The Evolution of the Regulatory Contract

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George Priest drew an analogy between public utility regulation and relational contracts, combining legal, economic, and historical analysis to explain an evolution from municipal franchise agreements to public utility commissions. The contract analogy has the benefit of drawing attention to both the supply and demand sides of regulation. I argue that this perspective can shed light on an episode that the economic theory of regulation has otherwise struggled to explain—the dramatic changes in the regulatory landscape beginning in the late 1970s, commonly known as deregulation. Changes to the organization of Congress had unanticipated consequences for its ability to supply the type of cartel-enforcing regulations then common in many large industries. The result was the end of cartel enforcement and an expansion of conduct of business rules. Simultaneously, post-government employment became a more important form of payment for favorable regulatory treatment.

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Introduction

The first generation of law and economics scholarship produced lasting insights in part because it was not compartmentalized. Law and economics researchers conceived of their field of study not as contract law, tort law, or corporate law, but as the use of economic analysis to understand law as a social system. While the field of jurisprudence also sees law as an integrated system, it has traditionally operated at a high level of abstraction. Law and economics scholars operated on the ground level. This enabled them to see connections that others had missed.

George Priest identified many such connections. He provided a subtle and persuasive explanation of the link between developments in tort law and the mid-1980s crisis in commercial casualty insurance.[1] He described how the rules of property rights in extracted oil made it easier for Standard Oil to monopolize the crude oil refining industry than the production industry.[2] More generally, his work frequently combined a careful review of historical evidence with economic and legal analysis in a way that few scholars have matched.

I will discuss a connection Priest made in "The Origins of Utility Regulation and the 'Theories of Regulation' Debate," a contribution to a conference on law and economics held in 1992 at the University of Chicago and published in the *Journal of Law & Economics*.[3] The article recounts the prehistory of utility regulation, or the era when the principal regulatory tool was the municipal franchise contract rather than a state-level public utility commission.

Priest accompanies the historical account with two analytical points. First, he argues that the history of public utility regulation is too complex to fit easily within either a simple public interest theory of regulation or the competing economic theory that emphasizes the private interests of regulators and regulated. Second, he notes that the interactions between utility companies and their regulators are characterized by frequent adjustment within a long-term framework, making it resemble a relational contract.

An enduring contribution of Priest's article is that it helps explain changes in utility regulation during the late nineteenth and early twentieth centuries. Regulation initially took the form of municipal franchise agreements. Over time, these agreements were amended and ultimately replaced by state-level public utility commissions. Indeed, part of the article's stated motivation is the inability of a simple natural monopoly theory of

1. *See* George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521 (1987).

2. *See* George L. Priest, *Rethinking the Economic Basis of the Standard Oil Refining Monopoly: Dominance Against Competing Cartels*, 85 S. CAL. L. REV. 499, 531-36 (2012).

3. George L. Priest, *The Origins of Utility Regulation and the "Theories of Regulation" Debate*, 36 J.L. & ECON. 289 (1993).

utility regulation to explain why public utility commissions sprang up at almost the same time in states with disparate economic environments.[4]

A better explanation observes that public utility commissions were simply a step in the evolution of a long-term relationship between utilities and governments. Governments wished to prevent monopoly pricing, while utilities wished to avoid appropriation of their substantial investments. Over time, franchise agreements gave utilities more security of tenure and municipalities more opportunities to renegotiate prices, which ultimately led to a regulatory system in which a commission approved price schedules on an ongoing basis subject to procedural safeguards.

This essay argues that the relational contract analogy helps explain regulatory change outside the field of public utility regulation where it has been most influential. I point out that the dramatic federal regulatory changes of the 1970s and 1980s were a response to changed conditions that undercut the existing system of cartel-enforcing regulations which directly controlled entry, prices, or both in several major industries, including transportation, communications, and energy.

Some of the prior scholarship attempts to explain these changes by reference to the demand side, arguing that economic and organizational changes eroded monopoly rents. I focus on the supply side. Reforms to the organization of Congress in the 1970s, although not prompted by concerns about cartel-enforcing regulations, contributed to their demise.

From the early 20th century until 1970, committee chairs wielded enormous power in Congress and were appointed almost exclusively based on seniority. This system facilitated long-term, reciprocal relationships in which Congress provided cartel-enforcing regulations and the relevant industries provided political support. The 1970s reforms eroded the seniority system, weakening committee chairs and multiplying subcommittees and staff positions. Regulation became less relational and more episodic, with price and entry restrictions largely replaced by more numerous and complex conduct of business rules. Simultaneously, post-government employment became a more important vehicle for sharing rents between regulated industries and legislative and regulatory personnel.

Section I briefly summarizes the theories of regulation debate. Section II describes how the regulatory contract in important industries such as surface and air transportation and communications changed over time. Section III argues that we can enhance our understanding of these changes by focusing on Congressional reforms of the early 1970s that made it more difficult for Congress and regulated industries to maintain their existing relational contracts. Current regulatory systems rely on different types of relationships. A conclusion follows.

4. *Id*. at 296 ("The rough simultaneity in timing across states is not easily reconciled with the explanation that regulatory commissions derived solely from the existence of natural monopoly.").

