merit under *Penn Central*'s three-part interest balancing); Paul W. Garnett, *Forward-Looking Costing Methodologies and the Supreme Court's Takings Clause Jurisprudence*, 7 CommLaw Conspectus 119, 122 n.19 (1999) (suggesting that recent Supreme Court rate-of-return takings cases have applied a test mirroring the standards that apply to land-use regulatory-taking challenges); Legg, *supra* note --, at 581-83 (analyzing post-*Verizon* takings claims within the parameters of *Penn Central*'s factors).

This Article suggests that the relevant law and scholarship to date presuppose different and quite contestable views about property, its regulation, and its proper constitutional protection. The scholarship specific to post-*Verizon* takings claims is influenced to a striking degree by choices or assumptions of different worldviews regarding property and takings. Of course, overarching theories of property policy and behavior do not and cannot prescribe outcomes in specific policy disputes by themselves. General conceptions of property leave a great deal of room for different facts and policies to make a difference in specific disputes. Even so, an author's choice of approach can often have a subtle effect in the details of policy analysis in a specialized field like telecommunications. To oversimplify slightly, the choice of approach can act as a powerful tie-breaker. Different approaches create different default presumptions to decide issues—in favor of government action or inaction, or compensation or no compensation—when a judge or industry specialist runs out of more specific factual information and can no longer apply policy expertise to fill the gaps remaining. To that end, this Article canvasses the relevant law and scholarship on such claims, identifies the claims that seem contestable in light of ongoing debates about property in the scholarship on takings, and examines to what extent different approaches to property are helping to advance prescriptions that could otherwise and perhaps be more appropriately be advanced by more technical and specific policy arguments.

To do so, this Article examines the law and scholarship related to post-*Verizon* local-exchange takings issues in light of two theoretical extremes in the scholarship on takings. One extreme represents a libertarian view, which tries to lay out the principles of regulation and just compensation that follow if one holds that government's overriding goal ought to be to protect and cultivate free initiative and action through property rights. This Article calls the other extreme, for want of a better term, the Legal Realist view. This label is probably inaccurate in some respects, for many of the key claims of this view have emerged in the takings law and scholarship only in the last quarter century. At the same time, many of its key claims draw heavily on claims about property and regulation that originated in the Legal Realist era.[12] This view errs on the side of government regulation and redistribution far more than the libertarian view, and tends to assign to property the status of one of several acceptable but not compelling

[12] I have demonstrated how contemporary takings doctrine depends on Legal Realist theory in Eric R. Claeys, *Takings and Private Property on the Rehnquist Court*, 98 Nw. U. L. Rev. – (2004).

objects that the law might promote. To be sure, by compressing the alternatives into two choices, this Article runs the risk of oversimplifying. Nevertheless, the libertarian and Realist views capture and integrate into fairly comprehensive frameworks claims about property and its nature that recur over and over in different takings doctrines and arguments.

The libertarian and Realist worldviews exert heavy influence in the law and scholarship about the takings issues created by the 1996 Act. In particular, many of the more assertive takings arguments made to date seem quite contestable. These claims make sense if one assumes the truth of claims that fit either the libertarian or Realist worldview of property, but neither of those worldviews is beyond question. As this Article shows, if one examines the relevant takings issues relying primarily on the libertarian elements in takings law, it is quite possible to generate a mixed *per se*/rate-of-return account of the relevant takings issues. Under these elements, the 1996 Act inflicts *per se* takings on the incumbents because it extinguishes their rights to exclude competitors when it preempts their state franchises and requires them to interconnect competitors to their exchanges. Rate-of-return principles then inform the incumbents' just compensation indirectly, for the proper compensation for these *per se* takings comes in large part from the discounted present value of the rates the incumbents expected to recover in the state rate-making proceedings cut off and preempted by the 1996 Act. This doctrinal framework expresses a strong preference for an obvious policy goal: In telecommunications, as in other utilities, there always exists a strong danger that regulators may discourage long-term dynamic efficiency in utility investment by using the power to regulate to expropriate capital. If takings law guarantees incumbents that they will recover any stranded costs that they cannot recover from competing to provide phone service or from charging their competitors interconnection rates, it guarantees long-term dynamic efficiency in telecommunications and other regulated industries.

On the other hand, if one examines the relevant issues relying on the Realist elements in takings law, it is quite possible to generate an account of the issues that is quite deferential to Congress and the FCC. On this account, the 1996 Act treats incumbents as innocuously as rent-control regulations treat landlords. It leaves the incumbents with a wide zone of freedom to profit in the telecommunications sector, and it provides them with several valuable benefits, including the rights to charge competitors for access to their local exchanges and the long sought-after right to compete in long-distance markets. This doctrinal framework expresses a

strong preference for strikingly different policy goals: Takings law need not compensate incumbents as extensively as the libertarian view suggests in order to guarantee dynamic efficiency. If anything, such compensation rules discourage Congress from intervening, as it did in 1996, to restructure industries to promote efficiency and other laudable goals.

By showing those connections here, I do not claim to refute or disprove any of the current law and scholarship on the 1996 Act and the law of takings. However, I do mean to suggest that many of these authorities beg the crucial policy questions. Ideally, the relevant questions could be answered with the sort of technical expertise that qualifies scholarly and professional specialists to count themselves as specialists. Telecommunications experts could then project with certainty whether and how the 1996 Act has dislocated investments in infrastructure and improvements in local exchanges. However, these questions are extremely difficult to analyze with certainty. In such conditions of uncertainty, it is tempting to settle the questions by appealing back to basic default presumptions, either to err on the side of paying owners compensation and thereby limiting government action, or to err on the side of encouraging government action, and thereby limiting individual compensation. Those presumptions seem to be exerting substantial influence on much of the takings scholarship thus far on the 1996 Act. Even if this analysis does not settle the most important questions raised, it does highlight important limitations in the scholarship to date, and it also shows how and to what extent takings law can reflect those crucial questions.

II. THE LOCAL-EXCHANGE PROVISIONS OF THE TELECOMMUNICATIONS ACT OF 1996

Verizon and the takings lawsuits arising in its wake arose out of a *quid pro quo* effectuated by the Telecommunications Act of 1996. Reduced to its simplest terms, the *quid* given to incumbent local-exchange carriers was permission to provide long-distance service in competition with AT&T, MCI, and other long-distance service. Congress and the FCC had previously denied the incumbents permission to compete in long distance, as the price to be paid for enjoying regulated but still-exclusive franchise monopolies over local phone service. In 1996, the *quo* taken from the incumbents consisted of those franchise monopolies.

Overall, both sides of this tradeoff aimed to inject more competition into all aspects of American telecommunications. On the long-distance side, previous law barred incumbents

created from the AT&T break-up from providing long-distance service.[13] The 1996 Act opened up long-distance markets to those incumbents, provided that they demonstrated to the FCC's satisfaction that they met a fourteen-point statutory checklist.[14] Among other criteria, an incumbent becomes eligible under the Act to compete in long-distance markets if it demonstrates to the FCC's satisfaction that it is opening up its local exchange to competition.[15]

On the local-exchange side, however, the Act also opened up many aspects of incumbents' local-service monopoly to competition. Before 1996, local telephone service was largely a regulated monopoly.[16] While one must be careful not to overstate the similarities between phone regulation in different states, state and local regulators regulated by some combination of contractual franchise and public-utility regulation, with more of the former earlier and more of the latter later.[17] (In this regard, changes in phone regulation broadly tracked changes in franchise regulation generally, as George Priest has documented.[18]) Usually, state or local utility regulators gave franchises to local-exchange carriers—to AT&T before its break-up in 1983, to the Bell Operating Companies and other incumbent local-exchange carriers thereafter. Consistent with traditional principles of utility regulation, state utilities regulated the incumbents' rates to customers for intrastate service.[19] It also gave the incumbents exclusive franchise monopolies within their territories.[20] Before 1996, AT&T and then the incumbents owed a few targeted duties to interconnect outsiders to their local exchanges--primarily to interexchange carriers (long-distance companies that needed to connect to local exchanges to reach their customers) and to competitive access providers (which connect end users to interexchange carriers through dedicated lines off of the local exchanges).[21] However, in other respects, the incumbents' franchise monopolies were largely exclusive. In particular, for the better part of the twentieth century, it was widely agreed that the incumbents owed no duty to

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[13] *See, e.g.*, CHARLES H. KENNEDY, AN INTRODUCTION TO U.S. TELECOMMUNICATIONS LAW 54-60 (1st ed., 1994).
[14] *See* 47 U.S.C. § 271(c) & §271(d)(3).
[15] *See* 47 U.S.C. § 271(c)(1)(A); *id.* § 271(c)(2)(A).
[16] *See, e.g.*, PETER HUBER ET AL., FEDERAL TELECOMMUNICATIONS LAW § 2.1.2 (2d ed. 1999).
[17] *See, e.g.*, KENNEDY, *supra* note --, at 5-17.
[18] *See* George L. Priest, The Origins of Utility Regulation and the "Theories of Regulation" Debate, 36 J.L. & Econ. 289 (1993).
[19] *See* Joseph D. Kearney & Thomas W. Merrill, The Great Transformation of Regulated Industries Law, 98 Colum. L. Rev. 1323 (1998).
[20] *See, e.g.*, Verizon Comms. v. Law Offices of Curtis Trinko, 124 S. Ct. 872, 875 (2004).
[21] *See, e.g.*, KENNEDY, *supra* note --, at 32-39.

carry signals for potential competitors in the local phone-service market.[22] Policymakers justified the exceptions on the ground that the "bottleneck" in local service created an obstacle to healthy competition in the long-distance market.[23] The exceptions, however, reinforced the basic rule that local exchanges were natural monopolies and best regulated as such.[24] Within the expectations that prevailed among policy makers, as Peter Huber, Michael Kellogg, and John Thorne explain, "[e]qual access obligations within the monopoly would have been useless or worse."[25]

Here telecommunications law followed an approach that prevailed throughout many areas of regulated-industries law for the better part of the twentieth century. This approach, however, started to recede in many of those other areas starting in the 1970s. Joseph Kearney and Thomas Merrill have thoroughly documented these changes in their article *The Great Transformation in Regulated Industries Law*. As Kearney and Merrill document, regulators and policymakers started to shift away from a New Deal command-and-control paradigm to a new paradigm that sought to "subject to ordinary contractual relations all common carrier and public utility services that can be provided by multiple competing providers."[26] For those sectors of an industry that could not be organized around ordinary principles of contract and competition, the new paradigm established "a new set of regulatory obligations--including the duty to interconnect, to lease unbundled network elements, and to sell services for resale." As Merrill and Kearney aptly explain, in the new paradigm "the owners of such bottleneck facilities . . . become[] the focal point of regulatory attention. In effect, the owners of natural monopoly facilities assume new

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[22] *See* STUART M. BENJAMIN ET AL., TELECOMMUNICATIONS LAW & POLICY 715 (2001) ("[a] central premise of the Bell divestiture was that the provision of local telephone service was a monopoly enterprise. This view had taken hold back in the 1920s and had led to the system of state-sanctioned local monopolies that both pre-dated and survived the Bell breakup."); PETER W. HUBER ET AL., FEDERAL TELECOMMUNICATIONS LAW § 2.1.2, at 86 (2d ed. 1999) ("[t]he 1996 Act reversed the presumption" that local phone service was a legal monopoly);; Picker & Lichtman, at 75 ("[T]he traditional approach to the local telephone market adopted by federal telecommunications law in its infancy and maintained up until the 1996 Act" was to "restrict competition—that is, turn away would-be competitors.").

