Takings Opinion Letter

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Re Opinion of Law Concerning the Constitutionality of the Commission's Proposal in *Direct Access to the INTELSAT System*, IB Docket No. 98-192, to Require Level 3 Direct Access to Space Segment Capacity on the INTELSAT System

Dear Mr. Zeger:

This letter responds to your request that I provide Comsat Corporation my opinion of law on various questions concerning the obligation of the U.S. government to compensate Comsat if the Federal Communications Commission (FCC) were to order Level 3 direct access to the International Telecommunications Satellite Organization (INTELSAT), as the agency has proposed to do in *Direct Access to the INTELSAT System, Notice of Proposed Rulemaking*, IB Docket No. 98-192, released October 28, 1998. In that docket, the Commission tentatively reached the following conclusions of law concerning the U.S. government's obligation to compensate Comsat:

> We tentatively conclude that permitting other U.S. carriers and users to obtain Level 3 direct access to INTELSAT satellites would not violate the Fifth Amendment. We tentatively conclude that the provisions of the Satellite Act and the regulatory scheme created thereby do not result in a regulatory contract between the U.S. Government and Comsat that confers on Comsat an exclusive right to access INTELSAT satellites from the U.S. In addition, we tentatively conclude that Comsat possesses no contractual property right with respect to its access to INTELSAT satellites that could be considered vested property within the meaning of the Fifth Amendment. Moreover, the allowance of Level 3 direct access would not result in a permanent physical occupation, a physical invasion or an economic regulation of Comsat's private property that would constitute a taking requiring just compensation under the Fifth Amendment.[1]

Briefly stated, the Commission's tentative conclusions are legally incorrect. Contrary to the Commission's tentative conclusion, its order of Level 3 direct access to INTELSAT would constitute an uncompensated taking of Comsat's property in violation of the Takings Clause of the Fifth Amendment to the U.S.

1. Direct Access to the INTELSAT System, Notice of Proposed Rulemaking, IB Dkt. No. 98-192, ¶ 32 (released Oct. 28, 1998) [hereinafter *Direct Access NPRM*].

Constitution. Thus, the Commission's order of Level 3 direct access to the INTELSAT system would subject the U.S. government to liability for just compensation. Apart from violating the Takings Clause, such an order also would breach the regulatory contract into which the U.S. government entered with Comsat, thus giving rise to a claim by Comsat for expectation damages.

I do not express an opinion on the Commission's statutory authority to order Level 3 direct access (accompanied by appropriate cost recovery for Comsat) or on the precise empirical magnitude of the compensable loss that Comsat would suffer as a result of the Commission's imposition of Level 3 direct access. My legal conclusions hold (1) even if the Commission were found to possess the statutory authority to order Level 3 direct access, and (2) as long as the economic loss thereby imposed on Comsat would be nontrivial. I have reviewed the analysis of Professors Jerry R. Green and Hendrik S. Houthakker of Harvard University and Mr. Johannes P. Pfeifenberger of the Brattle Group, filed by Comsat in this docket contemporaneously with this opinion of law (hereinafter "Green-Houthakker-Brattle Study"). I find the economic analysis of the Green-Houthakker-Brattle Study to be consistent with my own legal analysis of the takings and regulatory contract issues raised by this proceeding, and I accept for purposes of my legal analysis the accuracy of their assessment of Comsat's economic losses from Level 3 direct access.

My qualifications for rendering this legal opinion are detailed in a narrative biography and my curriculum vitae, which are attached to this letter. In brief, my credentials are as follows. I am the F.K. Weyerhaeuser Fellow in Law and Economics at the American Enterprise Institute for Public Policy Research, where for nearly seven years I have directed the Institute's Studies in Telecommunications Deregulation. I am also a Senior Lecturer at the Yale School of Management, where I teach a graduate course on regulation and strategy in telecommunications. I served as Deputy General Counsel of the FCC from 1987 to 1989. I am the author or co-author of several books on telecommunications regulation, including *Deregulatory Takings and the Regulatory Contract: The Competitive Transformation of Network Industries in the United States* (Cambridge University Press 1997). I have provided expert testimony on takings issues and regulatory contract issues in network industries in many proceedings in the United States and other nations.

I present this legal opinion in my individual capacity as a member of the Bar of the District of Columbia and not on behalf of the American Enterprise Institute or the Yale School of Management.

This opinion of law is organized as follows. Part I describes the essential facts concerning Comsat's business and Level 3 direct access to INTELSAT. Part II concludes that Level 3 direct access would breach the regulatory contract between Comsat and the U.S. government. Part III concludes that Level 3 direct access would constitute a permanent physical invasion of Comsat's property and thus a per se taking of property obligating the U.S. government to pay Comsat just compensation under the Takings Clause of the Fifth Amendment. Part IV concludes that the Commission's NPRM would fail to provide Comsat just compensation for the taking of its property or expectation damages for breach of its regulatory contract with the United States. If the Commission were to order Level 3 direct access, the access pricing rule (and associated cost recovery policies achieved through means other than the price of direct access) that would be necessary to give Comsat just compensation for the taking of its private property or to equal Comsat's expectation damages for the U.S. government's breach of the regulatory contract would be a rule that compensated Comsat for its opportunity cost of forgoing sales, in a competitive marketplace, of INTELSAT space segment capacity to U.S. carriers and users. Part V addresses miscellaneous administrative and jurisprudential questions raised by the NPRM.