I. Regulation as Transaction

Theories of regulation either explicitly or implicitly employ the logic of markets and firms. The standard public interest theory of regulation resembles Coase's theory of the firm.[5] It begins with the observation that markets may be plagued by monopoly, externalities, or information asymmetries that drive a wedge between privately and socially optimal behavior.[6] In principle, these market failures could be addressed through private contracts, Pigouvian taxes, and legal reforms that reduce transaction costs. In practice, however, the costs of market solutions may be greater than the cost of centralized direction by a regulator.[7]

Regulation therefore foregoes the price mechanism in favor of command. In that respect, it resembles the internal operations of a firm. Like corporate managers in the Coasian firm, regulatory agencies are central nodes of information in the public interest model. They determine the best way to coordinate the activities of businesses toward a social goal, such as reducing pollution or alleviating workplace accidents. They issue directives to the businesses that the latter must follow.

This simple analogy is imperfect in one important respect. The relationship between a regulator and the regulated entity is not consensual, like the relationships among entrepreneurs, workers, and capital suppliers within a firm. We must therefore ask why a regulator will pursue the public interest, even assuming it has all the information necessary to do so.

Government officials and corporate managers alike gain utility from greater compensation, power, and leisure, none of which directly benefits citizens or shareholders. In the case of firms, there are straightforward devices to better align managerial and shareholder interests. Most notably, equity-based compensation creates an incentive for managers to maximize share prices.[8]

By contrast, the divergence between the private interests of regulatory personnel and the public interest presents a challenge for the public interest theory of regulation. A regulator's pay is not tied in any meaningful way to performance. In a partly unionized, nonpartisan civil service, it is also extremely difficult to terminate agency personnel for shirking, further blunting incentives to exert costly effort.

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5. *See* Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

6. *See* Paul L. Joskow & Roger G. Noll, *Regulation in Theory and Practice: An Overview*, *in* STUDIES IN PUBLIC REGULATION 1, 36-37 (Gary Fromm ed., 1981) (identifying "normative analysis as a positive theory" of regulation that begins with market failure and concludes that regulation will improve economic welfare).

7. *See* Victor P. Goldberg, *Regulation and Administered Contracts*, 7 BELL J. ECON. 426, 431 (1976).

8. *See* Michael C. Jensen & Kevin J. Murphy, *Performance Pay and Top-Management Incentives*, 98 J. POL. ECON. 225, 226 (1990) ("It is . . . appropriate to pay CEOs on the basis of shareholder wealth since that is the objective of shareholders.").

Proponents of the public interest theory of regulation are left to argue that government personnel have non-economic motivations to serve the public good. Either altruistic individuals are more likely to be attracted to government service, or people who enter government service become more altruistic by virtue of their positions.[9] The limited plausibility and seemingly ad hoc nature of these explanations are part of the inspiration for private interest theories of regulation.

Private interest theories proceed from different factual assumptions than the public interest theory and reach different conclusions. The first key assumption is that individuals do not change depending on whether they are employed in a private business or a government agency. In either case, they act to maximize their own utility.[10] The second key assumption is that regulation confers benefits as well as costs on regulated entities, and for some the benefits will outweigh the costs.

In Stigler's early and influential private interest model, regulation is a commodity that is more valuable to some firms than others.[11] Regulations that restrict entry, either directly or by imposing substantial fixed compliance costs, are more valuable to incumbent firms. Incumbents therefore seek out regulation and legislators provide it in return for political support.[12]

Stigler uses the market not as an analogy but as a direct description of the creation of regulatory statutes. Industries purchase a valuable commodity—regulation with its attendant restrictions on entry—and pay with a currency consisting of campaign contributions, the labor of industry personnel as campaign volunteers, and so on. In his theory, regulation is essentially a one-shot transaction. A previously unregulated industry concludes that the benefits of regulation outweigh the costs of obtaining it and therefore drops by the regulatory grocery store, Congress, to make a purchase. The timing of this realization and shopping trip are not analyzed.

Peltzman's version of the private interest theory maintains the transactional lens but focuses on marginal effects.[13] He notes that actual regulatory systems do not merely transfer wealth from consumers to producers, but often from some categories of consumers to others through price

9. *See, e.g.*, Wouter Vandenabeele, *Toward a Public Administration Theory of Public Service Motivation*, 9 PUB. MGMT. REV. 545 (2007) (describing extrinsic sources of public service motivation); James L. Perry & Lois R. Wise, *The Motivational Bases of Public Service*, 50 PUB. ADMIN. REV. 367 (1990) (describing intrinsic sources of public service motivation).

10. *See* Richard A. Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 335, 343 (1974) ("[T]he economic theory [of regulation] is committed to the strong assumptions of economic theory generally, notably that people seek to advance their self-interest and do so rationally.").

11. *See* George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971).

12. *See id.* at 12 ("The industry which seeks regulation must be prepared to pay with the two things a party needs: votes and resources.").

13. *See* Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J.L. & ECON. 211 (1976).

discrimination and cross-subsidies. These features arise naturally in a model in which politicians seek to distribute the marginal dollar of benefit to the group that will provide the marginal dollar of support. The legislature is therefore not a grocery store, but an auction house where competing interests bid for favorable rules. Characteristics of the competing groups, which become parameters in Peltzman's model, determine who gets benefits, in what amounts, and at what prices.

With Peltzman's introduction of marginal analysis, the private interest model becomes a more fully developed economic theory. Becker further developed the economic theory by paying attention to regulation's welfare effects and not just its distributive effects.[14] He argues that the deadweight losses that accompany redistributive regulation create counterpressure by the groups most affected by those losses. The political sellers of regulation can therefore charge a higher price for regulations that minimize deadweight losses, all other things equal. Becker, unlike Stigler and Peltzman, does not model the seller, instead using the "political influence" of different interest groups as a parameter.