[23] *See, e.g.*, KENNEDY, *supra* note --, at 31-32.

[24] *See, e.g.*, Verizon Communications, Inc. v. FCC, 535 U.S. 467, 475 (2002). PETER W. HUBER ET AL., FEDERAL TELECOMMUNICATIONS LAW § 2.4 (Cum. Supp. 2004) The FCC proposed new rules in the late 1980s and early 1990s to create targeted duties to interconnect, *See* PETER W. HUBER ET AL., FEDERAL TELECOMMUNICATIONS LAW § 2.4 (Cum. Supp. 2004); HUBER ET AL., *supra* note --, § 5.4; but the rulemakings only reinforced the impression that the duty broke new ground from the paradigm that prevailed at the time. *See, e.g.*, Bell Atlantic Tel. Cos. v. FCC, 24 F.3d 1441 (D.C. Cir. 1994).

[25] *See* PETER W. HUBER ET AL., FEDERAL TELECOMMUNICATIONS LAW § 2.4 (Cum. Supp. 2004). *See also* United States v. AT&T, 524 F. Supp. 1331, 1352 n.65 (D.D.C. 1981).

[26] *Id.* at 1363.

common carrier duties toward their competitors, and these duties are regarded as more important than those they owe to their traditional customers.[27] This transformation eventually reached telecommunications law. As Peter Huber, Michael Kellogg, and John Thorne explain, in telecommunications, "both state and federal regulators had been moving steadily in th[e] direction" of this paradigm shift starting in the 1980s.[28] In the early 1990s, the FCC launched regulatory initiatives to encourage incumbents to interconnect provide phone-service providers to their exchanges.[29] In the years leading up to 1996, many states established either a regime of full competition for the provision of switched local exchange service, or a statutory mandate to open their local exchanges to competition in the near future.[30]

The 1996 Act completed this change of course. It abandoned the natural-monopoly conception of local phone service for the competition-antitrust conception that had developed in other similar industries. As one supporter of the 1996 Act explained, the Act broke new ground in that it told incumbents "to let the competitors come in and try to beat your economic brains out."[31] First, the Act extinguished the incumbents' franchise monopolies by preempting all state and local laws that "prohibit[ed] the ability of entity to provide any interstate or *intrastate* telecommunications service."[32] With the exclusive franchise monopolies out of the way, sections 251 and 252 of the Act proceeded to impose "must-carry" requirements on the incumbents. Section 251(a) imposes on each incumbent a general duty to interconnect its local exchange to the facilities and equipment of other carriers.[33] To discharge this general duty, section 251(c) lays out several specific duties. The first is physical or virtual "collocation": Incumbents must provide to competitors the office space and other physical plant necessary for them to interconnect to the local exchange or to unbundled network elements.[34] Section 251(c)(4) imposes on incumbents a duty to offer at wholesale services that it provides to customers at retail, so the competitors may resell the services in competition with the

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[27] *Id.* at 1364.
[28] Huber et al., [2004 Supp.] § 2.4, at 70.
[29] *See id.* § 2.4, at 70-71.
[30] *See id.* § 2.4, at 74.
[31] 141 Cong. Rec. 15572 (1995) (remarks of Sen. Breaux), *quoted in Verizon*, 535 U.S. at 488.
[32] 47 U.S.C. § 253(a) (emphasis added).
[33] *See* 47 U.S.C. § 251(a).
[34] *See* 47 U.S.C. § 251(c)(6). Incumbents can avoid providing physical space if they can provide an adequate substitute with "virtual collocation" and show that physical collocation is not practical for technical or space reasons. *See id.*

incumbents.[35] Sections 251(c)(2) and (3) require incumbents to interconnect to competitors' local networks and to competitor unbundled network elements, respectively.[36]

The 1996 Act anticipated that the incumbent local-exchange carriers would get compensated for assuming these interconnection duties. Sections 251(c)(2), (3), and (6) specify that incumbents are entitled to charge rates that "are just, reasonable, and nondiscriminatory." With regard to interconnection and unbundled network elements (covered by 251(c)(2) and (3)), section 252(d) goes on to provide that rates that "may include a reasonable profit" and "shall be based on the cost . . . of providing the interconnection or network element."[37] Section 252(d) also specifies, however, that, whatever this term "cost" means, it must be "determined without reference to a rate-of-return or other rate-based proceeding."[38]

These provisions gave the FCC considerable leeway to identify the proper measure of "cost," rate formulas that would be "just, reasonable, and nondiscriminatory." That choice raises sensitive policy questions. On one hand, the FCC could have spread historical costs, the costs the incumbents had expended building or maintaining their exchanges in the past, by including historical costs as an element of the "cost" competitors were required to pay incumbents for forced access.[39] Distributional concerns could have justified such an approach, because the incumbents have a not-unreasonable argument that the competitors ought to share in the costs used to create and maintain the exchanges they are using to their benefit.[40] Perhaps dynamic-efficiency concerns could have justified this approach as well. Such concerns entitle incumbents to compensation, from *some* source, for stranded investments, to promote efficient research and development for local-exchange infrastructure over the long haul.[41] On the other hand, the FCC could also have insisted on leaving stranded costs where they fell. If the FCC had billed competitors for stranded costs using interconnection rates, it would have increased interconnection rates above the marginal cost of providing service through the local exchange.

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[35] *See* 47 U.S.C. § 251(c)(4).
[36] *See* 47 U.S.C. §§ 251(c)(2) & (3).
[37] *See* 47 U.S.C. § 252(d)(1).
[38] *See id.*
[39] In dissent in *Verizon*, Justice Breyer thought the text, structure, and purpose of the 1996 Act *required* this interpretation of cost. *See Verizon*, 535 U.S. at 548-49 (citing 1 A. Kahn, Economics of Regulation: Principles and Institutions 330 (1988)).
[40] *See* Richard A. Epstein, Principles for a Free Society 311 (1998).
[41] See Lichtman & Picker, *supra* note --, at 67.

That increase would then have discouraged efficiency along another axis, by discouraging the efficient use of and competition over network elements by incumbents and competitors.[42]

The FCC opted in favor of efficient use of and competition over the local exchanges.[43] When it promulgated the rate regulations for the interconnectivity provisions of section 251, the FCC interpreted "cost," "just," "reasonable," and "non-discriminatory" to require a formula based on "TELRIC"—"Total Element Long-Run Incremental Cost" pricing. When an incumbent provides a competitor access to a network element, the incumbent is entitled to the sum of TELRIC costs plus a reasonable allocation of forward-looking common costs.[44] The latter addend, "forward-looking common costs," consist of "economic costs efficiently incurred in providing a group of elements or services . . . that cannot be attributed directly to individual elements or services."[45] The regulations specify that the former addend, TELRIC costs, "should be measured based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers."[46] TELRIC rates thus keep rate payments at or below incumbents' actual costs. If someone invents a new technology that makes the local exchange more efficient than anyone in the industry could have expected, TELRIC frees the competitors from sharing the costs of the incumbents' less-than-optimal investments. The regulations reinforce this result when they exclude "embedded costs," defined as "the costs that the incumbent LEC incurred in the past."[47]

This general background brings to light most of the factual and policy issues relevant to the Takings Clause. The TELRIC regulations make clear that the FCC does not mean to use interconnectivity rates to make competitors share stranded historical costs with the incumbents that made those costs.[48] There is at least a possibility that the TELRIC regulations leave incumbents holding the bag for substantial stranded historical costs. If state and local rate-regulation proceedings have more often than not been dominated by the political demands of residential customers, pre-1996 local phone-service rates were systematically low, in which case incumbents' stranded historical costs post-1996 are now quite large. On the other hand, perhaps

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[42] Cite FCC Order. Lichtman & Picker, *supra* note --, at 67; see also Epstein, Principles, *supra* note --, at 313.
[43] *See* Order ¶ ¶ 679, 738.
[44] 47 C.F.R. § 51.505(a).
[45] 47 C.F.R. § 51.505(c).
[46] 47 C.F.R. § 51.505(b)(1).
[47] 47 C.F.R. § 51.505(d).
[48] Or assumed a fraction of AT&T's costs from AT&T when it was divested.

incumbents exerted more concentrated interest-group pressure in state and local utility proceedings than customers and the consumers' groups that represented them. If so, it is also at least plausible that the incumbents' stranded historical costs are low or non-existent. This is a crucial issue of fact to be litigated case by case, looking at the practices in the jurisdiction for which the takings claim arises. Another issue of fact inquires how valuable long-distance service is to the incumbents. On one hand, as William Baumol and Thomas Merrill maintain, perhaps incumbents will recoup a substantial portion of their stranded costs after they enter and profit in long-distance markets. On the other hand, perhaps long-distance markets are so close to perfect competition that profits in them are bound to remain quite small for the foreseeable future. And these questions of fact point to the crucial questions of policy: Whether takings protections encourage dynamic efficiency in the telephone industry or more generally throughout regulated industries; and, if so, what level of just compensation properly balances interests in dynamic efficiency against other possible policy goals.

II. THE TENSION WITHIN TAKINGS LAW

Nevertheless, a huge conceptual obstacle makes it difficult to analyze these problems within existing takings law and scholarship: There is no consensus in either takings law or takings scholarship about how to conceive of "takings" or "private property." Thomas Merrill and William Baumol have aptly described the case law: While the U.S. Supreme Court has shown "a pronounced tendency to talk tough about property rights," in some cases, it often "beat[s] a hasty retreat" in cases that involve "complex regulatory schemes generating pools of winners and losers."[49]

A. The Rivalry Between Libertarian and Realist Property Theory

While that split tendency stems from several factors, one particularly important factor is the tension between two understandings of property theory. One consists of a body of libertarian thought that has influenced constitutional property-rights law, heavily so before 1900, and to a lesser but still noticeable extent more recently. The Takings Clause was drafted by and expected by many Framers to execute principles of social-compact and natural-rights theory relating to the

[49] William J. Baumol & Thomas W. Merrill, *Does the Constitution Require That We Kill the Competitive Goose? Pricing Local Phone Services to Rivals*, 72 N.Y.U. L. REV. 1122, 1129 n.34 (1998).

protection and encouragement of property.[50] Whether or not one agrees with such theory, and whether or not one believes it ought to control contemporary takings doctrine, it still casts at least a shadow on contemporary takings issues.

On the other hand, many of the key features of the New Deal regulatory state and subsequent twentieth-century property were instituted as the result of a principled rejection of pre-1900 American natural-rights theory and its libertarian tendencies. Legal Realism and other twentieth-century schools of legal thought generated a competing account of property and regulation. This account frames questions about property, regulation, and takings in a language and a scheme of concepts that are compatible with the main aims of the post-New Deal state. Examples of such aims include, though they are by no means limited to: providing statutory or regulatory entitlements to the less advantaged; using the power of property regulation to correct perceived imbalances of power between different classes in society; and guiding or coercing individual conduct towards environmental or other public goals that individuals and decentralized markets will not achieve to the public's satisfaction. Because this approach relies heavily on ideas about property and regulation associated with the Legal Realist movement, this approach to property and takings will be described here as the "Legal Realist approach."[51] This Part, though not comprehensive, briefly sketches those two rival approaches and the features that are most relevant to understanding the issues raised by the 1996 Act.