I. LEVEL 3 DIRECT ACCESS AND COMSAT'S ORIGINAL MISSION AND STRUCTURE

The Communications Satellite Corporation, later renamed Comsat Corporation, was formed pursuant to the Communications Satellite Act of 1962, often called the Satellite Act.[2] The policy of the statute was to "establish, in conjunction and cooperation with other countries, as expeditiously as practicable a commercial communications satellite system . . . which will be responsive to public needs and national objectives, which will serve the communication needs of the United States and other countries, and which will contribute to world peace and understanding."[3] One of Congress's particular objectives in creating Comsat was to ensure that "care and attention . . . be directed toward providing such services to economically less developed countries and areas."[4] Subsequently, INTELSAT was created by treaty with Comsat as the U.S. signatory.[5] The United States committed itself to "foster and support" INTELSAT, to make communications services available to consumers "utilizing the space segment facilities of INTELSAT," and not to allow use of competing facilities if such use would cause "significant economic harm to the global system of INTELSAT" or would violate the obligations of the United States under the INTELSAT Agreement.[6] In 1978, Congress provided for U.S. participation in a second treaty organization, the International Maritime Satellite Organization (INMARSAT), to "develop and operate a global marine satellite telecommunications system" to serve "maritime commercial and safety needs of the United States and foreign countries."[7]

A. *Ownership and Governance of Comsat under the Formative Legislation and Agreements*

Congress determined in 1962 that "United States participation in the global [satellite] system shall be in the form of a private corporation, subject to appropriate governmental regulation."[8] At the time, Congress found that U.S. participation in the global system through a single private and regulated corporation would allow for the "widest possible participation by private enterprise," was the proper way to offer "nondiscriminatory access" to all "authorized users," and would "strengthen competition in the provision of communications services to the public."[9] Comsat was therefore formed to be the U.S. participant in INTELSAT. One form that this participation has taken is that Comsat is, by the direction of the U.S. government, the sole U.S. "signatory" to INTELSAT.

2. Pub. L. No. 87-624, 76 Stat. 423 (1962) (codified as amended at 47 U.S.C. §§ 731-57).
3. 47 U.S.C. § 701(a).
4. *Id.* § 701(b).
5. *See* INTELSAT AGREEMENT ART. II; *see also* INTELSAT OPERATING AGREEMENT ART. 2.
6. Pub. L. No. 99-43, 99 Stat. 425 *et seq.*, title I, § 146(a)(2), (3).
7. Pub. L. No. 95-564, 92 Stat. 2392 *et seq.* (1978) (codified at 47 U.S.C. § 751(a)).
8. 47 U.S.C. § 701(c).
9. *Id.*

Comsat is, by statute, a "corporation for profit" and is not "an agency or establishment of the United States Government."[10] The United States has neither funded nor otherwise subsidized Comsat. Unlike a government-owned enterprise such as the U.S. Postal Service, Comsat pays federal, state, local, and foreign taxes on its income[11] and is explicitly subject to the antitrust laws.[12] Far from subsidizing Comsat, Congress authorized and expected Comsat to help finance a global satellite communications system by selling shares of voting capital stock "in a manner to encourage the widest distribution to the American public"[13] and, with the FCC's approval, to sell other stock and debt securities to private investors.[14] Comsat's stock is listed on the New York Stock Exchange.

INTELSAT is governed by the Agreement Relating to the International Telecommunications Satellite Organization, entered into force February 12, 1973, as amended, to which the parties are 142 countries (commonly called the INTELSAT Agreement), and the Operating Agreement Relating to the International Telecommunications Satellite Organization, of the same date, as amended, the signatories to which (including Comsat) are designated by their respective countries (commonly called the INTELSAT Operating Agreement). Comsat was directed by the U.S. government to sign the INTELSAT Operating Agreement and is, of course, bound to it. The INTELSAT Operating Agreement governs, among other things, each signatory's share of ownership, mandatory new capital investment, and share of revenue distributions (capital repayments and compensation). The INTELSAT Agreement provides that each signatory "shall have an investment share corresponding to its percentage of all utilization of the INTELSAT space segment by all signatories."[15] That provision means that Comsat's investment share, and hence its share of INTELSAT's costs, is determined by the U.S. share of INTELSAT's *traffic*. In general, each signatory, including Comsat, is obligated to make contributions to INTELSAT's capital requirements "in proportion to its investment share" and is entitled (assuming that Comsat retains exclusive access to INTELSAT) to receive capital repayment and a return on capital in the same proportions.[16] In that sense, Comsat can best be regarded as a partner in INTELSAT, an unincorporated entity.[17] Pursuant to the INTELSAT Operating Agreement, as of December 31, 1997, Comsat held 18.0 percent of the ownership of INTELSAT.[18] Comsat's share of INTELSAT's traffic is approximately 15 percent. Comsat has increased its ownership by three percentage points (know as "excess ownership") to its 18 percent share of INTELSAT by acquiring, pursuant to INTELSAT rules, the ownership shares of other signatories, usually impoverished nations in need of capital.

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10. *Id.* § 731.

11. *Compare* COMSAT CORP., 1997 ANN. REP. 41 (1998) *with* J. GREGORY SIDAK & DANIEL F. SPULBER, PROTECTING COMPETITION FROM THE POSTAL MONOPOLY 2 (AEI Press 1996).