As Geoff Miller's contemporary comment on Priest's paper observes, Priest makes two somewhat contradictory arguments in response to the Stigler/Peltzman/Becker economic theory of regulation.[15] First, he contends that no single theory of regulation is sufficient to explain regulatory behavior. He then, however, suggests his own variant of the economic theory: the regulation of public utilities, and perhaps other industries, is a type of relational contract.

Early public utility regulations were actual contracts. Municipal governments entered into franchise agreements giving a utility the right to operate subject to conditions that might include maximum prices and minimum standards for service quality.

Because providing electricity, gas, or water required substantial fixed investment, utilities desired long-term franchises. Like other long-term contracts among parties with imperfect foresight, however, franchise agreements could not anticipate all contingencies that might arise and provide terms to specify the parties' consequent rights and obligations. The result was that utility regulation evolved to facilitate adjustment to changing conditions. Municipalities and utilities began to amend franchise agreements regularly. Over time, these amendments built greater flexibility into the agreements. Finally, utility commissions replaced franchise agreements.

14. *See* Gary Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J. ECON. 371 (1983).

15. *See* Geoffrey P. Miller, *Comments on Priest, the Origins of Utility Regulation and the Theories of Regulation Debate*, 36 J.L. & ECON. 325 (1993).

The literature on economic regulation has addressed the normative implications of the analogy between regulation and relational contract.[16] Taking the analogy to its logical extreme, some scholars have argued that regulated utilities should be entitled to expectation damages when opportunistic regulatory changes appropriate the utility's investment in new generation or transmission facilities.[17] Others have asked the more general question whether some form of compensation for regulatory changes can provide both regulators and regulated entities the incentive to make welfare-increasing adjustments.[18]

I will ignore these normative issues and focus on a descriptive question: can the relational contract analogy help us understand temporal changes in regulatory style and substance outside the field of public utility regulation? Regulation today looks very different than it did in the 1970s, when the theories of regulation debate was joined. The next section describes these changes, the possible reasons, and the consequences for the economic theory of regulation.

II. Different Eras, Different Contracts

Regulation has changed both substantively and procedurally since the formative years of the theories of regulation debate. Prior to the late 1970s, many industries characterized by high fixed investment, including surface and air transportation, telecommunications, and energy production and transmission, operated under regulatory systems that imposed restrictions on pricing, entry, and sometimes the types and locations of service. The relevant statutes effectively provided government enforcement of collusive practices in those industries. The collusion might consist of price fixing, geographical or product market allocation, or other restrictions on competition. In the interests of simplicity, I will lump all these forms of regulation under the term "cartel enforcement," whether it involved restricting entry, fixing prices, protecting a monopoly, or forcing cross-subsidization.[19]

For example, agencies like the Civil Aeronautics Board and the Interstate Commerce Commission exercised tight control over competition in passenger and freight transportation.[20] They licensed carriers, allocated routes, and set minimum rates. The agencies themselves acted principally

16. *See, e.g.*, Goldberg, *supra* note 7; J. Gregory Sidak & Daniel F. Spulber, *Deregulatory Takings and Breach of the Regulatory Contract*, 71 N.Y.U. L. REV. 851 (1996); Thomas P. Lyon & Haizhou Huang, *Legal Remedies for Breach of the Regulatory "Contract,"* 22 J. REGUL. ECON. 107 (2002).

17. *See* Sidak & Spulber, *supra* note 16.

18. *See* Lyon & Huang, *supra* note 16.

19. The analysis in this and the next four paragraphs is drawn from my recent paper, Paul G. Mahoney, *The SEC, the Supreme Court, and the Administrative State*, 47 SEATTLE L. REV. 927, 934-36 (2024).

20. *See* Todd J. Zywicki, *The Law and Political Economy Project: A Critical Analysis* 44-46 (George Mason Univ. L. & Econ. Research Paper, Paper No. 24-12, 2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4836562 [https://perma.cc/RA3X-9DY7].

through adjudicatory procedures, responding to requests from carriers or would-be carriers and complaints from shippers or passengers.

The underlying theory was that regulation was necessary to ensure competitive pricing and output decisions in these industries. Congress concluded that some such industries suffered from a lack of competition, while others suffered from excessive or "ruinous" competition. Agency experts could adjust the dials of pricing, entry, and/or market segmentation and achieve a more nearly optimal result.

It is easy to see how these systems created rents for the regulated industries and why the theories of regulation debate arose when it did. Stigler's paper pointed out the centrality of limitations on entry, which ensured that rents need not be shared with upstarts.

These cartel-enforcing rules came under sustained attack from both the political left and right in the 1970s.[21] The result was a set of legislative and executive actions that wrought fundamental changes in regulation. The government ceased controlling prices and entry in many industries. The industries remained regulated, but the focus shifted to protecting consumers and citizens by constraining business practices that were thought to be unfair or otherwise harmful. The canonical regulatory agency was no longer the Civil Aeronautics Board, but the Environmental Protection Agency (created in 1970).

Both supporters and opponents of these reforms referred to them as "deregulation," although it would be more accurate to call it "de-cartelization." The number of agencies and the size of their rulebooks continued to grow. Only on the untenable theory that direct regulation of prices and entry alone can create rents did the 1970s constitute the end of history for economic theories of regulation.

Scholars have offered several different explanations for this large and sudden shift. One family of explanations stresses changes in the demand for cartel-enforcing regulations. Regulatory rents were diminishing in some regulated industries in the 1970s for reasons that varied from industry to industry, but included changing technologies, macroeconomic volatility, customer preferences, and modes of service.[22] These industries became less willing and able to pay for a less valuable regulatory product.