B. Libertarian Property Theory

Consider first the libertarian approach. Virtually all writers who embrace this approach start from the claim that property reflects and encourages inherent human tendencies to work, produce, and acquire for one's own chosen ends. Chancellor James Kent, a New York state judge and an author of a leading nineteenth-century legal treatise influenced heavily by natural-rights ideas, described "the sense of property [as] graciously implanted in the human breast, for the purpose of rousing us from sloth, and stimulating us to action."[52] Jeremy Bentham made basically the same claim within a utilitarian framework: "If I despair of enjoying the fruits of my labour, I shall only think of living from day to day: I shall not undertake labours which will only

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[50] See Eric R. Claeys, *Takings, Regulations, and Natural Property Rights*, 88 Corn. L. Rev. 1549 (2003); Eric R. Claeys, "Public-Use Limitations and Natural Property Rights," forthcoming, Michigan State Law Review, 2005 (manuscript on file with author).

[51] For two thoughtful expositions of the objects of the post-New Deal regulatory state, see Cass R. Sunstein, The Second Bill of Rights (2004), and Cass R. Sunstein, After the Rights Revolution: Reconceiving the Regulatory State (1990).

[52] 1 James Kent, Commentaries on American Law 257 (1st ed. 1827).

benefit my enemies."[53] The libertarian approach accepts that claim as politically true—if not accurate in every situation, still accurate enough often enough to rely on in establishing government institutions.

Several important descriptive and prescriptive consequences follow. Descriptively, because self-love and acquisitiveness tie people's interests and attachments to what they own, the owners of assets generally have better information about how to use their assets than the government or other individuals. As Friedrich Hayek claimed, "There would be no difficulty about efficient control or planning were conditions so simple that a single person or board could effectively survey all the relevant facts. It is only as the factors which have to be taken into account become so numerous that it is impossible to gain a view of them that decentralization becomes imperative."[54]

Prescriptively, one of the overriding objects of government becomes to establish laws that recognize, take advantage of, and encourage these linkages between human initiative and external assets. As John Locke put it, the proper object of property regulation is "by established laws of liberty to secure protection and incouragement to the honest industry of mankind."[55] In one sense, when the laws promote what Locke called "honest industry," private property becomes an, or the, overriding object of government. But in another sense, the protection and encouragement of property is simply another way of saying that the law should, to the extent that it can, push policy decisions out of the hands of legislative majorities and public officials, and into the hands of individual owners. If the institution of property recognizes and works with the fact that different people have different talents, tastes, and needs, the law ought to presume that individual owners can use what is closest to them to fit their own needs more effectively than a legislative majority can with a large class of assets.

These overarching claims lead to several important claims that become relevant in takings law. First, they create a presumption that "private property" ought to be conceived of broadly. Because property ordinarily encourages tendencies that are generally productive, as a starting presumption, owners should be left with the fullest range of use rights consistent with the rights of others. Adam Mossoff has described this approach as an "integrated" approach to

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[53] Jeremy Bentham, *Principles of the Civil Code*, *in* 1 THE WORKS OF JEREMY BENTHAM 297, 310 (John Bowring ed., Edinburgh, William Tait 1843).
[54] Friedrich Hayek, The Road to Serfdom 49 (1944).
[55] John Locke, Second Treatise on Government § 42.

property.[56] Thomas Merrill and Henry Smith have called it an "*in rem*" conception of ownership.[57] The Supreme Court reflects the same understanding when it insists from time to time that "private property" normally covers "every sort of interest the citizen may possess"—not only the "vulgar and untechnical sense of the physical thing," but also "the group of rights inhering in the citizen's relation to the physical thing, as the right to possess, use and dispose of it."[58]

One important corollary of this claim is that libertarian property theory tends to resist conceiving of property solely in terms of owners' expectations or future plans. Property protects not any one concrete set of expectations but a freedom to make choices. Libertarian theory usually presumes that economic life is characterized by change more than by stasis, that owners' interests differ more than they resemble one another, and that owners are better-positioned than neighbors, rivals, or planners to know how best to use their own assets. If these generalizations describe economic life tolerably accurately, it follows that the law should protect not only owners' current plans but also their rights to change their minds. The law may take account of owners' expectations, but expectations play a largely secondary role. They are relevant to measuring owners' just compensation when they lose property rights, for strong expectations suggest that the rights taken are quite valuable to the owner. But libertarian property theory seeks to protect the freedoms to change and adapt on terms similar to the freedom to continue what one has already been doing.[59] This claim follows, as Thomas Merrill and Henry Smith explain, from a "deep design principle" by which owners are entitled to control "the future use and enjoyment of particular resources . . . that holds against all the world."[60]

Second, libertarian property theory creates a presumption that, in the absence of some compelling justification, government ought to preserve security in property by paying just compensation whenever it restrains the free exercise of property rights. Courts appreciate this connection when they say, as the Supreme Court often says in the run-of-the-mill cases, that the Takings Clause's overriding purpose is "to bar Government from forcing some people alone to

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[56] Adam Mossoff, *What Is Property? Putting the Pieces Back Together*, 45 ARIZ. L. REV. 371 (2003).
[57] Merrill & Smith, *supra* note --, at 360.
[58] United States v. General Motors Corp., 323 U.S. 373, 377-78 (1945).
[59] See Claeys, [Cornell piece], at 1607-15.
[60] Thomas W. Merrill & Henry E. Smith, *What Happened to Property in Law and Economics?*, 111 YALE L.J. 357, 359, 361 (2001).

bear burdens which, in all fairness and justice, should be borne by the public as a whole."[61] If society makes a strong commitment to protecting and encouraging property rights, the common good seems is the aggregation of the rights of all citizens. That relation entitles the government to act for the common good by taking property for public uses, but at the same time it requires the government to spread private losses across the entire public. The compensation may come in-kind, through other consequences of the government action, or explicitly, through a cash payment. In either case, the owner is entitled to the fair value of rights extinguished by government actions.

In utility law, that preference creates at least some presumption that, other things being equal, utilities' investments and franchise rights count as constitutionally protected "private property." This presumption explains an otherwise strange feature about takings law. If one were to read the leading Supreme Court takings cases and scholarship, it would be reasonable to suspect that utilities should not be protected by takings principles. The leading cases and scholarship tend to focus on regulatory-takings issues associated with land, and particularly land use. These authorities generate strong pressures to say that "takings" principles were originally meant to apply only to outright interferences with title ownership and the right to exclude.[62] If the law were to follow this claim to its logical conclusion, takings protections should apply to utilities only barely, if at all. In fact, the law reflects some inchoate intuition that takings principles capture the risks associated with stranding utility companies' investments. Utility regulation generates hundreds if not thousands of judicial and administrative takings disputes.[63] Courts and commentators may disagree about the substance of takings principles as they apply to utilities, but at some minimal level they agree that, in John Drobak's words, "constitutional ratemaking doctrine embodies the principles of the takings clause."[64]

Third, the libertarian approach presumes that it is conceptually possible and substantively necessary to enforce a relatively fixed conception of the power to "regulate." That conception

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[61] Armstrong v. United States, 364 U.S. 40, 49 (1960).
[62] *See* Tahoe-Sierra Preservation Council v. Tahoe Regional Planning Agency, 535 U.S. 302, 321-22 (2002); John F. Hart, *Land Use Law in the Early Republic and the Original Meaning of the Takings Clause*, 94 NW. U. L. REV. 1099 (2000); John F. Hart, *Colonial Land Use Law and Its Significance for Modern Takings Doctrine*, 109 HARV. L. REV. 1252 (1996); William Michael Treanor, *The Original Understanding of the Takings Clause and the Political Process*, 95 COLUM. L. REV. 782 (1995).
[63] *See* John Drobak, *From Turnpike to Nuclear Power: The Constitutional Limits on Utility Rate Regulation*, 65 B.U.L.REV. 65, 65-66 & n. 1 (1985).
[64] Drobak, *supra* note --, at 68.

provides the main justification for taking property without compensation, for laws that "regulate" may restrain property without triggering just-compensation requirements. In libertarian theory, "regulations" are primarily laws that "make property rights regular"—laws that define the zone of free use, control, and transfer rights that are fairly proportional to any asset, laws that define and enforce abuses of those rights, and laws that facilitate the orderly use and transfer of property.[65]

That general understanding of "regulation" narrows the permissible grounds for "regulating" the property conflicts that arise in telecommunications law. In telecommunications, the main "regulatory" limit allows government to restrain operators' rights to exclude and control their rates. Under any understanding how to apply general social-compact principles, even an understanding especially jealous of private property, when an owner receives a monopoly from the state, he cedes the right to exclude customers on any basis.[66] When the state grants him control over an asset with an obvious public use, it imposes on him the responsibility to ensure that the asset is used consistent with the rights of all. In general, then, the owner assumes a duty not to discriminate among customers, and to sell or rent the monopoly good at rates reasonable in comparison with rates of return for comparable investments.[67] That general proviso still leaves the state with choices about how to enforce the basic substantive limitation. As explained in the previous part, traditional common-carrier principles apply this limitation to the utility in relation to its customers, while contemporary antitrust/bottleneck principles apply the limitation between the utility and its competitors. In either case, utilities retain all property rights not necessary to enforce this substantive understanding of *publici juris* regulation. When a law restrains the free use of property more than necessary to enforce this understanding of "regulation," it therefore "takes" the property rights of the utility.

Last, libertarian property theory encourages lawyers to think of property in "formalist" terms, specifically by treating different takings cases as analogous. This claim follows from

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[65] See Claeys, Cornell, at 1553-55; Richard A. Epstein, The "Necessary" History of Property and Liberty, 6 Chapman Law Review 1, 2-3 (2003).

[66] The best illustration of this position, even by a judge jealous of private-property rights, comes from Justice Field's dissenting opinion in Munn v. Illinois, 94 U.S. 113 (1877).

[67] *See* Munn, *supra*; Spring Valley Water Works v. Schottler, 110 U.S. 347, 354 (1883); Railroad Comm'n Cases, 116 U.S. 307, 331 (1886); Reagan v. Farmers Loan & Trust Co., 154 U.S. 362 (1894). For a historical perspective on *Munn* and the concept of *publici juris*, see Harry N. Scheiber, *The Road to* Munn*: Eminent Domain and the Concept of Public Purpose in the State Courts*, *in* LAW IN AMERICAN HISTORY 327, 338-55 (Donald Fleming & Bernard Bailyn, eds., 1971).

libertarian theory's expansive "integrated" or "*in rem*" conception of property rights. If all owners are presumptively entitled to the enjoyment of the fullest range of rights possible, if an owner in a case involving land wins just compensation for losing a particular right in the proverbial bundle, the decision presumptively counts as precedent for protecting that same right to dispose in the context of water rights, franchises, or intellectual property. Of course, that presumption can be reversed. If one can show that the exercise of a specific right will be harmful to the public or disadvantageous to the rights of all for one species of property when it is not so harmful or disadvantageous in other contexts, that difference can create grounds for "regulation" unique to the species for which the concerns arise. Separately, the same right may be more or less valuable for different species of property. But under libertarian principles, as long as the basic starting presumption has not been rebutted, it is possible to compare and contrast rights like use, control, and transfer across a wide range of species of property. If a given right seems more valuable to one species than to another, that difference can be considered not when determining whether a taking has occurred; rather, a taking *has* occurred, and this difference goes to determining how much to pay for it in just compensation. What seem like clever analogies, then, are in fact an expression of a deep commitment to protect owners' expectations that, as long as they do not threaten their neighbors, they will retain control over the use and enjoyment of their property to the exclusion of the rest of the world.