12. *Compare* 47 U.S.C. § 701(c) ("The activities of [Comsat] . . . and of the persons or companies participating in the ownership of the corporation shall be consistent with the federal antitrust laws.") *with* SIDAK & SPULBER, PROTECTING COMPETITION FROM THE POSTAL MONOPOLY, *supra* note 11, at 1, 156–57, 162.

13. 47 U.S.C. § 734.

14. *Id.* §§ 721(c)(8), 734(c).

15. INTELSAT AGREEMENT ART. V(b); *see also* INTELSAT OPERATING AGREEMENT ART. 6.

16. *See* INTELSAT OPERATING AGREEMENT ARTS. 6, 8.

17. COMSAT CORP., 1997 SEC FORM 10-K, at 6, 13 (1998).

18. *Id.* at 6, 13.

B. *Incumbent Burdens Imposed on Comsat by Statute or Regulation*

Although Comsat is a private, for-profit entity, the United States and its agencies have played a large role in Comsat's affairs. For example, Congress has directed Comsat to "plan, initiate, construct, own, manage, and operate itself or in conjunction with foreign governments or business entities a commercial communications satellite system,"[19] and "to acquire the physical facilities, equipment and devices necessary to its operations, including communications satellites and associated equipment."[20] On important matters, Comsat must consult with, and obey the instructions of, the President of the United States, the Department of State, the FCC, and other agencies. For example, the President shall supervise relationships of Comsat with foreign governments or entities or with international bodies to assure consistency with U.S. foreign policy.[21] Similarly, Comsat must notify and consult with the Department of State regarding "business negotiations . . . with any international or foreign entity."[22] The Department of State may, and as a practical matter does, directly participate in such negotiations.[23] Comsat is also a common carrier broadly subject to the FCC's authority to regulate facilities and rates.[24] These agencies, and the Department of Commerce, supervise Comsat's activities within INTELSAT and instruct Comsat on the positions that it should take before INTELSAT's governing board.[25]

In addition to directing Comsat's activities in certain respects, the United States has also *restricted* Comsat's activities, barring the corporation from taking actions, including pursuing otherwise valuable business opportunities, that could adversely affect the success of INTELSAT. For example, the FCC in 1980 curtailed Comsat's freedom to pursue the satellite business outside INTELSAT if the agency believed that such activities would compete with INTELSAT or otherwise interfere with the Comsat's primary allegiance to INTELSAT.[26] Comsat also faces two significant regulatory restrictions on its capital structure. First, the Satellite Act forbids any person other than an authorized carrier from owning more than 10 percent of Comsat's common stock.[27] Second, the same statute authorizes the FCC to regulate Comsat's debt-to-capital ratio.[28]

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19. 47 U.S.C. § 735(a)(1).

20. *Id.* § 735(b)(2).

21. *Id.* § 721(a)(4).

22. *Id.* § 742.

23. *See* Elizabeth A. Snodgrass, Note, *Foreign Affairs in the Twilight Zone: The Foreign Affairs Powers of the Federal Communications Commission*, 83 VA. L. REV. 207, 216 (1997) ("[T]he Communications Satellite Act clearly indicates that the State Department controls Comsat's role as United States representative to INTELSAT and the United States' contacts with foreign nations.").

24. 47 U.S.C. §§ 741, 753(e).

25. *See id.* §§ 721(a)(4), 742.

26. Implementation of Section 505 of the International Maritime Satellite Act (COMSAT Study), 77 F.C.C.2d 564 (1980).

27. 47 U.S.C. § 734(b)(3); *see also* COMSAT CORP., 1997 SEC FORM 10-K, at 36 (1998).

28. 47 U.S.C. §§ 721(c)(8), 734(c). The FCC plays a role in regulating Comsat's capital structure that is reminiscent of a bank regulator or a loan officer at a commercial bank:

> The corporation's capital structure and debt-financing activities are regulated by the FCC. The corporation is required to submit a capitalization plan to the FCC for review annually. In August 1997, the FCC approved the corporation's 1997 capitalization plan. Under the approved FCC guidelines, the corporation is subject to a limit of $200 million in short-term debt, a maximum long-term, debt-to-total-capital ratio of 45%

Until April 28, 1998, when the FCC declared Comsat to be "nondominant,"[29] Comsat had essentially been regulated as a public utility. As such, it was subject to rate-of-return regulation. The FCC's nondominance decision officially eliminated that regulation and recognized that Comsat faces competition over international routes that so constrains its pricing as to make rate regulation superfluous, if not deleterious. Since the 1980s, other private companies have been allowed to provide facilities-based satellite communications services. As the Green-Houthakker-Brattle Study explains, Comsat also faces extensive competition from other facilities-based providers of international telecommunications services—notably, high-capacity, fiber-optic, undersea cables.