An alternative explanation stresses the importance of new ideas.[23] Stigler, Peltzman, and others pointed out the theoretical and empirical

21. *See* MARTHA DERTHICK & PAUL J. QUIRK, THE POLITICS OF DEREGULATION 42-43 (1985); Zywicki, *supra* note 20, at 49-50.

22. *See* Sam Peltzman, *The Economic Theory of Regulation after a Decade of Deregulation*, BROOKINGS PAPERS ON ECONOMIC ACTIVITY, MICROECONOMICS 1, 18-37 (1989) [hereinafter Peltzman, *Deregulation*].

23. Derthick and Quirk stress the influence of economic theories of regulation on the deregulatory move of the 1970s, *see* DERTHICK & QUIRK, *supra* note 21, at 8-13 (describing economic critiques of price and entry regulation); *id.* at 238 (emphasizing the role of a shift in "elite opinion").

shortcomings of cartel-enforcing regulations. Congress and the executive branch reacted by shifting from cartel enforcement to conduct of business regulation. To the extent economists thought about "social" regulations designed to protect workers, consumers, investors, or the environment, they found them at least plausibly justified by externalities.[24] But most didn't think about them. To many economists of that era, the study of regulation was a branch of industrial organization, and the central issue was the effect on industry structure. To them, the term "regulation" was synonymous with price and entry restrictions.[25]

I will offer a third perspective inspired by Priest's paper. I start by noting that economists have paid relatively more attention to the substantive changes in regulation described above than to the procedural changes that accompanied them. An important procedural change was a shift in the relative importance of Congress and the regulatory agencies in writing rules of conduct. In the heyday of cartel-enforcing regulation, Congress set policy. The agency's principal mission was to implement the policy by finding facts and on that basis setting price caps or floors, as relevant, or determining whether "public convenience and necessity" supported additional entry by a firm applying for a license.

After de-cartelization, however, agencies do more of their work through generally applicable rulemaking.[26] They use the vaguely specified rulemaking authority in their organic statutes to identify problems and craft solutions without direct Congressional input. Consequently, agencies now write relatively more rules of conduct, and Congress relatively fewer, in comparison to the early 1970s. As a necessarily crude example, consider the Securities and Exchange Commission, the statutory mission of which has remained reasonably constant over its existence. By my count, the number of words in the statutes it enforces increased by about 2.8 times from the 1970 edition of the U.S. Code to the 2018 edition, but the number of words in SEC regulations increased by about 3.7 times over the same period.

These procedural changes cry out for an explanation. In the Stigler and Peltzman models, the seller of regulation is a vaguely specified political party and payment is in the form of political support. But regulatory commissions are unelected. Many of them are so-called "independent" agencies outside the direct line of command of cabinet-level departments and typically required to have representation from both political parties.

24. *See, e.g.*, Michael Spence, *Consumer Misperceptions, Product Failure and Producer Liability*, 44 REV. ECON. STUD. 561 (1977); Robert U. Ayres & Allen V. Kneese, *Production, Consumption, and Externalities*, 59 AM. ECON. REV. 282 (1969).

25. *See* Joskow & Noll, *supra* note 6, at 1 (describing the "economics of government regulation" as "[t]he study of public-policy approaches to problems in industrial organization").

26. *See* Antonin Scalia, *Vermont Yankee: The APA, The D.C. Circuit, and the Supreme Court*, 1978 SUP. CT. REV. 345, 376-77 (1978).

As currently understood, the President's power to direct and remove members of independent commissions is limited.[27]

One could accordingly describe the reforms that began in the 1970s as a decision by Congress to cede part of its regulatory function to executive agencies. Assuming that writing regulations is a profitable activity, why would Congress choose to share some of this income with unelected agency personnel?

I propose that the shift was partly an unforeseen and unintended consequence of structural changes within Congress itself. In the early 1970s, Congress embarked on a set of reforms that weakened the power of committee chairs. The next section describes these changes and their motivation and the consequences for the regulatory contract.

III. Congress, Regulatory Agencies, and Regulated Industries

A. Prior to the 1970s

Beginning in the early 20th century and ending in the 1970s, committees and their chairs dominated the work of Congress.[28] Committee governance became even stronger following the Legislative Reorganization Act of 1946, which sharply decreased the number of standing committees, to 19 in the House and 15 in the Senate, and carefully delineated their jurisdictions.[29] Internally, the norm of seniority as the basis of committee chairmanship hardened into a nearly inviolable practice.[30] Because many southern Democrats occupied safe seats and Democrats were the majority party in Congress for most of the period from the New Deal through the 1970s, the consequence was to give a small and regionally concentrated group of legislators an outsized and durable impact on the legislative process.

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27. The statutes establishing certain independent agencies provide for presidential removal only for "inefficiency, neglect of duty, or malfeasance in office." *See, e.g.*, 5 U.S.C. § 7104 (Federal Labor Relations Authority); 15 U.S.C. § 2053(a) (Consumer Product Safety Commission). Other agencies, such as the Securities and Exchange Commission, were established under statutes that do not explicitly describe the President's removal authority, but lower courts have assumed that it is similarly limited. *See, e.g.*, SEC v. Blinder, Robinson & Co., 855 F.2d 677, 681-82 (10th Cir. 1988) ("[I]t is commonly understood that the President may remove a commissioner only for 'inefficiency, neglect of duty or malfeasance in office'"). In *Free Enterprise Fund v. Public Company Accounting Oversight Board*, 561 U.S. 477, 487 (2010), involving whether a federal officer may be protected by two levels of for-cause removal protection, the parties agreed that SEC Commissioners have such protection, and the Court therefore assumed without deciding that they do. In *SEC v. Jarkesy*, 603 U.S. 109 (2024), the Court again declined to reach the removal issue. Some scholars doubt Congress's Constitutional authority so to constrain the President's removal power. *See* Cass R. Sunstein & Adrian Vermeule, *The Unitary Executive: Past, Present, Future*, 2020 SUP. CT. REV. 83 (2020) (surveying the literature).