C. The Realist Approach

The Realist approach breaks with the libertarian approach on a wide range of fronts. Most fundamentally, it questions the account of human nature that grounds the libertarian approach. For instance, Margaret Jane Radin has challenged the libertarian arguments of Richard Epstein because she questions Epstein's "Hobbesian model of human nature," within which "[n]othing will get produced unless people are guaranteed the permanent internalization of the benefits of their labor."[68] By calling that claim into question, the Realist approach expands the realm of the possible for the state. If selfish industrious, productive, and acquisitive passions do not limit and therefore channel state action, the state has more reason to assume it is realistic to achieve a wider range of goals. The general welfare, as determined by an encompassing majority, becomes the overriding object of legislative policy. By the same token, property

[68] Margaret Jane Radin, *The Liberal Conception of Property: Cross Currents in the Law of Takings*, 88 Colum. L. Rev. 1667, 1683 (1988).

becomes subordinate, one of many possible goals such a majority might or might not choose to pursue. As Frank Michelman recognized, once a state has embraced "the economically active and regulatory state with its licenses, franchises, and the like . . . the claims of popular sovereignty and classical property cannot, in truth, be stably reconciled at a very high level of abstraction or generality."[69]

The character of property changes to match these changes in the horizons of possible political action. First, if property is "integrated" within the libertarian approach, it is "disintegrated" in the *Penn Central* approach.[70] That is why, for instance, Legal Realist defined "property" in the 1937 edition of the *Encyclopedia of the Social Sciences* as "a euphonious collection of letters which serves as a general term for the miscellany of equities that persons hold in the commonwealth."[71] That is also why *Penn Central* warned that "'[t]aking' jurisprudence does not divide a single parcel into discrete segments and attempt to determine whether rights in a particular segment have been entirely abrogated."[72] To borrow Thomas Merrill and Henry Smith's description, the Realist/*Penn Central* approach applies a "list of uses" approach to property: "as a list of particularized use rights that individuals have in resources."[73]

This "list of uses" understanding of property creates a slight presumption, which is rebuttable but no less perceptible, against recognizing particular use rights as "property." As Thomas Merrill and Henry Smith describe the nerve of Realist property theory, "property has no fixed core of meaning, but is just a variable collection of interests established by social convention [that] the state [may] freely expand or . . . contract . . . in the name of the general welfare."[74] From this starting perspective it follows that owners ought not to be entitled to property in specific control, use, or transfer rights unless and until they can show that such rights contribute to the general welfare. In individual cases, owners may be able to make this showing. But where the libertarian approach presumes that particular rights are useful and part of "property" until specifically shown to be harmful, the *Penn Central* approach presumes that particular rights are not useful until specifically shown to redound to the general welfare.

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[69] Frank I. Michelman, *Takings, 1987*, 88 Colum. L. Rev. 1600, 1627, 1628 (1988).
[70] Thomas C. Grey, The Disintegration of Property, NOMOS XXII: PROPERTY 69 (1980).
[71] 11 ENCYCLOPEDIA OF THE SOCIAL SCIENCES 528 (1937), *quoted in* Thomas W. Merrill, *Property and the Right to Exclude*, 77 NEB. L. REV. 730, 738 (1998).
[72] Penn Central Transp. Co. v. City of New York, 438 U.S. 104, 130 (1978).
[73] Merrill & Smith, supra note --, at 366.
[74] Thomas W. Merrill & Henry E. Smith, *What Happened to Property in Law and Economics?*, 111 YALE L.J. 357, 365 (2001).

To be sure, within the *Penn Central* approach, property still means more than the right to use one's own consistent with the state's conception of what contributes to the general welfare. But to determine whether owners have special attachments to any stick in the proverbial bag of rights, "private property" tends to focus on owners' expectations. Frank Michelman contributed to this view when he argued that, for takings purposes, "private property" ought to be conceived of largely in reference to an owner's "investment-backed expectations."[75] The U.S. Supreme Court embraced Michelman's argument by making "investment-backed expectations" a crucial element of regulatory-takings law in *Penn Central*.[76] This focus subtly builds in a presumption that owners are *not* entitled to claim property rights in development potential, or more generally in the right to put existing property to new and different uses.

Next, because the *Penn Central* approach presumes that many different social policies may be desirable in different circumstances and for different people, it tends to doubt that the law can draw clear distinctions between government actions that "regulate" and "take." This tendency comes out most often in law and scholarship about the concepts of "harm" and "benefits." In *Lucas v. South Carolina Coastal Council*, Justice Scalia explained, "The transition from [the Court's] early focus on control of 'noxious' uses to [its] contemporary understanding of the broad realm within which government may regulate without compensation was an easy one, since the distinction between 'harm-preventing' and 'benefit-conferring' regulation is often in the eye of the beholder."[77] Frank Michelman lent a great deal of respectability to this view in his 1967 article *Property, Utility, and Fairness*, which concluded that "there is no basis for a general rule dispensing with compensation in respect of all regulations apparently of the 'nuisance-prevention' type."[78] If one subscribes to such sentiments, one is much more skeptical than the libertarian approach would suggest that the law can maintain clear distinctions between "regulations" and "takings"—in nuisance law, in common-carrier law, or anywhere else.

Finally, where the libertarian approach presumes that the law can draw analogies about the same right from one species of property to another, the Realist approach presumes the opposite. This presumption follows because the Realist approach prefers to treat questions of property on a right-by-right basis, and it expects different legislative majorities in different

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[75] Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation*, 80 Harv. L. Rev. 1165, 1211-13 (1967).
[76] *See* Penn Central Transp. Co. v. City of New York, 438 U.S. 104, 124 (1978).
[77] 505 U.S. 1003, 1024 (1989).
[78] Michelman, [Property, Utility, Fairness,] *supra* note --, at 1197.

settings to use the power to regulate to different ends. Thus, Margaret Jane Radin praises the Realist approach because it is "ad hoc," because it "is essentially particularist, essentially context-bound and holistic; each decision is an all-things-considered intuitive weighing."[79] As Frank Michelman explains, "the emergence of the economically active and regulatory state" creates a strong trend toward the "denaturalization and positivization (implying the politicization) of property."[80] Under those assumptions, it becomes more difficult to claim that property protects a regular set of expectations common to different species. If anything, as Frank Michelman says, it is "obtuseness" to assume that there is any such commonality, or to analogize between different species by using the forms of property rights.[81]

III. THE 1996 ACT AND TENSIONS UNDER THE TAKINGS CLAUSE

Both of these approaches are well-represented in the law and scholarship on takings. The fundamental tensions between these two approaches help make takings law and scholarship as rich and interesting as they are. At the same time, those tensions also set traps for the unwary. A takings doctrine that seems straightforward on the surface can vary wildly in application depending on whether the libertarian or the Realist understanding seems to fit better with a judge's or policymaker's views on the facts of a challenged regulation. That tension seems to be informing the debate over the local-exchange provisions of the 1996 Act.

A. Rate-of-Return Takings Versus Regulatory Takings

Consider first a meta-question—whether the 1996 Act ought to be reviewed as a rate-of-return or ratemaking case or a "regulatory taking" case. Broadly speaking, controlling Supreme Court precedent recognizes three categories of takings principles: ratemaking cases, which entitle the regulated entity to claim a taking if it does not receive a reasonable rate of return on capital it has invested; *per se* rules, which entitle the claimant to claim just compensation for a regulation with specified features; and balancing rules, which apply as a backstop to regulations that do not have the features that trigger *per se* compensation rules.

Many telecommunications lawyers agree that rate-of-return principles do and should govern takings challenges to the local-exchange provisions of the Act and the FCC's regulations.

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[79] Radin, *supra* note --, at 1680.
[80] Frank I. Michelman, *Takings, 1987*, 88 Colum. L. Rev. 1600, 1627 (1988).
[81] Michelman, 1988, 1628.

Stuart Buck,[82] Michael Legg,[83] and Jim Chen[84] have all assumed as a matter of course that rate-of-return principles will apply and that regulatory-takings principles will not. As Chen puts it, "the Supreme Court . . . has consistently distinguished takings clause restraints on ratemaking from the takings clause doctrine that governs physical occupations of real property."[85] There are reasons to support this view. For instance, in *Verizon*, the Supreme Court applied to the takings issues it discussed leading rate-of-return precedents including *Smyth v. Ames*, *FPC v. Hope Natural Gas*, and *Duquesne Light Co. v. Barasch*.[86]

At the same time, it is not nearly as easy to classify these local-exchange takings challenges as these authorities suggest. These authorities beg important normative questions about which approach to takings principles ought to apply, and these normative questions are informed at least in substantial part by overarching questions about property theory. There are several reasons to prefer the rate-of-return model, but at least some of them "fit" Realist background assumptions about takings law. Within those assumptions, it makes a great deal of sense to keep rate-of-return and regulatory-takings precedents separate. *Penn Central* claims that all takings cases are "*ad hoc*," and it warns lawyers and judges off from using "conceptual severance" and other formalistic tools to draw analogies across different classes of takings cases.[87] If one agrees with that sentiment, it makes comparatively little sense to organize takings analysis around the property rights taken. By the same token, however, it makes a great deal more sense to organize the law around the economics and industry where the alleged takings occur. Factors that seem *ad hoc* from the standpoint of takings law may be salient and regular features of an industry's business structure. If so, rate-of-return principles ought to govern presumptively in telecommunications and other regulated industries. By contrast, regulatory-takings principles ought to govern in real-estate cases, and otherwise act as a backstop only for the takings cases that are hard to classify.

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[82] See Stuart Buck, TELRIC v. Universal Service: A Takings Violation?, 56 Fed. Comm. L.J. 1, 38 (2003) ("the confiscatory rate doctrine by definition relates to an unfair rate structure, which would be precisely the [incumbents'] complaint").

[83] Michael J. Legg, Verizon Communications, Inc. v. FCC—Telecommunications Access Pricing and Regulatory Accountability Throught Administrative Law and Takings Jurisprudence, 56 Fed. Comm . L.J. 563, 581-84 (2004)

[84] See Chen, at 1686.

[85] Jim Chen, The Nature of the Public Utility: Infrastructure, the Market, and the Law, 98 Nw. U. L. Rev. 1617, 1685 (2004) (book review of Gosé A. Gómez-Ibáňez, Regulating Infrastructure: Monopoly, Contracts, and Discretion (2003)).

[86] *See* Verizon, 535 U.S. at 624 (citing Duquesne Light Co. v. Barasch, Smyth v. Ames, and FPC v. Hope Natural Gas.)

[87] Cite Penn Central.

But if one subscribes to a libertarian understanding of property, these arguments do not seem compelling. Again, the libertarian approach pays a great deal of respect to the forms of private property. Rights are important proxies for zones of freedom that allow owners to do productive things and hedge against uncertainty and change. Rate-of-return cases focus on whether the state is "regulating" the dangers of monopoly by limiting a utility's profits to a reasonable level and by requiring it to provide access to the public. By contrast, the 1996 Act extinguishes rights to exclude—the incumbents' franchises, and their rights not to interconnect competitors. Now, as section III.C will make clear, rate-of-return considerations may be relevant to the incumbents' entitlement to just compensation. As Stuart Buck recognizes, if the law were to conclude that there had been a regulatory taking, "the real question would then become: Does the price structure allowed to the [incumbents] amount to just compensation or not," a question for which the law "would likely have to consult the confiscatory rate doctrine."[88]

Even so, if one subscribes to general libertarian background assumptions, at the takings stage, rate-of-return cases raise the wrong question. Under this framework, rate-of-return regulations raise questions about whether regulators are holding incumbents to an unacceptably low level of return, but exclusivity regulations raise questions about whether the regulators have extinguished the means by which utilities can recover any return at all. Those latter concerns are typically the concerns of regulatory-takings law.