C. *Comsat's Exclusive Access to INTELSAT from the United States*

The primary means by which Comsat recovers, and earns a competitive return on, its invested capital is by selling, at retail, access to space segment capacity on the INTELSAT system. Comsat owns the U.S. portion of the system and serves as the exclusive provider for INTELSAT services in the United States. In other words, Comsat earns a profit for its shareholders by selling retail access to a competitive satellite system in which it is a partial owner. Comsat's exclusive rights to access the INTELSAT system from the United States are analogous to a familiar phenomenon in the *Sylvania* line of antitrust cases: The manufacturer of a branded product grants exclusive territories on distributors for the purpose of promoting their investment (in marketing efforts or other activities) that enhance the product's competitiveness relative to other branded substitutes.[30] In Comsat's case, it is both the American distributor of INTELSAT services and a co-owner of the INTELSAT system, which competes against other satellite systems and submarine cables. Depriving Comsat of its exclusive franchise within the United States would cut out Comsat as the seller of INTELSAT transmission capacity and substantially diminish Comsat's opportunity to recover, and earn a competitive return on, its investment in INTELSAT.

> and an interest coverage ratio of 2.3 to 1. The latter two guidelines are measured at year end. The corporation was in compliance with the guidelines at December 31, 1997, with a long-term, debt-to-total-capital ratio of 44.1%, $163 million in short-term debt outstanding and an interest coverage ratio of 2.6 to 1.
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> If the corporation were to fail to satisfy one or more of the FCC guidelines as of an applicable measurement date, the corporation would be required to seek advance FCC approval of future financing activities on a case-by-case basis. If such approval were not granted, the corporation could be required to reduce or reschedule planned capital investments, reduce cash outlays, reduce debt or sell assets.

COMSAT CORP., 1997 SEC FORM 10-K, at 41 (1998).

29. Comsat Corporation; Petition Pursuant to Section 10(c) of the Communications Act of 1934, as amended, for Forbearance from Dominant Carrier Regulation and for Reclassification as a Non-Dominant Carrier; Policies and Rules for Alternative Incentive Based Regulation of Comsat Corporation; Petition for Partial Relief From the Current Regulatory Treatment of Comsat World Systems' Video and Audio Services; Petition for Partial Relief From the Current Regulatory Treatment of Comsat World Systems' Switched Voice, Private-Line, and Video and Audio Services; Panamsat Corporation; Petition to Reopen Changes in the Corporate Structure and Operations of the Communications Satellite Corporation, Order and Notice of Proposed Rulemaking, IB Dkt. No. 98-60, CC Dkt. No. 80-634, 13 F.C.C. Rcd. 14,083 (1998) [hereinafter *Comsat Nondominance Order*].

30. Continental T.V., Inc. *v.* GTE Sylvania Inc., 433 U.S. 36 (1977).

"Direct access" is the shorthand phrase used to describe the termination of Comsat's exclusive access to INTELSAT satellites from the United States. In its NPRM, the Commission tentatively concluded (contrary to the conclusion contained in the legal opinion of Wiley, Rein & Fielding, filed contemporaneously with this opinion of law) that Congress has already delegated to the agency the statutory authority to compel Comsat to permit U.S. carriers and users to bypass Comsat and to contract directly with INTELSAT for the purchase of space segment capacity. This form of direct access is called "contractual" or Level 3 direct access. The effect of Level 3 access would be to enable a U.S. user of INTELSAT space segment capacity to buy that capacity at the wholesale price paid by Comsat to INTELSAT, rather than Comsat's retail price to its customers.

Comsat purchases space segment capacity from INTELSAT at a price called the "INTELSAT utilization charge," or IUC. The difference between the IUC and the space segment portion of Comsat's tariff is Comsat's retail margin on the sale to U.S. users of space segment capacity on the INTELSAT system.[31] As the Commission noted in its NPRM in this proceeding, it previously found in 1984 that "that the IUC, while serving as a measure of the costs INTELSAT incurs in operating the system, is not a measure of *Comsat's* costs because it does not reflect the internal costs which Comsat incurs making satellite circuits available to U.S. customers and engaging in other activities connected with its role as U.S. Signatory."[32]

By far the largest part of Comsat's return on its investment in INTELSAT has resulted from its role as the exclusive provider in the United States of access to the INTELSAT system, with the accompanying obligation to provide access to all U.S. users on a nondiscriminatory basis.[33] By terminating Comsat's exclusivity and allowing Level 3 direct access to users who have no obligation to make any capital investment in the INTELSAT system, the Commission's NPRM would sharply reduce Comsat's revenue from its sale of space segment capacity on the INTELSAT system. Moreover, the NPRM would do so without any corresponding decrease in Comsat's continuing obligations to INTELSAT, which depend on the share of U.S. traffic carried on the INTELSAT system, *including* the traffic of users that would bypass any payment to Comsat by taking advantage of Level 3 direct access. The NPRM would allow Comsat's customers to secure access to the American portion of the INTELSAT system directly, while ignoring the financial impact on the American co-owner of that system, Comsat. Customers would thereby get a free ride: They would gain the use of facilities partially owned by Comsat, without compensating the U.S. carrier. To perform its role within INTELSAT, Comsat has made nonsalvageable investment of many hundreds of millions of dollars to build and maintain the INTELSAT system. Comsat has also made contractual commitments for up to fifteen years into the future, reserving space in the INTELSAT system based on Comsat's contracts with its customers. In contrast, as the Commission noted in its NPRM, "Level 3 customers have no investment obligations . . . in the operation of the INTELSAT system."[34] Hence, Level 3 direct access customers would receive the benefits of

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31. *See* Regulatory Policies Concerning Direct Access to INTELSAT Space Segment for the U.S. International Service Carriers, Report and Order, 97 F.C.C.2d 296 (1984) [hereinafter *1984 Direct Access Order*], *aff'd*, Western Union Int'l, Inc. *v.* FCC, 804 F.2d 1280 (D.C. Cir. 1986).