28. *See* DAVID W. ROHDE, PARTIES AND LEADERS IN THE POSTREFORM HOUSE 5-6 (1991).

29. *See* Legislative Reorganization Act of 1946, Pub. L. No. 79-601, 60 Stat. 812, 814-30; CHRISTOPHER J. DEERING & STEVEN S. SMITH, COMMITTEES IN CONGRESS 30-33 (3d ed. 1997).

30. *See* BARBARA HINCKLEY, THE SENIORITY SYSTEM IN CONGRESS 4-8 (1971).

These institutional arrangements were conducive to the transactional model of regulation that Stigler et al. described. The "seller" of regulation was not an amorphous leadership team, but an identifiable person—the chair of the standing committee with jurisdiction over the relevant industry. The chair was in a strong position to deliver promised legislation or block unwelcome legislation, and therefore to negotiate the terms on which Congress would provide the desired regulatory climate.

The lengthy tenure of these chairmen also facilitated a relationship that was more like a contract and less like a spot transaction. The committee chairs could credibly promise a steady stream of rents. The regulated industry could credibly promise political support stretching over years or even decades. Each side had an incentive to keep its commitments and adjust to changing circumstances, as Priest's analysis suggests.

The ability to adjust as needed is important because of a standard feature of collusive regimes. It is collectively in the best interests of the members of a cartel to comply, but individually in their best interests to cheat. As members of regulated industries discovered ways to cheat, the industry relied on Congress to head them off.

For example, the Civil Aeronautics Act of 1938 required every "air carrier" to submit its fare schedules to the Civil Aeronautics Board for approval and prohibited it from providing transportation for any different compensation.[31] Many airline tickets, however, were sold through independent ticket agents. The airlines discovered that they could encourage these agents to grant discounts, giving the carrier the ability to compete on price. Congress accordingly amended the Act in 1952 to prohibit independent ticket agents from granting rebates or engaging in other "unfair methods of competition" as determined by the Board.[32]

The central role of committee chairmen also solved the tricky problem of sharing the resulting purchase price—that is, the campaign contributions and other forms of support—among legislators. The committee chair dealt with industry personnel either directly or through a committee member for whom the industry was a favored constituency.[33] The chair could therefore direct industry support to cooperative legislators, perhaps in consultation with party leadership. Just as the supply of regulation is sensitive to marginal effects in the Peltzman model, so too the distribution of the payment among members of Congress could be managed in a way that maximized the chair's power.

In short, the institutional structure of Congress fit neatly with the regulatory techniques of the middle half of the 20th century. Although they

31. Civil Aeronautics Act of 1938, Pub. L. No. 75-706, §§ 403(a)-(b), 52 Stat. 973, 992-93.

32. An Act to Amend the Civil Aeronautics Act of 1938, Pub. L. No. 82-538, §§ 2-3, 66 Stat. 628, 628-29 (1952).

33. *See* RICHARD F. FENNO, JR., CONGRESSMEN IN COMMITTEES 114-22 (1973) (describing leadership styles in House committees).

imposed deadweight losses, cartel-enforcing regulations were a simple and efficient means to generate rents for industries and to distribute those rents within the industry, for the reasons Stigler outlined. The power and long tenure of committee chairs facilitated long-term relationships in which politicians received a predictable stream of support and the industry a predictable stream of rents, subject to adjustment for unanticipated conditions.

In this system, the regulatory agency's role was largely ministerial. It found facts and on that basis approved price schedules and granted or denied (mostly denied) applications for new entry into the regulated industry. Congress made the important policy decisions. Indeed, Weingast and Moran found that during the period 1964-1976, the Federal Trade Commission's discretionary decisions can be explained by the preferences of Congressional oversight committees, supporting what the authors call a "legislative control model" of independent agencies.[34]

B. From the Early 1970s to Today

Were Congress only in the business of writing regulatory statutes, the system just described might have continued indefinitely. Southern and northern Democrats of the postwar era, however, disagreed on social issues, particularly civil rights and social welfare legislation.[35] Those disagreements came to a head in the 1960s, as newly elected, liberal northern Democrats introduced bills that died or were watered down in committees chaired by southern Democrats.[36]

Calls for Congressional reform began in the 1960s and came to fruition in the early 1970s. The most important reforms for purposes of this discussion were made at the level of the Democratic caucus.[37] It changed its rules so that when it was the majority party, committee chairs could be replaced by secret ballot of the caucus upon the request of 20 percent of its members.[38] Various other measures reduced the power of committee chairs.

The changes were intended to centralize power by strengthening the hand of party leaders at the expense of committee chairs. They did indeed strengthen party leaders relative to committee chairs, but they did not effectively centralize power. Instead, subcommittees and staffers proliferated, introducing new chokepoints into the legislative process.[39] In the Senate, each member became to some extent a separate power center.