B. Taking a Common Carrier's Right to Exclude Competitors

But the key takings issues do not decide themselves simply because one has chosen to analyze the Act under regulatory-takings principles instead of rate-of-return principles. "Regulatory takings" law is deeply split in its tendencies. Some portions of the law incline toward the libertarian approach, others toward the Realist approach. The former tend toward categorical, or *per se*, rules concluding that so-called regulations inflict takings; the latter tend to apply the most nuanced and deferential understanding of *Penn Central*.

To appreciate the tensions, it is worthwhile to dispel a perception that causes a great deal of confusion in the commentary on takings law. Many commentators portray the categorical and balancing regulatory-takings cases as two sharply, almost hermetically-separate, fields of

[88] Buck, supra note --, at 36.

takings law.[89] This portrait, while accurate and useful in some respects, is highly misleading in others—particularly in its tendency to elevate black-letter doctrine over substance.

Whenever the U.S. Supreme Court creates a *per se* rule, it does so after making a substantive policy choice. All of the Supreme Court's recent regulatory-takings cases, balancing or categorical, respect *Penn Central* as the "polestar" of regulatory-takings law.[90] As a result, all apply *Penn Central*'s three-part test, balancing the owner's economic losses and the owner's lost reasonable investment-backed expectations against the character of the government action.[91] This test leads to categorical rules in some cases and all-the-factors balancing in others because different cases strike courts differently on the merits. Courts then appeal to either the libertarian or Realist understandings of property to reinforce their intuitions about the substance of the property and regulation at issue, and then tilt the *Penn Central* balance appropriately. If, for substantive reasons, the property right at issue seems socially valuable in a wide range of contexts, courts conclude under the second prong that owners have strong expectations in enjoying that right. They then turn to the third prong and discount the character of government action third prong by the extent to which they interfere with the free exercise of that right. The first prong, the owner's economic losses, has little or no impact at the takings stage; courts consider those losses later, at the just-compensation stage.[92]

On the other hand, if the regulation under challenge seems to have more social value than the property interest claimed, the balancing changes. Courts profess strong rational-basis deference—*Penn Central* calls it "reasonable relationship" deference[93]--to the government action. This deference tacitly presumes that the property right at issue has little or no social value worth protecting over the constitutional long term. Courts then use the first and second prongs to narrow the owner's ability to claim the right at issue as constitutional "private property." They protect the owner's interest in the claimed right only if the owner can show that by dint of long effort and investment she has acquired strong expectations in protecting that

[89] *See, e.g.*, Buck, supra note --, at 35-38; Legg, supra note --, at 581-82.
[90] *See Tahoe-Sierra*, 535 U.S. at 336 (quoting Palazzolo v. Rhode Island, 533 U.S. 606, 636 (2001) (O'Connor, J., concurring)).
[91] *See Penn Central*, 438 U.S. at 124.
[92] *See* Claeys, Northwestern, *supra* note --, at --; Claeys, Cornell, *supra* note --, at 1556-58.
[93] *See Penn Central*, 438 U.S. at 131.

right. Likewise, the owner's economic losses must be viewed in context with and discounted by the gains she can make from the uses the law leaves her to make of her property.[94]

Much of the scholarship relevant to the 1996 Act does not sufficiently appreciate these features of regulatory-takings case law. In particular, the local-exchange provisions of the 1996 Act raise a crucial policy question that could be decided in one of many ways under existing regulatory-takings precedent: Should common carriers entitled to exclude competitors and other outsiders on the same terms as land owners, intellectual-property owners, and owners of other forms of property?

Consider first the debate between Daniel Spulber and Christopher Yoo on one hand and Jim Chen on the other about physical-takings law. This debate focuses on the provisions of section 251 that impose on incumbents duties of physical collocation and interconnection. Under section 251(c)(6), local exchange carriers owe a "duty to provide . . . for physical collocation of equipment necessary for interconnection or access to unbundled network elements at the premises of the local exchange carrier," unless the incumbent can show that physical collocation is impractical.[95] Collocation clearly establishes a "physical" taking in the most literal sense, for it requires incumbents to make office space and physical plant available to competitors.[96] The interconnection provisions in sections 251(c)(2) and (3) create more strained analogies—a fact that Spulber and Yoo tacitly acknowledge when they describe interconnection as "virtual collocation."[97] As soon as a collocation ceases to be physical and becomes "virtual," as a matter of black-letter doctrine it falls outside the *per se* category for physical takings.[98]

However, takings doctrine is not as rule-bound and is much more policy-oriented than either Chen or Spulber and Yoo assume. To appreciate the discrepancy, it helps to consider how the Supreme Court first announced the *per se* rule for physical occupations, in *Loretto v. Teleprompter Manhattan CATV Corp*.[99] A New York state law authorized cable companies to install cable lines and directional taps on landlords' buildings, to service not only the tenants but also other buildings in the neighborhood. The Court respected *Penn Central* as the leading

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[94] *See* Claeys, [Cornell], *supra* note --, at 2647-48.
[95] 47 U.S.C. § 251(c)(6).
[96] *See* Spulber & Yoo, supra note --, at 977 (citing Qwest v. United States, 48 Fed. Cl. 672 (2001), 1021 (citing GTE Northwest v. Public Utility Commission, 900 P.2d 495 (Or. 1995)).
[97] Spulber & Yoo, supra note --, at 979.
[98] *See* Chen, *supra* note --, at 1685 & n. 474 (citing, *inter alia*, FCC v. Fla. Power Corp., 480 U.S. 245, 252 (1987); Pennell v. City of San Jose, 485 U.S. 1 (1988)).
[99] 458 U.S. 419 (1982).

regulatory-takings case,[100] but then used the second and third prongs to require compensation *per se* whenever the government permanently and physically occupies property.[101] Much of the Court's analysis focused on owners' expectations in relation to controlling their land: The "power to exclude [is] one of the most treasured strands in an owner's bundle of property rights."[102] Because the Court regarded an invasion of land as "perhaps the most serious invasion of an owner's property interests,"[103] it then downgraded the third prong, the character of the government action. It explained that "when the character of the government action is a permanent physical occupation of property, our cases uniformly have found a taking to the extent of the occupation, without regard to whether the action achieves an important public benefit or has only minimal economic impact on the owner."[104] Now, it may well be the case that cable junction boxes are different from franchise and no-interconnection rights. Perhaps owners invest themselves in land to an extent that they do not in intangible forms of property,[105] in which case the second and third prongs of the *Penn Central* balance would count occupations differently in telecommunications from land. But that issue presents questions of property theory and regulatory policy, not doctrine.

Furthermore, the theoretical issues present themselves in more compelling fashion if one turns to other, less-known takings cases analogous to the Act's local-exchange provisions and regulations. Some of these analogies support the incumbents' claims more closely than *Loretto* does. In these cases, the government takes the right to exclude without forcing the owner to submit to a permanent occupation similar to the taking in *Loretto*. These cases have not been understood to fashion a *per se* compensation rule comparable to *Loretto*'s rule. Nevertheless, they do suggest this much: When a government extinguishes an owner's right to exclude, the law definitely tilts the *Penn Central* calculus to account for chilling effects caused when a law interferes with the right to exclude.

Consider how to analogize from the local-exchange provisions of the Act to the regulation of land, starting with section 251's interconnection provisions. These provisions are analogous formally to easements and rights of way. When the government establishes an

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[100] *Loretto*, 458 U.S. at 426, 432.
[101] *Loretto*, 458 U.S. at 427; *see id.* at 434-37.
[102] *Id.* at 435.
[103] *Id.* at 435.
[104] *Id.* at 434-35.
[105] See, e.g., id. at 432: "physical invasion cases are special".

easement or right of way on an owner's property, it leaves the owner in broad control of the property; it does not oust her in favor of some other owner, while eliminating the land owner's sense of total control over the property and significantly diminish her power to use the property for her own chosen ends. The Court's "exactions" cases supply important precedents for treating rights of way as takings, for they have applied *per se Loretto* principles to declare rights of way to be takings.[106]

However, the most analogous right-of-way case is *Kaiser Aetna v. United States*, which captures ambiguities between private property and public trust in land law that parallel the ambiguities between private property and common-carrier status in utility law.[107] Kaiser Aetna owned land around a Hawaii lagoon completely sealed off from the Pacific Ocean. Under Hawaii law, the lagoon was private property, unencumbered by any public-trust servitude, on the same terms as the dry land around the lagoon. As part of a project to develop the land around the lagoon, Kaiser Aetna dug a channel connecting the lagoon to a nearby bay. Before it dug, it notified U.S. Army Corps of Engineers staff, who acquiesced with little comment. After it dug, however, the Corps claimed that the channel subjected Kaiser Aetna's lagoon to the federal navigational servitude.[108] *Kaiser Aetna* is especially analogous to the 1996 Act because the owners' private-property rights stand in the same gray area. In telecommunications law, the incumbents (and before them AT&T) have never held an unqualified right to exclude. Their franchise agreements generally gave them the right to exclude competitors from using their local exchanges, but there have been some exceptions to that general principle, and in any case common-carrier regulations have always denied them the right to exclude customers who want local phone service. Similarly, as long as Kaiser Aetna's lagoon was not connected to the Pacific Ocean, it was private property. But as soon as Kaiser Aetna made it useful by connecting it to the Pacific, there was a substantial possibility that it would become *public juris*. In both cases, this ambiguity clouds the question whether there is "private property" in the claimed right to exclude.

In *Kaiser Aetna*, the Court resolved this ambiguity in by appealing to the idea that "'not all economic interests are "property rights"; only those economic advantages are "rights" which

[106] *See, e.g.*, Dolan v. City of Tigard, 512 U.S. 374 (1994); Nollan v. California Coastal Commission, 483 U.S. 825 (1987).
[107] 444 U.S. 164 (1979).
[108] *See id.* at 166-69.

have the law back of them.'"[109] The Corps' conduct, he concluded, led "to the fruition of a number of expectancies embodied in the concept of 'property'—expectancies that, if sufficiently important, the Government must condemn and pay for."[110] The Corps' regulatory behavior thus led Kaiser Aetna to have private property. While Kaiser Aetna retained the rights to use and generally to possess and control the lagoon, it lost the right to exclude outsiders. It "lost one of the most essential sticks in the bundle of rights that are commonly characterized as property—the right to exclude."[111] That loss tipped the *Penn Central* balance decisively in favor of Kaiser Aetna because it made the company's expectations exceedingly severe.[112]

Along the same lines, if section 251 can be viewed as establishing telecommunications' equivalent of a right of way, section 253 can be viewed as extinguishing telecommunications' equivalent of an intellectual-property right. Again, pre-1996, incumbents (and before them, AT&T) enjoyed franchise monopolies under state or local law to provide local phone service on an exclusive basis. Section 253 preempted any and all local franchise laws still in effect when the 1996 Act took effect. Section 253 thus extinguished incumbents' right to exclude in a manner similar to an intellectual-property owner faces when the government extinguishes his right to sue and enjoin infringements of the intellectual property.