32. *Direct Access NPRM* at ¶ 6 (citing *1984 Direct Access Order*, 97 F.C.C.2d at 310–19) (emphasis added).

33. 47 U.S.C. §§ 701(c), 735, 741.

34. *Direct Access NPRM* at ¶ 9.

Comsat's considerable investments in INTELSAT without contributing a fair and efficient share toward Comsat's recoupment of the cost of those investments, including a competitive, risk-adjusted return on invested capital.

As the Commission noted in its NPRM, INTELSAT began in 1992 to develop procedures for non-signatory carriers and users to purchase space segment capacity directly from INTELSAT rather than through INTELSAT signatories, including through Level 3.[35] But, as the Commission also noted, "INTELSAT only permits direct access in countries where direct access is authorized by the Signatory representative."[36] It bears emphasis that the Commission's discussion of Level 3 direct access did not at this point (or, indeed, at any point in the NPRM) consider the significance of whether the signatory representative to INTELSAT from a particular country was (1) a public enterprise rather than a private, investor-owned corporation or (2) a vertically integrated national carrier, such as the PTT that has traditionally been found in most industrialized nations other than the United States and has only recently undergone privatization and demonopolization.

The significance of the first fact neglected by the Commission is that it would affect whether the costs of a particular nation's decision to authorize Level 3 direct access to INTELSAT would be internalized across all taxpayers in their role as owners of a state enterprise that was the signatory to INTELSAT, or alternatively whether such costs would be externalized by being selectively imposed on the private investors of the corporation holding signatory status. The significance of the second fact neglected by the Commission is that it would indicate the likelihood that other carriers would exist in a particular nation's market, such that they would be able to seize upon the opportunity to contract directly with INTELSAT for space segment capacity. If a particular nation had a state-owned PTT and did not allow competitive entry into its telecommunications markets, the consequences of that nation's decision to embrace Level 3 direct access would be far different from the imposition of Level 3 direct access in a nation, such as the United States, where multiple carriers (such as AT&T, MCI WorldCom, and Sprint) and multiple users (such as the television networks, ABC, CBS, NBC, and Turner Broadcasting) have long existed and each individually greatly exceeds the size of the signatory to INTELSAT, Comsat. Thus, in its NPRM the Commission presented at best an incomplete description of the relevance of the practices of other nations to the current practice of the United States when the agency observed that "while direct access is not available in the United States, . . . [s]eventy-six countries permit Level 3 direct access . . . ."[37] Those foreign experiences are not relevant to the unique experience of Comsat, a privately owned corporation that provides competitive services to a wide range of other private corporations possessing far greater financial resources.

35. *Id.* at ¶ 8.
36. *Id.* at ¶ 9.
37. *Id.* at ¶ 10.

II. LEVEL 3 DIRECT ACCESS WOULD BREACH THE REGULATORY CONTRACT

Comsat's right to compensation for economic losses arising from unilateral, opportunistic changes in regulatory policy flows from first principles of contract law. "In both the civil and the criminal context, the Constitution places limits on the sovereign's ability to use its lawmaking power to modify bargains it has made with its subjects."[38] The regulatory contract is an enforceable legal relationship, not a mere metaphor. Compelling economic arguments confirm the need for such a contract, and substantial historical evidence substantiate that the regulatory contract does exist. In its NPRM, however, the Commission disputed Comsat's claim "that a regulatory contract arises under the Satellite Act between the U.S. Government and Comsat, and that U.S. Government action that permits U.S. carriers and users to access INTELSAT satellites directly from the U.S. would breach this contract."[39] Although the Commission based that conclusion in part on its reading of the Supreme Court's 1865 decision in *The Binghamton Bridge*,[40] the agency principally relied on its reading of the Court's 1996 decision in *United States* v. *Winstar Corporation*.[41] The Commission did not consider at all whether economic analysis is relevant to the question of whether a regulatory contract exists between Comsat and the U.S. government.

A. *Economic Theory Reinforces the Regulatory Contract*

The Commission's NPRM neglected any discussion of the substantial body of economic literature that explains the salutary effects from the creation and enforcement of the regulatory contract. Such analysis directly supports the conclusion that Comsat and the U.S. government entered into a binding regulatory contract. Moreover, such reasoning permeates the Supreme Court's reasoning in its 1996 decision in *Winstar*, the second of only two decisions by the Court that the Commission discussed in its abbreviated analysis of whether a regulatory contract exists between Comsat and the U.S. government.

Consumers and businesses voluntarily participate in a market transaction only if they receive *gains from trade*—that is, only if the transaction yields positive net benefits for them. A supplier will not invest in a transaction unless he expects the returns from the transaction to cover all costs, including a competitive return to invested capital. That principle is summarized in Armen A. Alchian's classic definition of cost: "In economics, the cost of an event is the highest-valued opportunity *necessarily* forsaken."[42] The supplier's costs of investing in the transaction include the highest net benefit of all opportunities forgone, known as *opportunity cost*.