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34. *See* Barry R. Weingast & Mark J. Moran, *Bureaucratic Discretion or Congressional Control? Regulatory Policymaking by the Federal Trade Commission*, 91 J. POL. ECON. 765, 765 (1983).

35. *See* ROHDE, *supra* note 28, at 7-8, 11, 17-20 (describing tensions between liberal and conservative Democrats and pressure for institutional change).

36. *See* DEERING & SMITH, *supra* note 29, at 32-33.

37. *See* ROHDE, *supra* note 28, at 17-28.

38. *See* DEERING & SMITH, *supra* note 29, at 36-37; ROHDE, *supra* note 28, at 11-12.

39. *See* DEERING & SMITH, *supra* note 29, at 42-44; ROHDE, *supra* note 28, at 12.

Although the direction of causation is neither clear nor important for present purposes, the post-reform Congress also became more ideologically polarized, as liberal Republicans and conservative Democrats either exited Congress or switched parties. Commentators commonly refer to the consequence as "gridlock."[40] Gridlock makes it difficult for Congress to compromise and therefore to legislate in ways that change the status quo.[41]

Major policy shifts now tend to come in the form of "omnibus" bills with two characteristics. First, they put together many vaguely related issues into a single, large bill. Second, the resulting bill often progresses under procedures that limit committee and floor debate and amendment.[42]

On one hand, omnibus bills give party leaders a way to control the legislative process. Leaders assemble bills behind closed doors, with individual members in the dark about the full details of the package.[43] On the other hand, omnibus bills are classic examples of logrolling that give individual members an opportunity to insert provisions of particular interest to them as the price for their vote (perhaps sight unseen) on the rest of the package.[44]

In short, Congress operates very differently today compared to the period from the New Deal to 1970. The 1970s reforms demolished the structure that facilitated long-term relationships between regulated industries and Congress. It is not surprising, then, that the type of regulatory legislation Congress produces is also different.

Numerous classic contracts cases involve a standard pattern. Parties to a long-term contractual relationship act for years according to the precepts of relational contracting, adjusting their obligations informally in response to changing circumstances in ways that their original agreement does not explicitly require.[45] This process, however, falls apart after a change in the ownership or management of one of the parties. The new owner or manager insists on reverting to the formal contract terms.

For example, in *Feinberg v. Pfeiffer Co.*,[46] a company paid a pension to a retired employee to which her entitlement was moral rather than contractual—until the company's president and largest stockholder died and his heirs took control of the company. The heirs ended the payments after consulting an attorney about their legal enforceability. Similarly, in *Webb*

40. The term is sufficiently common that it received its own symposium, *see* Symposium, *The American Congress: Legal Implications of Gridlock*, 88 NOTRE DAME L. REV. 2065 (2013).

41. *See* SARAH A. BINDER, STALEMATE: CAUSES AND CONSEQUENCES OF LEGISLATIVE GRIDLOCK 34-56 (2003).

42. *See* GLEN S. KRUTZ, HITCHING A RIDE: OMNIBUS LEGISLATING IN THE U.S. CONGRESS 3-4 (2001).

43. *Id.* at 4, 8, 32.

44. *Id.* at 33.

45. *See* Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations under Classical, Neoclassical, and Relational Contract Law*, 72 NW. L. REV. 884, 889-99 (1978) (describing principles of relational contract law).

46. 322 S.W.2d 163 (Mo. Ct. App. 1959).

v. McGowin,[47] the president and part owner of a lumber company promised and made regular payments to a worker who had been injured on the job. After the president's death, his successors discontinued the payments, again after consulting counsel.

Contracts teachers and students know these old chestnuts as part of the evolution of reliance and restitution-based exceptions to the consideration doctrine. For present purposes, however, the key feature is that one party was willing to maintain an informal adjustment of its obligations that the contract did not clearly require, but that sustained the larger contractual relationship. That adjustment continued until a change in management, whereupon the affected party reverted to the original terms of the contract.

Congress also experienced something akin to a change in management in the 1970s. It can no longer provide legislation any time the price is right. Instead, policy shifts are possible only in limited and unpredictable circumstances when the political winds blow in just the right direction. Congress and regulated industries cannot, therefore, maintain long-term reciprocity-based relationships.

As Peltzman notes, a shortcoming of the economic theory of regulation is its inability to explain the timing of regulatory change.[48] The economic theory did not predict the de-cartelization wave of the late 1970s and early 1980s because it focused only on the demand for regulation. The demand-side explanations are unsatisfactory. For example, they can plausibly explain regulatory change in the railroad industry, which saw its rents largely disappear by the 1970s. By contrast, the interstate trucking industry continued to benefit from the Interstate Commerce Commission's ability to fix prices and restrict entry. Yet a combination of ICC decisions and legislation de-cartelized both.

Priest's relational contracting framework, which naturally draws our attention to regulation's supply side as well as its demand side, can better explain the timing. Congress's sudden inability to continue long-term, reciprocity-based relational contracts made it difficult or impossible for industries to fend off growing competitive innovations. This does not mean that ideas played no role; scholars have made a strong case that economic theories of regulation influenced agency and Congressional reaction to these innovations. But it is noteworthy that the dam broke so quickly after Congress revised its practices in ways that left it unable to commit credibly to make and enforce adjustments to regulatory parameters.

It might seem that the post-reform Congress would have as much trouble de-cartelizing as it has had enacting other types of legislation. This was not the case for the straightforward reason that anticompetitive rules

47. 168 So. 196 (Ala. Ct. App. 1935).
48. Peltzman, *Deregulation*, *supra* note 22, at 14-26.

are under constant pressure from innovators and potential entrants. Once support for cartel-enforcing rules declined, that pressure increased.