The Supreme Court has rendered very few takings decisions about intellectual property, but the leading recent case follows the same approach as *Kaiser Aetna*: The *Penn Central* balance tipped in favor of the owner because the law in question extinguished the intellectual-property owner's right to exclude. That case is *Ruckelshaus v. Monsanto Co.*[113] In *Monsanto*, Congress changed federal pesticide-registration laws so as to authorize the EPA to disclose manufacturer trade secrets it had previously been required to keep confidential. In other words, Monsanto and other pesticide manufacturers still retained the right to use the ideas in their trade secrets, but they lost the right to exclude others from using those ideas. The Court recognized that "the right to exclude others is central to the very definition of the property interest" for which just compensation was sought. Even though Monsanto, again like Kaiser Aetna, and like incumbents post-1996, did not lose all of its property when the law extinguished its right to exclude, the Court insisted: "That the data retain usefulness for Monsanto even after they are

[109] *Kaiser Aetna*, 444 U.S. at 178 (quoting United States v. Willow River Co., 324 U.S. 499, 502 (1945)).
[110] *Id.* at 179.
[111] *Id.* at 176.
[112] *See id.* at 179-80.
[113] 467 U.S. 986 (1984).

disclosed . . . is irrelevant to the determination of the economic impact of the [EPA] action on Monsanto's property right. The economic value of that property right lies in the competitive advantage over others that Monsanto enjoys by virtue of its exclusive access to the data, and disclosure or use by others of the data would destroy that competitive edge."[114] That factor caused *Penn Central*'s expectations prong to tip decisively in favor of Monsanto.[115]

On the other hand, other regulatory-takings decisions beckon to a Realist resolution, with analogies more favorable to Congress and the FCC. The most pertinent analogies are to the Supreme Court's case law on rent-control regulations. Rent-control laws test the lines between *Penn Central* balancing and *Loretto per se* compensation, again in ways that parallel the rights affected by the 1996 Act. Rent-control laws parallel section 251's interconnection provisions in that they relate in part to the right to exclude, for a tenant may not move into an apartment until the apartment owner has in one way or another surrendered the right to exclude. They also parallel section 252's rate-regulation provisions because they restrict the price the landlord may set for surrendering his right to exclude.

The rent-control cases are especially revealing because they highlight the tensions between the libertarian and Realist renditions of *Penn Central*. The right to exclude raises parallels to *Loretto* and *Kaiser Aetna*, while the right to price-discriminate seems a less central right and raises parallels to deferential cases under *Penn Central*. At a high level of generality, the Supreme Court settles rent-control cases on the basis of a factor it calls "required acquiescence." The legal notion of required acquiescence has its roots in another case involving the FCC—*FCC v. Florida Power Corp.* The law under challenge in *Florida Power Corp.* regulated the negotiations between local utility companies and cable companies that wanted to buy or lease access to their utility poles. The law did not deserve *Loretto* treatment because it concentrated only on regulating prices; it did not impose on the utilities any duty to provide the cable companies with access to their poles. In the Court's explanation: "it is the invitation, not the rent, that makes the difference. The line which separates [this case] from *Loretto* is the unambiguous distinction between a ... lessee and an interloper with a government license."[116] By inference, if the law in question gives an interloper license to trespass, it triggers the concerns

[114] *Monsanto*, 467 U.S. at 1011-12.
[115] *Id.* at 1011. For more detailed elaboration on the ideas in this paragraph, see Richard A. Epstein, *The Constitutional Protection of Trade Secrets Under the Takings Clause*, 71 U. CHI. L. REV. 57 (2004).
[116] 480 U.S. 245 (1987), *quoted in Yee*, 503 U.S. at 527-28, 532-33.

that informed *Loretto*, *Kaiser Aetna*, *Monsanto*, and other cases that apply *Penn Central* in a libertarian spirit. Its social character must then be discounted for the extent to which it chills the expectations that owners hold in the free use and control over their property.

But many of the rent-control cases follow Realist tendencies much more than cases such as *Florida Power Corp.* would suggest. The Supreme Court generally does not believe that governments will disrupt owner expectations or encourage bad social consequences if they restrain landlords' power to rent at the prices of their choosing.[117] Moreover, if a rent-control law deprives a landlord of a few incidents of the right to exclude while still respecting his right to get out of the business, the law does not raise the same concerns about chilling effects as *Loretto*. Thus, in *Yee v. City of Escondido*, the Supreme Court declined to give *per se Loretto* treatment to a law that restrained trailer-park landlords' rights to veto tenants' attempts to assign their leases.[118]

These case analogies suggest that the key issues are not doctrinal but substantive—and particularly the sorts of issues that divide libertarian property theory from Realist property theory. To conclude that the incumbents deserve just compensation, one must first conclude that many behavioral claims from the libertarian approach to property describe the effects of the 1996 Act, and that many normative claims from that approach require just compensation. The most important of these claims run as follows. Common carriers have substantially as much interest in and claim to the right to exclude competitors as do land owners and intellectual-property owners. This claim may follow as a matter of general principles about reaping and sowing. But it may also follow because investments in telecommunications are especially deep and precarious in comparison to other industries, in which case there is a special need for credible commitments to protect telecommunications investments from confiscatory legislation.[119]

If this starting presumption is valid, it is not crucial that the right to exclude plays different roles for land owners, intellectual-property owners, and utilities. Takings law can

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[117] *See* Pennell v. City of San Jose, 485 U.S. 1 (1988) (reaching this conclusion as a matter of constitutional due-process and equal-protection principles).
[118] 503 U.S. 519 (1992).
[119] Brian Levy and Pablo Spiller have collected several especially thorough studies of this relationship in Regulations, Institutions, and Commitment: Comparative Studies of Telecommunications (Brian Levy & Pablo T. Spiller eds., 1996). I do not have the expertise to say whether these studies, which focus on telecommunications regulation in the United Kingdom and other countries outside the United States, are directly relevant to American telecommunications regulation. But the studies do an excellent job of framing the economic and regulatory questions relevant to the property questions addressed in this Article.

adjust for any differences between different species of property when it comes time to determine just compensation. Nor is it crucial to inquire whether particular state or local franchise agreements guaranteed to incumbents in clear terms the right to exclude competitors for their networks. The incumbents' rights and regulatory treatment, in *Kaiser Aetna*'s words could still have led "to the fruition of a number of expectancies embodied in the concept of 'property'—expectancies that, if sufficiently important, the Government must condemn and pay for."[120] Takings law encourages dynamic innovation and development with property, because it encourages all species of property owners to rest assured that they will be held harmless if the government extinguishes their rights to control the use and enjoyment of their assets by controlling the exclusion and access of outsiders.

Finally, a good libertarian would probably find this result to make practical sense. Even if the incumbents have suffered a *per se* or near *per se* taking, that conclusion does not require Congress to pay the incumbents any money—it simply requires a fair inquiry into whether the incumbents have received just compensation. The more that the incumbents (and AT&T before them) have already recovered a fair or even excessive return on the capital they have invested in local exchanges in state and local ratemaking proceedings, the less they will deserve in just compensation. Similarly, the higher the profits that the incumbents recover in the long-distance industry post-1996, the less they will deserve in just compensation. A *per se* or near-*per se* taking rule would require Congress simply to make up any shortfall left by these two sources and the FCC's TELRIC payments. Within libertarian horizons, such payments would be a small price to pay to encourage dynamic efficiency over the long term.

On the other hand, to conclude that Congress and the FCC ought to prevail, it helps to appeal to corresponding behavioral and normative claims that issue from the Realist understanding of property. Within this understanding, one presumes that the right to exclude, like any other formal right, is *not* transferable from land and intellectual property to common carriers unless specific evidence suggests otherwise. And a Realist could plausibly conclude that that there is not enough evidence to rebut this presumption. Land might be special because it is tangible and because Americans by long history and tradition have built up strong expectations about it. Intellectual property rights might be special because their monopolies are more exclusive and less far-reaching than utilities'. Telecommunications companies, by contrast, have

[120] 444 U.S. at 179.

never had an unqualified right to exclude. They have always owed a duty to provide access to customers. While they may have enjoyed the right to conduct the operations of their franchises exclusively, the broad distinctions between the exclusive and open aspects of their businesses have always left gray areas. One particularly telling gray area is the duty to interconnect competitive access providers, which the FCC imposed on the incumbents by regulation in the 1980s. Similarly, as William Baumol and Thomas Merrill have argued, many state and local franchise agreements did not specifically guarantee that incumbents would enjoy exclusive control over local exchanges; they merely provided a "permissive authorization" to build such exchanges.[121] And even if economics scholarship suggests that telecommunications law needs credible commitments to protect telecommunications companies' capital, such scholarship could be distinguished. For instance, while Brian Levy, Pablo Spiller, and their colleagues have conducted convincing studies about credible commitments in the United Kingdom, the Phillipines, Jamaica, and other countries,[122] political and economic conditions in those countries might be different from conditions here in the United States.

On the other side of the calculus, a good Realist would also stress all the social costs that would follow if Congress needed to pay just compensation whenever it tinkered with the rights and obligations of common carriers. If the Takings Clause applied whenever Congress so tinkered, Congress would never consider innovations as beneficial and far-reaching as the 1996 Act. If Congress's hands were thus tied, it would have a very difficult time responding if telecommunications carriers captured the FCC or if economic conditions changed in ways that required new approaches to regulation. For instance, such instincts explain and lend force to Jim Chen's argument that *per se* compensation rules would "pose a serious obstacle to structural reform of utility markets."[123] Such concerns would lead one to conclude, within the *Penn Central* calculus, that incumbents should not have held any reasonable expectations that they could keep their franchise and no-interconnection rights.

Separately, a good Realist would want to view the 1996 Act holistically. Under *Penn Central*, "takings law does not divide parcels up into discrete ssegments," and that much legislation "adjusts the burdens and benefits of economic life."[124] Going by that proviso, it

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[121] Baumol & Merrill, *supra* note --, [72 N.Y.U. L. Rev.] at 1047 & n.39 (citing Priest, *supra* note --, at 303).
[122] See Regulations, Institutions, and Commitment, *supra* note --.
[123] Chen, *supra* note --, [98 Nw. U. L. Rev.] at 1688.
[124] Check quotes and get cites.

would exalt form over substance to say that the Act extinguished incumbents' right to exclude competitors. Both pre- and post-1996, the incumbents had ceded the right to exclude, and they owed duties not to discriminate and to provide access to the local exchange at reasonable rates. Pre-1996, the companies owed those duties to *customers*, while post-1996, they owed those duties to *competitors*. Moreover, the 1996 Act guaranteed the incumbents *some* compensation from competitors, which now comes in the form of TELRIC rates, and it also created new opportunities for them to profit in long-distance markets. If so, better not to insist on a rigid approach that formalistically treats these various rights as different; better instead to treat the question whether to tinker with them as a legislative policy judgment. Since the Act aimed to promote competition, the character of Congress's action would rate high, and the *Penn Central* balance would tip in favor of Congress.