Transaction-specific investment, such as Comsat's investment in INTELSAT's satellite, plays an important role in the regulatory contract. A regulated firm, such as Comsat was when it made its investments in INTELSAT, would not have undertaken the extensive investments required to provide regulated service within its franchise region without the opportunity to recover its costs. Professor Daniel

38. Lynce *v.* Mathis, 519 U.S. 433, 440 (1997).

39. *Direct Access NPRM* at ¶ 33.

40. 70 U.S. 51, 74 (1865), *cited in Direct Access NPRM* at ¶ 33 & n.97.

41. 518 U.S. 839 (1996).

42. Armen A. Alchian, *Cost*, *in* 3 INTERNATIONAL ENCYCLOPEDIA OF THE SOCIAL SCIENCES 404, 404 (David L. Sills ed., MacMillan Co. & Free Press 1968) (emphasis added).

Spulber has specifically written about the regulated firm's recovery of transaction-specific investments under the regulatory contract:

> The regulatory contract is often justified as a means of mitigating the risks of making large irreversible investments that are faced by regulated utilities. Customers of utilities gain from such commitments, since efficient levels of investment yield lower costs of service. There is an incentive to honor commitments regarding compensatory rates of return to assure that regulated firms will undertake future investment and that they will maintain their existing capital equipment. In practice, honoring commitments to investors in regulated utilities keeps down future borrowing costs by reducing investor risk.[43]

The President's Council of Economic Advisers endorsed such economic reasoning in its 1996 report:

> [T]here is an important difference between regulated and unregulated markets. Unregulated firms bear the risk of stranded costs but are entitled to high profits if things go unexpectedly well. In contrast, utilities have been limited to regulated rates, intended to yield no more than a fair return on their investments. If competition were unexpectedly allowed, utilities would be exposed to low returns without having had the chance to reap the full expected returns in good times, *thus denying them the return promised to induce the initial investment*. A strong case therefore can be made for allowing utilities to recover stranded costs where those costs arise from after-the-fact mistakes or changes in regulatory philosophy toward competition, as long as the investments were initially authorized by regulators.[44]

Similarly, the eminent French economists Jean-Jacques Laffont and Jean Tirole observe: "In the absence of a detailed long-term contract, the regulated firm may refrain from investing in the fear that once the investment is in place, the regulator would pay only for variable cost and would not allow the firm to recoup its sunk cost."[45]

Partial deregulation does not suddenly extinguish the duties that the government assumed under the regulatory contract. In the case of Comsat, the Commission's decision that it would no longer serve the public interest to subject Comsat to rate regulation on competitive routes is not evidence that a regulatory contract has not existed between Comsat and the U.S. government. Moreover, the

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43. DANIEL F. SPULBER, REGULATION AND MARKETS 610 (MIT Press 1989). For similar analyses, see JEAN-JACQUES LAFFONT & JEAN TIROLE, A THEORY OF INCENTIVES IN PROCUREMENT AND REGULATION 53–127 (MIT Press 1993); Victor P. Goldberg, *Relational Exchange: Economics and Complex Contracts*, 23 AM. BEHAVIORAL SCIENTIST 337, 340 (1980), *reprinted in* READINGS IN CONTRACT LAW 16, 18 (Victor P. Goldberg ed., Cambridge University Press 1989); Victor P. Goldberg, *Regulation and Administered Contracts*, 7 BELL J. ECON. 426 (1976); Paul L. Joskow & Richard Schmalensee, *Incentive Regulation for Electric Utilities*, 4 YALE J. ON REG. 1, 8–12 (1986); Dennis L. Weisman, *Default Capacity Tariffs: Smoothing the Transitional Regulatory Asymmetries in the Telecommunications Market*, 5 YALE J. ON REG. 149, 157–61 (1988); Glenn Blackmon & Richard Zeckhauser, *Fragile Commitments and the Regulatory Process*, 9 YALE J. ON REG. 73, 76–78 (1992).

44. 1996 ECONOMIC REPORT OF THE PRESIDENT 187 (Government Printing Office 1996) (emphasis added); *see also* 1997 ECONOMIC REPORT OF THE PRESIDENT 204–05, 207 (Government Printing Office 1997).

45. LAFFONT & TIROLE, *supra* note 43, at 54.

Commission's elimination of rate regulation on Comsat's competitive routes did not excuse the Commission from its continuing duty to allow Comsat the reasonable opportunity to recover costs *already incurred* to satisfy its obligation to serve. Even though Comsat has been declared nondominant on thick routes, it is still a common carrier with an obligation to serve the public accordingly. The Commission retains a duty to allow Comsat the reasonable opportunity to recover the cost of, and a competitive return on, its investments heretofore made to provide service.

A common carrier such as Comsat has had to undertake substantial investments to discharge its obligation to serve. The purpose of a regulatory contract is to provide for recovery of the full cost of an activity, including direct expenditures, the time cost of money expended for capital investment, and any other opportunity costs. As mentioned earlier, an opportunity cost of an activity is the net benefit forgone from the best alternative activity. The time cost of money is an opportunity cost of an investment because it represents the highest return that the investor could have earned by investing the money elsewhere.

The Commission's imposition of Level 3 direct access, without any accompanying cost recovery mechanism, would be an example of regulatory opportunism or "holdup." Professor Oliver E. Williamson defines *opportunism* as "self-interest seeking with guile"[46] and describes utility regulation as a "highly incomplete form of long-term contracting" in which the terms are adapted to "changing circumstances" to ensure the supplier of a fair rate of return.[47] The problem of regulatory opportunism stems from the fact that regulatory assets, including expenditures for plant and equipment and capitalized outlays to perform duties mandated by regulators, are likely to be transaction-specific. That is, the assets have little value outside the regulatory transaction. By incurring substantial capital expenditures to perform its obligation to serve, the regulated firm has made itself vulnerable to confiscation.