Innovators and new entrants were highly active in the 1970s. Mutual fund companies created money market mutual funds offering market rates of interest in competition with banks whose interest rates were capped by federal regulation. Institutional investors used regional stock exchanges to bypass the New York Stock Exchange's SEC-approved fixed commission rates. The advent of point-to-point microwave communication threatened AT&T's long-distance telephone monopoly.

In a prior era, the affected industries could have gone to the relevant committee chairs and sought amendments to the relevant statutes to address these new competitive methods. With committee powers on the wane, regulatory agencies became the front-line responders and were forced to decide whether to attempt to suppress the innovations. In some instances, such as bringing money market mutual funds into the banking system or outlawing the use of microwave transmissions to carry voice signals, it was not even clear that the agency had the authority to do so without new legislation.[49]

Moreover, more junior and entrepreneurial members of Congress began to signal to agencies that support for cartel-enforcing regulations was waning.[50] Beginning in 1974, Senator Edward Kennedy, chair of the Subcommittee on Administrative Practice and Procedure of the Judiciary Committee, held hearings criticizing the Civil Aeronautics Board. The CAB then shifted in a more pro-competitive direction, which accelerated when Alfred Kahn became the agency's head in 1977. By the time of the Airline Deregulation Act of 1978, which ended the CAB's control over fares and routes and phased out the agency, de-cartelization was well underway. Similarly, Representative Torbert MacDonald, also of Massachusetts, held hearings in the newly created Subcommittee on Communications of the Committee on Interstate and Foreign Commerce criticizing the Federal Communications Commission for hampering competition in cable television and long-distance telecommunications.

The regulated industries initially fought these incursions from innovators and new entrants, but by the time Congress acted, they had muted or dropped their opposition to de-cartelization.[51] One can simply conclude that the industries' political clout had collapsed. A more theoretically satisfying possibility is that industry incumbents concluded that any victory would be pyrrhic—they would continue to operate under a regulatory

49. *See, e.g.*, MCI Telecommunications Corp. v. FCC, 561 F.2d 365 (D.C. Cir. 1977) (FCC erred in denying MCI permission to expand its microwave telecommunications services); Paul G. Mahoney, *Deregulation and the Subprime Crisis*, 104 VA. L. REV. 235, 294 & n.229 (2018) (Justice Department advised SEC that shares in money market mutual funds were not "deposits" for federal banking law purposes).

50. *See* DERTHICK & QUIRK, *supra* note 21, at 66-67.

51. *Id.* at 147.

umbrella, but Congress could no longer credibly commit to expand the umbrella to cover new competitors and new forms of competition.

Regulation did not die out, nor did it cease to benefit producers at the expense of consumers. But the simple system of cartel enforcement with its steady stream of rents and payments came to an end. In its place, we have an explosion of individual conduct of business rules, any one of which can redistribute wealth from one interest group to another.

Industries learned that health and safety regulations can protect incumbent firms from innovators or new entrants, particularly if the industry helps shape the details. Large pharmaceutical companies get faster approval of new drugs from the Food and Drug Administration than their smaller rivals.[52] Critics argue that university accreditation under Department of Education guidance creates a one-size-fits-all model, stifling innovations with the potential to reduce the cost of higher education.[53] Even the mandatory disclosure system adopted in the Securities Act of 1933 led to more concentration in the investment banking industry.[54] Regulated industries' external lobbyists and trade associations are therefore fixtures in Congress and the regulatory agencies, arguing that incumbent firms' practices are pro-consumer, pro-labor, or pro-environment, whereas competitors' practices are harmful.

The goals and tactics of those lobbyists and associations have changed. Regulation in the pre-reform era was like a formal banquet with a set menu, well defined portions, and a small and carefully curated guest list. The job of an industry lobbyist was simply to get an invitation. Today, regulation is more like the sporadic appearance of a large snack tray with dozens or even hundreds of different items. An industry's job now is to predict when and where the tray will come out and to request that its favored snack be included.

The industry lobbyist's task today is also more complex than maintaining cordial relations with the relevant committee chair and party leader. Industries play an active role in crafting legislative and regulatory language. Although Congressional leadership assembles the pieces of an omnibus regulatory bill such as the Sarbanes-Oxley Act, the Dodd-Frank

52. *See, e.g.*, Daniel Carpenter, Brian Feinstein, Colin Moore, Marc Turenne, Ian Yohai and Evan James Zucker, *Why Do Bigger Firms Receive Faster Drug Approvals?* (Harv. U. Dep't of Gov. Working Paper, 2004) (manuscript at 1) (noting "apparent consensus underlying the regulatory advantages of larger firms" in the FDA process); *see also* Henry G. Grabowski and John M. Vernon, *Structural Effects of Regulation on Innovation in the Ethical Drug Industry*, in ESSAYS ON INDUSTRIAL ORGANIZATION IN HONOR OF JOE S. BAIN 181, 182, 190 (P. David Qualls ed. 1976) (noting that prior research on competitive effects has focused on "'traditional' regulatory situations in which entry or prices are directly controlled", but finding that the FDA approval process also affects industry structure).

53. *See* Susan D. Phillips and Kevin Kinser, ACCREDITATION ON THE EDGE: CHALLENGING QUALITY ASSURANCE IN HIGHER EDUCATION 2 (Susan D. Phillips and Kevin Kinser, eds., 2018) ("[A]ccreditation is seen as in opposition of needed innovation by some.").