Of course, as this contrast suggests, black-letter regulatory-takings doctrine does not and cannot clearly resolve questions about the 1996 Act. Nevertheless, this contrast does clarify the issues raised. One way to restate the issue is to ask whether, on general principle or for reasons peculiar to the telecommunications industry, incumbents' rights to enjoy exclusive control of their local exchanges were sufficiently important within the scheme of pre-1996 regulation that the incumbents should be held harmless from any adverse consequences of the 1996 Act. If one is more interested in technical policy than formal rights, one can restate the question by asking whether the 1996 Act jeopardizes policy values associated with dynamic efficiency seriously enough that the incumbents ought to be held harmless for any lost investments. In any case, the doctrinal tensions underscore how little work is being done by telecommunications expertise is doing and how much work is being done by overarching principles about how to conceive of and how to regulate property.

C. Just Compensation

The theoretical questions that lurk beneath the takings questions also lurk beneath the questions relevant to just compensation. Let us assume that the 1996 Act's local-exchange provisions do inflict regulatory takings on the incumbents. Under any theory of the Takings Clause, the 1996 Act takes private property for public use, for it restructures a public network while still keeping that network public.[125] Thus, assuming that the Act does inflict regulatory

[125] This conclusion is beyond cavil under prevailing federal law, which decides public-use issues on deferential "rational basis" grounds. *See, e.g.*, Hawaii Hous. Auth. v. Midkiff, 467 U.S. 229 (1984); Berman v. Parker, 348

takings, the next doctrinal objective is to determine the just level of compensation to which the incumbents are entitled. As it turns out, if one subscribes to libertarian assumptions about property and takings, the doctrine leaves room for the incumbents to receive the value they expected to receive in state rate proceedings, minus the money they receive from TELRIC payments, ongoing local service, and new benefits that the 1996 Act conferred to them. But if one subscribes to Realist assumptions, the doctrine also leaves room to limit the incumbents' just compensation to the payments and benefits they receive under the Act.

At a high level of generality, it is well accepted that owners are entitled to fair value for the private property taken from them, minus any compensation that the condemning law makes in the form of money payments or in-kind compensation. As the Supreme Court has explained, the owner who suffers a taking should be placed "in as good a position pecuniarily as if his property had not been taken."[126] Although there are variations and important practical problems, as a starting point the owner is entitled to receive "what a willing buyer would pay in cash to a willing seller."[127] If, however, the law that inflicts the taking also provides other sources of compensation, the claimant's compensation needs to be discounted appropriately. This requirement has long been recognized in takings case law,[128] is supported by the Supreme Court's "reciprocity of advantage" case law,[129] and has been developed extensively in recent takings scholarship about implicit in-kind compensation.[130]

It is fairly easy to identify the factors that drop the incumbents' compensation to reflect offsetting reciprocal advantages. The first is a source of explicit compensation—the TELRIC rates, which explicitly compensate the incumbents for carrying the local services of the competitors.[131] The second source consists of any source of in-kind compensation provided by

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U.S. 26 (1954). See also Baumol & Merrill, 73 N.Y.U. L. Rev. at 1130 n.39. But even the most suspicious public-use cases allow the government to take private property and create a public right of access to it. *See, e.g.*, Southwestern Illinois Developmental Ass'n v. National City Environmental, L.L.C., 768 N.E.2d 1, 9 (Ill. 2002) ("Gateway's racetrack may be open to the public, but not 'by right.'"). In substance, the interconnection and franchise-repeal provisions of the Act create a public right of access in local exchanges.

[126] Olson v. United States, 292 U.S. 246 (1934).

[127] United States v. 546.54 Acres of Land, 441 U.S. 506, 511 (1979).

[128] *See, e.g.*, Paxson v. Sweet, 13 N.J.L. 196 (1832) (rejecting a takings challenge to a law that required home owners to pave the sections of public streets in front of their homes on the ground that the owners received just compensation in the form of better access to public facilities and their neighbors' homes).

[129] *See, e.g.*, Penn. Coal Co. v. Mahon, 260 U.S. 393 (1922); Jackman v. Rosenbaum Co., 260 U.S. 22 (1922).

[130] *See, e.g.*, Epstein, Takings, supra note --, at 195-215; Michelman, [Harv 1967], supra note --, at 1225.

[131] To the extent that TELRIC payments are part of the incumbents' constitutional just compensation, courts will need to consider many procedural details of TELRIC that might not otherwise take on constitutional significance. For example, incumbents and the FCC are now engaged in administrative disputes about the "uncollectibility"

the Act. The most obvious such source consists of the new right, conferred on incumbents by section 271 of the Act, to compete in long-distance markets.[132] As William Baumol and Thomas Merrill argue (and as no one seriously disagrees), incumbent carriers will receive a "valuable quid pro quo . . . in the form of access to the long-distance market."[133] To the extent that other provisions of the Act compensate the incumbents in kind along the lines of section 271, the incumbents' just compensation should be discounted appropriately.

A third source must be considered, namely incumbents' ongoing and forward-looking profits in the local phone-service business. This downward adjustment is needed to preserve the symmetry between the interconnectivity rules and a hypothetical case in which Congress completely extinguishes the incumbents' rights over local service. This symmetry is comparable to the symmetry in such a case as *Kaiser Aetna* between a total condemnation, which takes the fee, and a condemnation for a right of way. A similar principle applies in *Monsanto* and other cases involving exclusive intellectual property.[134] If the government nationalizes a trade secret and takes over the owner's monopoly, the owner is entitled to just compensation for the fair market value of the secret. By contrast, if the government only discloses the trade secret, it destroys the owner's monopoly but still frees the owner to compete in the newly-competitive market. The owner's just compensation drops to account for the extent to which he can still make a competitive profit on the idea. In telecommunications, although the incumbents lose exclusive control over the local exchanges, they still retain ownership of the local exchanges and the right to compete in local markets. To the extent they can recoup their historical costs and their operating costs in competition, they must do so.

However, while it is easy to identify the factors that lower the appropriate measure of just compensation, it is not as easy to put a dollar value on the crucial rights taken. A few are easy to

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problem. Incumbents want the right to refuse to interconnect a competitor on the ground that the competitor stands a real chance of not being able to pay its TELRIC bills after it gets access, or at least to require such a competitor to front security deposits or advance payments as a condition before interconnecting. By contrast, the FCC has not ruled these procedures out, but it has discouraged the incumbents from using them. *See, e.g.*, In the Matter of Verizon Petition for Emergency Declaratory and Other Relief, WC Docket No. 02-202, FCC 02-337 (Dec. 23, 2002). The FCC spelled out its recommended procedures in *id.* ¶ 26. Assuming that the Act effects a taking, such rules drive down the just compensation that incumbents get through rates set under section 252 of the Act, and drive up the payment that Congress must make out of federal funds.

[132] See 47 U.S.C. § 271 (2000).

[133] Baumol & Merrill, 73 N.Y.U. L. Rev. at 1131; see also id. at 1141-46. J. Gregory Sidak and Daniel F. Spulber agree with this discount at least at a high level of generality in Givings, Takings, and the Fallacy of Forward-Looking Costs, 72 N.Y.U. L. Rev. 1067, 1093-96 (1997).

[134] See Epstein, [Trade Secrets], supra note --, 71 U. Chi. L. Rev. at 62-63.

identify, particularly the physical-collocation requirements of section 251(c)(6).[135] These provisions entitle the incumbents to the market value of the office space taken by competitors and any costs the incumbents must spend to help the competitors use that office space productively. However, it is much easier to valuate and much cheaper to make full compensation for these physical takings than it is to determine the just level of compensation for the interconnectivity provisions of section 251 and the franchise-preemption language of section 253. It would be easy to the incumbents' office space on a competitive market; not so their franchises. Common-carrier regulation exists in situations in which there is and probably can be no open market, most often because the industry is a natural monopoly. In these cases, the public utility usually has no natural competitors, and valuation becomes more hypothetical and difficult.

On this point, the most relevant precedent is probably *Monongahela Navigation Co. v. United States*.[136] In that case, Pennsylvania had chartered a franchise with the Monongahela company to build locks and dams along the Monongahela River. The company fronted money to build the locks and dams; Pennsylvania compensated it with an exclusive franchise to operate the locks, and also the power to set tolls in order to recoup its investments.[137] Later, however, Congress passed a law directing the Secretary of War to take one lock and dam. The act that provided for the taking also specified that, when the Secretary calculated just compensation, "the franchise of said corporation to collect tolls shall not be considered or estimated."[138] The Monongahela company argued that its just compensation needed to include the discounted present value of the tolls; the United States argued that the act of Congress properly excluded these tolls from the just-compensation determination.[139] The federal condemnation stands in the same relation to the 1996 Act as the Pennsylvania act of incorporation stands to the state laws and agreements that vested franchises in AT&T and then later in incumbents. In each case, state law created a franchise, and federal law subsequently terminated it.[140] These parallels are instructive because the Court was thus forced to consider how to determine the just

[135] 47 U.S.C. § 251(c)(6).
[136] 148 U.S. 312 (1893).
[137] *See id.* at 313-15.
[138] *Id.* at 313.
[139] *See id.* at 318-19.
[140] *See id.* at 341 (noting that Congress has superior power to take state franchises, "even against the will of the State; but it can no more take the franchise which the State has given than it can any private property belonging to an individual").

compensation to which the franchisee was due after Congress condemned and used its state franchise.

The Court concluded that the Monongahela company was entitled to the discounted present value of the tolls it would and could have charged under its state franchise. Generally speaking, the Court observed that just compensation turns on an understanding of value that "is not determined by the mere cost of construction, but more by what the completed structure brings in the way of earnings to its owner."[141] When Congress took the lock and dam, it deprived the Monongahela company "of the aggregate amount of such compensation which otherwise it would continue to receive."[142] Because Pennsylvania had guaranteed the Monongahela company the right to charge tolls as part of its franchise, "these tolls, in the nature of the case, must enter into and largely determine the matter of value."[143] "[I]f the property is held and improved under a franchise from the State, with power to take tolls," the Court insisted, "that franchise must be paid for, because it is a substantial element in the value of the property taken."[144]

Under *Monongahela* and the general principles it reflects, the incumbents are entitled to compensation comparable to the value of their franchises under state law. State and local franchises gave incumbents power to recoup their investments by charging regulated rates for local phone service. To measure the economic value of those franchises, one important source of value includes the discounted present value of those regulated rates. If state or local regulators had posted such rates in regular schedules, in regulations or in contractual franchise agreements, the law would discount the scheduled rates to present value. However, as recounted in Part I, many if not most state and local utility regulators shifted from a franchise model to ongoing and *ad hoc* rate-of-return regulation during the twentieth century.[145] Where and when rates are set on such an *ad hoc* basis, *Monongahela*'s rule of decision requires courts to forecast the likely levels of state rates if the 1996 Act had not displaced state regulation, and then determine the discounted present value of those rates.

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[141] *Id.* at 328.
[142] *Id.*
[143] *Id.* at 329.
[144] *Id.* at 337; *accord id.* at 329.
[145] *See* Priest, *supra* note --, at 301-23; Kennedy, *supra* note --, at 5-17; notes – and accompanying text.

This conclusion also helps explain why many commentators[146] and the *Verizon* opinion[147] have assumed that courts should apply rate-of-return principles to takings challenges to the 1996 Act. This assumption can be questioned when considering the relevant *takings* issues raised. While the TELRIC formula limits the incumbents' rates, rate-of-return cases other important features of the Act, particularly that it extinguishes the vested rights incumbents may have held in state or local franchises, and that it imposes on incumbents new duties of access and interconnection. At the same time, rate-of-return principles help clarify the *just compensation* issues that follow if these features of the Act inflict *per se* takings. Constitutional rate-of-return principles have long informed and limited the rates that incumbents have recovered from state and local utility regulators. Those principles would surely help set the benchmarks for forecasting how state regulators might have regulated incumbent rates if the 1996 Act had not become law.