A regulated firm such as Comsat has already constructed its network facilities. It will keep those facilities in operation as long as revenues cover operating costs, even if revenues are not sufficient to allow even partial recovery of capital costs. The regulator understands that fact. The Commission has tentatively concluded in the NPRM that it will confiscate Comsat's retail margin on sales of access to the INTELSAT system and redistribute that stream of cash flows (which economists call quasi-rents) to Comsat's existing customers, such as AT&T, MCI WorldCom, Sprint, ABC, CBS, NBC, and Turner Broadcasting.

It would breach the regulatory contract for the Commission to make unilateral changes in regulation that might prevent Comsat from recovering the costs of investments that it made to discharge its regulatory obligations to serve. Contractual protections of the interests of the regulated firm and its investors exist so that the government and private companies can continue to make agreements requiring investments in highly specialized capital. The regulatory contract depends on protections to reduce and allocate the risk of cost recovery for specialized assets that cannot be salvaged if the contract is not per-

46. OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS 26 (Free Press 1975); OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING 47 (Free Press 1985).

47. Oliver E. Williamson, *Franchise Bidding for Natural Monopolies—in General and with Respect to CATV*, 7 BELL J. ECON. 73, 91 (1976).

formed.

Economic theory widely recognizes that commitments made in bargaining situations influence the behavior of other actors only to the extent that the person making such commitments is credibly bound (by himself or others) to honoring them.[48] The notion of enforceable agreements plays a similar role in regulated industries as it does in competitive markets. If the Commission orders Level 3 direct access, it must provide Comsat a substitute means of recovering the cost of, and a competitive return on, the investments that it made, at the U.S. government's behest, to build and maintain INTELSAT. The President's Council of Economic Advisers has made the same argument concerning recovery of stranded costs:

> [R]ecovery should be allowed for legitimate stranded costs. The equity reason for doing so is clear, but there is also a strong efficiency reason for honoring regulators' promises. Credible government is key to a successful market economy, because it is so important for encouraging long-term investments. Although policy reforms inevitably impose losses on some holders of existing assets, good policy tries to mitigate such losses for investments made based on earlier rules.[49]

The investors in a regulated firm would not be willing to commit vast amounts of capital to carry out an obligation to serve unless the regulator's offer of an opportunity to earn a fair rate of return were credible. Regulated firms (such as Comsat) have relied upon such contractual assurances in planning and carrying out their investment and service plans.

B. *The Historical Foundation for the Regulatory Contract in the Supreme Court*

Historical analysis confirms the existence of the regulatory contract. In its NPRM, the Commission implied, but did not explicitly assert, that the Supreme Court's 1865 decision in *The Binghamton Bridge*[50] is inapposite to the questions of whether a regulatory contract exists between Comsat and U.S. government and whether, if that contract exists, the Commission's imposition, without offsetting compensation to Comsat, of Level 3 direct access to INTELSAT would breach the contract. The Commission stated: "In *The Binghamton Bridge* case, the Court held that a state breached an express statutory provision conferring geographical exclusivity on a bridge builder when the state subsequently permitted another bridge builder to construct a bridge in violation of the first bridge builder's exclusive rights."[51] The Commission's reading of *The Binghamton Bridge* misses the forest for the trees: The agency asserts that the U.S. government made no express promises to Comsat, and thus the Commission proceeds to ignore the reasoning upon which the Court's ruling rests. In defending an exclusive bridge

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48. *See, e.g.*, PAUL MILGROM & JOHN ROBERTS, ECONOMICS, ORGANIZATION AND MANAGEMENT 131 (Prentice Hall 1992); OLIVER E. WILLIAMSON, THE MECHANISMS OF GOVERNANCE 120–44 (Oxford University Press 1996); WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM, *supra* note 46, at 167; THOMAS C. SCHELLING, THE STRATEGY OF CONFLICT (Oxford University Press 1960).

49. 1996 ECONOMIC REPORT OF THE PRESIDENT 187 (Government Printing Office 1996).

50. 70 U.S. (3 Wall.) 51 (1865).

51. *Direct Access NPRM* at ¶ 33.

franchise from impairment, the Court emphasized the inviolability of contract as the keystone to the relationship between government and private enterprise:

> The purposes to be attained are generally beyond the ability of individual enterprise, and can only be accomplished through the aid of associated wealth. This will not be risked unless privileges are given and securities furnished in an act of incorporation. The wants of the public are often so imperative that a duty is imposed on the Government to provide for them; and, as experience has proved that a State should not directly attempt to do this, it is necessary to confer on others the faculty of doing what the sovereign power is unwilling to undertake. The legislature, therefore, says to public-spirited citizens: "If you will embark, with your time, money, and skill, in an enterprise which will accommodate the public necessities, we will grant to you, for a limited period, or in perpetuity, privileges that will justify the expenditure of your money, and the employment of your time and skill." Such a grant is a contract, with mutual considerations, and justice and good policy alike require that the protection of the law should be assured to it.[52]

Contrary to the Commission's reading of *The Binghamton Bridge*, the same could be said of what Congress told Comsat's incorporators and investors in 1962, when it expressly created Comsat and directed it to build the INTELSAT system.