54. *See* Paul G. Mahoney, *The Political Economy of the Securities Act of 1933*, 30 J. LEGAL STUDIES 1, 12-13 (2001).

Act, or the Affordable Care Act, the pieces themselves may originate with the White House, lobbyists, or think tanks or other policy entrepreneurs.[55] Industries must constantly court potential allies and be ready with proposed legislative language that achieves their goals. Between major legislative interventions, regulatory agencies make policy. Industries must therefore be on the lookout for proposed rules and ready to submit comments and meet with commissioners or staff.

Congress has carved out a new and creative role for itself in this interstitial policy making process. Brian Feinstein and Todd Henderson recently documented that former Congressional staffers make up nearly half of the commissioners of a group of major independent regulatory agencies.[56] That number has risen steadily since the mid-1970s. This phenomenon gives individual members of Congress influence over policy making in the agencies.

I have focused so far on the type of regulation supplied and the procedure by which it is created. The arrangements through which industries pay for this regulation have changed too. Rather than being wined and dined by lobbyists, members of Congress plan to serve and then *become* lobbyists, receiving cash to help deliver a few precious sentences or phrases in a statute or rule. In 1976, roughly 5% of retiring Senators subsequently became lobbyists. By 2012, the number was nearly 60%.[57] Recent research on post-government employment of Representatives also found that about 60% worked in lobbying or related activities.[58] Meanwhile, former commissioners and staffers of regulatory agencies often take jobs in the industry they regulated.[59]

These patterns make sense in a world in which seniority and title are no longer the best indicators of an official's ability to supply regulatory rents. Hiring a former official as the head of a trade association or contracting with the ex-official as an external lobbyist can serve as a form of deferred payment for services rendered. In addition, the availability of

55. For descriptions of the process, see John Cannan, *A Legislative History of the Affordable Care Act: How Legislative Procedure Shapes Legislative History*, 105 LAW LIB. J. 131 (2013); DAVID SKEEL, THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES (2010); Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521 (2005).

56. *See* Brian D. Feinstein & M. Todd Henderson, *Congress's Commissioners: Former Hill Staffers at the SEC and Other Independent Regulatory Commissions*, 38 YALE. J. ON REGUL. 175, 184-89 (2021).

57. *See* Jeffrey Lazarus, Amy McKay & Lindsey Herbel, *Who Walks Through the Revolving Door? Examining the Lobbying Activity of Former Members of Congress*, 5 INT. GRPS. & ADVOCACY 82, 85 (2016); *see also* Alan Zibel, *Revolving Congress: The Revolving Door Class of 2019 Flocks to K Street* 1, 4-5 (Public Citizen 2019) (listing post-Congress employment of former members of 115th Congress)

58. *See Zibel, supra* note 57, at 4-5 (listing post-Congress employment of former members of 115th Congress).

59. *See* Ivana V. Katic, Antecedents and Consequences of the Revolving Door between U.S. Regulatory Agencies and Regulated Firms 51 (2015) (Ph.D dissertation, Columbia University) (SCRIBD).

lucrative post-government employment turns the time in office into a try-out. An industry can observe the performance of legislative and regulatory personnel, determine which ones are most skilled at shepherding redistributive regulations through the relevant process, and then hire them after their government service.

Consider, for example, the aftermath of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, a complex mixture of entitlements, subsidies and regulations in a 400-plus page statute.[60] Shortly after its enactment, one of its chief architects departed Congress to become the CEO of Pharmaceutical Research and Manufacturers of America, the pharmaceutical industry's principal lobbying organization.[61] Multiple Congressional staffers contemporaneously departed to lobby for the industry.[62] Former members of Congress head trade associations in other heavily regulated industries, including higher education and the securities industry.[63]

The changing pattern of compensation reflects the changing distribution of power within Congress and regulatory agencies. Campaign contributions are an effective currency in a relatively centralized system in which the power to deliver desired regulations is largely determined by position. Post-government employment is a more effective currency in a decentralized system in which regulatory innovations are often the result of entrepreneurial effort. Long-term relationships continue to matter, but selecting and paying the contractual partner has become a more complex task.

Conclusion

George Priest's relational contract model of regulation was useful for understanding why public utility regulation evolved as it did. States switched *en masse* from regulation by franchise agreement to regulation by public utility commission even though the characteristics of the utilities themselves, and therefore the demand side of the regulatory bargain, varied from state to state.

A similar mode of analysis can help us understand why the dominant mode of regulation switched *en masse* from price and entry regulation to conduct of business rules. Changes in the distribution of power within Congress made it difficult to maintain existing relationships between regulated industries and the relevant Congressional committees. Over time, a new

60. *See* Pub. L. 108-173, 117 Stat. 2066 (2003).

61. *See* Emma Dorey, *Conflicts of Interest*, CHEM. & INDUS. 12, 12 (Feb. 2005).

62. *Id.*

63. *See Jason Altmire*, CAREER ED. COLLEGES AND UNIVS., https://www.career.org/web/About/Staff-Profiles/Jason-Altmire.aspx [https://perma.cc/VK8X-B295] (bio of Jason Altmire, CEO of Career Education Colleges and Universities); *Kenneth E. Bentsen, Jr.*, SIFMA, https://www.sifma.org/people/kenneth-e-bentsen-jr [https://perma.cc/FA76-5MK6] (bio of Kenneth E. Bentsen, Jr., CEO of the Securities Industry and Financial Markets Association) .

set of relationships based on post-government employment or contracting has emerged.