Under those principles, the incumbents are entitled to recover some measure of their investment and a rate of return reasonable for an industry with a risk profile similar to the profile for local telephony.[148] Rate-of-return law has traditionally left state regulators with broad discretion about how to determine utilities' sunk costs, and whether those costs are prudent: Regulators are "not bound to the use of any single formula or combination of formulae in determining rates."[149] Given this flexibility, *Monongahela Navigation*'s general prescription would probably still leave Congress and the FCC some flexibility to adjust federal compensation to reflect the possibility that incumbents profited in particular states more than prudent rate-of-return principles require. And again, the just-compensation calculus would then need to deduct for the incumbents continue to make in the local market, the profits they make in long distance, and the rates they recover from the TELRIC formula. But by and large, state ratemaking and its constitutional limits set the benchmark from which these deductions are subtracted.

This approach has come under two separate types of criticism. One criticism holds that this approach does not compensate the incumbents enough. Most recently, Daniel Spulber and Christopher Yoo have argued that the incumbents are entitled to just compensation based not on

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[146] *See supra* notes – and accompanying text [citing Chen, Legg, and Buck].
[147] *See supra* note – and accompanying text.
[148] *See* Smyth v. Ames, 169 U.S. 466 (1898) (fair value); Fed. Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944) (prudent historical costs). For discussions of the similarities and differences between the two standards, see Epstein, [Principles], at 307-09; Chen, *supar* note --, at 1679-1685; Spulber & Yoo, 908-12.
[149] FPC v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944).

constitutional-ratemaking law but rather on the fair market value of the access rights that they are required to surrender under the Act and TELRIC regulations. The incumbents' just compensation for mandatory interconnection, they argue, "depends on what the company could have obtained by selling network services."[150] Since "the emergence of platform competition and the shift from rate regulation to access regulation have now made it possible to base rates on market benchmarks,"[151] they conclude that "ideally the purchase cost of inputs would represent a good approximation of the earning potential—and thus the market value—of those inputs."[152]

I cannot render any definitive judgment on Spulber and Yoo's proposal on its economic merits.[153] At the same time, it is safe to say that their proposal is not required as a matter of black-letter takings law, and that there are understandable policy reasons why not. Ordinarily, as Spulber and Yoo observe, just-compensation looks to the market value of the property taken.[154] At the same time, as they also recognize, the doctrine looks to other measures when the property is traded too infrequently for there to exist a market, or when other extraordinary circumstances require a different measure.[155] In particular, as the U.S. Supreme Court made clear in *Monongahela Navigation* (on which Spulber and Yoo rely substantially for their general claims about market value[156]), when it comes to "property devoted to a public use, the amount of compensation [is] subject to the determination of the . . . State which authorized the creation of the property."[157] If the state establishes tolls as the method of compensation, "these tolls, in the

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[150] Spulber & Yoo, *supra* note --, at 903.
[151] Spulber & Yoo, *supra* note --, at 911. *See also id.* at 900-07 (canvassing several different ways to use market mechanisms to price network rates).
[152] Spulber & Yoo, *supra* note --, at 891.
[153] Their proposal would certainly make takings law easier, for it would be administratively much easier to set just compensation by market value than by the approach prescribed in this section. That advantage, however, would be a one-time-only benefit, and others have warned that market-value compensation would seriously discourage technological innovation in the long-term market for local telephone services. See Chen, supra note --, at 1688; Adam Candeub, Network Interconnection and Takings, 54 Syracuse L. Rev. 369, 426-27 (2004). Both Chen and Candeub cite and rely on arguments propounded by Nicholas Economides, The Tragic Inefficiency of the M-ECPR, in Down to the Wire: Studies in the Diffusion and Regulation of Telecommunications Technologies 140-51 (A. Shapine, ed. 2003). Spulber and Yoo defend their proposal on its substantive merits *supra* note --, at 895-900, and attack the standard alternatives in *id.* at 908-14.
[154] *See* Spulber & Yoo, *supra* note --, at 952 (citing, *inter alia*, Olson v. United States, 292 U.S. 246 (1934); Boom Co. v. Patterson, 98 U.S. 403 (1878)).
[155] *See id.* at 953 (citing, *inter alia*, United States v. 50 Acres of Land, 469 U.S. 24 (1984); Kimball Laundry v. United States, 338 U.S. 1 (1949)).
[156] *See id.* at 950.
[157] Monongahela Navig. Co. v. United States, 148 U.S. 312, 329 (1892).

nature of the case, must enter into and largely determine the matter of value."[158] Without making any final judgments, this doctrinal exception is not unreasonable from the standpoint of policy. When a state uses its power to grant a franchise for a bridge, rail line, or phone network, more often than not there is no meaningful market for the asset created under the franchise. The exception holds the state and the franchisee to the terms of their bargain *ex ante*. It therefore lets states control the terms on which—and particularly the exposure under which—they create franchises and other quasi-property.

There is another way to criticize the proposal presented in this section, which is to object that it compensates the incumbents too much. These criticisms have been made most forcefully in opposition to J. Gregory Sidak and Daniel Spulber's thesis of the "regulatory contract." In an article[159] and then a subsequent book,[160] Sidak and Spulber have argued that some features of pre-1996 regulation were so regular and pronounced that they created in the incumbents expectations that they were guaranteed to recover prudent historical costs through ratemaking.[161] Now, the proposal in this section differs from Sidak and Spulber's argument in one important respect: While Sidak and Spulber contend that the incumbents are entitled to all prudent historical costs, the analysis presented here suggests that they are entitled only to the likely discounted present value of the rates they expected to recover in each state. If a state refused to follow historical, prudent costs and applied some other, less-generous but still constitutional methodology, the incumbent would be entitled only to the less-generous level.[162] Even so, both approaches posit that the incumbents were entitled to compensation in the event that government regulators extinguished their franchises and their control over the local exchanges.

This claim came under serious criticism when Sidak and Spulber proposed it, because it seems to run contrary to the "unmistakeability" doctrine. This doctrine holds that governments should be held only to contractual promises that they make in unmistakeable terms. In other words, in cases of doubt, government contracts should be construed in favor of the government

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[158] *Id. See also id.* at 337 ("if that property be improved under authority of a charter granted by the State, with a franchise to take tolls for the use of the improvement, in order to determine the just compensation, such franchise must be taken into account").
[159] J. Gregory Sidak & Daniel Spulber, Deregulatory Takings and Breach of the Regulatory Contract, 71 N.Y.U. L. Rev. 851 (1996).
[160] J. Gregory Sidak, Deregulatory Takings and the Regulatory Contract: The Competitive Transformation of Network Industries in the United States (1997).
[161] *See* Sidak & Spulber, [first article], *supra* note --, at 878-79.
[162] *See* Baumol & Merrill, *supra* note --, at 1050;

and against the contractor.[163] That doctrine has led commentators to criticize Sidak and Spulber's proposal. If states did not explicitly promise that they would set or maintain rates at any fixed level, the argument runs, the incumbents may not claim that they are legally entitled to any specific rate figures in the future, whether through rate-making under the 1996 Act or in a just-compensation proceeding. As Herbert Hovenkamp argues, "public utility investors get from the state precisely what they are able to bargain for, no more and no less."[164]

This split between Sidak and Spulber and their critics highlights the last tension between Realist and libertarian approaches to takings. Both approaches can accommodate some version of the unmistakeability doctrine, but they differ about how aggressively to apply it. Realist theory lends itself to an aggressive interpretation of the doctrine. It favors broad government action, and it tends to construe private owners' expectations narrowly to preserve government's freedom of action. Libertarian theory, by contrast, construes the unmistakeability doctrine more narrowly, so as not to frustrate just compensation in takings cases. Laws that extinguish incumbents' franchise and exclusivity rights take the incumbents property. The Supreme Court recognized as much when it insisted in *Monongahela Navigation* that franchises are "a vested right," which may be retaken only "upon the payment of just compensation."[165] If and when the government extinguishes franchises, the libertarian approach suggests, the unmistakeability doctrine need not and should not apply. Claimants are entitled to receive the most likely approximate value of their franchises. If state tolls or rates provide the best available evidence of that value, then those tolls or rates are relevant even if the government did not promise unmistakeably and unambiguously that it would continue to provide those rates.

Thus, the just-compensation stage raises questions as fundamental as the takings stage. If the incumbents have property in their franchises and freedom not to carry to the extent that libertarian theory prescribes, it follows quite nicely as a matter of doctrine that the incumbents are entitled to recover from Congress costs left over from state ratemaking after enforcement of the 1996 Act. But if those franchises and freedom-from-carriage expectations have as little social value as Realist theory suggests, the incumbents should be satisfied with the compensation

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[163] Charles River Bridge v. Warren Bridge, 36 U.S. (11 Pet.) 420 (1837); see also Hovenkamp, at 816-17 (citing National R.R. Passenger Corp. v. Atchison, Topeka, & Santa Fe Ry., 470 U.S. 451 (1985); Atl. Coast Line R.R. v. Phillips, 332 U.S. 168 (1947); Keefe v. Clark, 322 U.S. 393 (1947)).
[164] Herbert Hovenkamp, The Takings Clause and Improvident Regulatory Bargains, 108 Yale L. J. 801, 816 (1999).
[165] 341.

they get from TELRIC and the money they make in their own lines of business. The basic policy choice is the same.

CONCLUSION

It often happens that people who regard their own affairs as being complicated assume that other people's affairs are much more simple and straightforward. Whether that phenomenon is a universal feature of human life, something like it has influenced the scholarship and the early developments of the law governing takings challenges to the local-exchange provisions of the 1996 Act. Policymakers and telecommunications scholars have tended to assume that the law of takings is straightforward: that takings doctrine comes in one of three simple varieties, and that one of these varieties clearly applies to the 1996 Act.

In reality, however, takings doctrine reflects many of the same theoretical and policy tensions with which policy makers have been grappling in telecommunications. Some elements of takings law and theory lend themselves quite well to concerns about dynamic efficiency and the possibility that the Act might disrupt investment in new technologies for local phone services or throughout regulated industries quite generally. These elements are represented well-enough in the law to give incumbents credible arguments that they have suffered *per se* takings of their franchises and their rights to exclude competitors, and that they are entitled in compensation to any difference between the rates and charges they can recover under the Act and the rates they would have recovered under state rate regulation if the Act had not passed. Other elements of the law and theory, however, lend themselves quite well to concerns that Congress's hands ought not to be tied, that it would be undesirable to frustrate the Act's goal of making the market for local phone service more competitive. These elements are also represented well enough to give Congress credible arguments that the incumbents should remain satisfied with the compensation they receive from TELRIC rates and the money they make in local and long-distance service.

These limitations may be troubling or encouraging, depending on how one views them. On one hand, it may be troubling to know that takings doctrine cannot impose certainty or order on the policy issues that inform telecommunications law. On the other, it is encouraging to appreciate that the law of takings can at least focus and sharpen the debate. If the cases and the doctrines are understood properly, takings law can connect the specific and immediate telecommunications issues that arise from the 1996 Act to enduring questions about the proper relation between government action and the individual initiative associated with property.