Curiously, the Commission's legal analysis of the regulatory contract then skipped ahead more than 130 years to the *Winstar* decision. Left unremarked by the Commission are the many Supreme Court decisions from the late nineteenth and early twentieth centuries that enforced regulatory contracts against government bodies. Those decisions were usually unanimous and are striking for the sophistication with which they described in nontechnical terms the economic rationale for the regulatory contract and based their legal conclusions on such reasoning. By neglecting to address those precedents, the Commission based the legal conclusions in its NPRM concerning the regulatory contract on an inadequate and simplistic depiction of the controlling law, law which animates the reasoning of seven Justices in the Supreme Court's 1996 decision in *Winstar*.

Twenty years after *The Binghamton Bridge*, the Supreme Court held unconstitutional, in *New Orleans Water-Works Co.* v. *Rivers*, a local government's ordinance that infringed upon the exclusive rights that the state legislature granted a water company.[53] The Court upheld the exclusivity of the franchise and, in a unanimous opinion by Justice John Marshall Harlan, said that a firm's franchise to operate a waterworks

> was a contract, the obligation of which cannot be impaired by subsequent legislation, or by a change in her organic law. It is as much a contract, within the meaning of the Constitution of the United States, as a grant to a private corporation for a valuable consideration, or in consideration of public services to be rendered by it, of the exclusive

52. *The Binghamton Bridge*, 70 U.S. (3 Wall.) at 73–74.
53. 115 U.S. 674 (1885).

> right to construct and maintain a railroad within certain lines and between given points, or a bridge over a navigable stream within a prescribed distance above and below a designated point.[54]

Similarly, in *Walla Walla City* v. *Walla Walla Water Co.*, the Court stated in 1898:

> [T]his court has too often decided for the rule to be now questioned, that the grant of a right to supply gas or water to a municipality and its inhabitants through pipes and mains laid in the streets, upon condition of the performance of its service by the grantee, is the grant of a franchise vested in the State, in consideration of the performance of a public service, and after performance by the grantee, is a contract protected by the Constitution of the United States against state legislation to impair it.[55]

The Supreme Court well recognized by the turn of the twentieth century that key provisions in the regulatory contract existed to ensure cost recovery for specialized investments and to deter opportunism. In *Walla Walla* it observed: "It is not to be supposed that the company would have entered upon this large undertaking in view of the possibility that, in one of the sudden changes of public opinion to which all municipalities are more or less subject, the city might . . . practically extinguish the rights it had already granted to the company."[56] In 1902, the Court similarly observed in *Detroit* v. *Detroit Citizens' Street Railway Co.*: "It would hardly be credible that capitalists about to invest money in what was then a somewhat uncertain venture, . . . would at the same time . . . . give the right to the [municipality] to change at its pleasure from time to time those important and fundamental rights affecting the very existence and financial success of the company . . . ."[57]

The understanding of utility regulation as contract permeates a number of other Supreme Court decisions from the late nineteenth and early twentieth centuries. For example, in a 1912 decision concerning municipal regulation of gas prices, *Cedar Rapids Gas Light Co.* v. *City of Cedar Rapids*, Justice Oliver Wendell Holmes wrote for a unanimous Supreme Court that such regulation "has to steer between Scylla and Charybdis,"[58] for it resulted from bilateral bargaining in the shadow of takings jurisprudence:

> On the one side if the franchise is taken to mean that the most profitable return that could be got, free from competition, is protected by the Fourteenth Amendment, then the power to regulate is null. On the other hand if the power to regulate withdraws the protection of the Amendment altogether, then the property is nought. This is not a matter of economic theory, *but of fair interpretation of a bargain*. Neither extreme can have been meant. A midway between them must be hit.[59]

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54. *Id.* at 681. *See also* New Orleans Gas Co. *v.* Louisiana Light Co., 115 U.S. 650, 661 (1885).
55. 172 U.S. 1, 8-9 (1898).
56. *Id.* at 17-18.
57. 184 U.S. 368, 385 (1902).
58. 223 U.S. 655, 669 (1912).
59. *Id.* at 669-70 (emphasis added).

Similarly, in *Russell* v. *Sebastian* a unanimous Court in 1914 reiterated the concern over contractual opportunism and specifically endorsed a public service corporation's expectation of a profitable rate of return on its investment.[60] The Court reasoned that a private enterprise accepted a franchise offer with the expectation to earn a profitable rate of return on the investments required to fulfill its obligations under the franchise contract.[61] The Court viewed such an expectation to be inherent in the parties' bargained-for exchange, and it noted that contract formation relied heavily on notions of detrimental reliance and investment-backed expectations:

> [T]he provision plainly contemplated the establishment of a plant devoted to the described public service and an assumption of the duty to perform that service. That the grant, resulting from an acceptance of the State's offer, constituted a contract, and vested in the accepting individual or corporation a property right, protected by the Federal Constitution, is not open to dispute in view of the repeated decisions of this court.[62]

A "practical, common-sense construction" of the regulatory contract led the Court to reject the proposition that "the investment in extensive plants—in the construction of reservoirs, and in the building of manufacturing works—was invited without any assurance that the laying of the distributing system could be completed or that it could even be extended far enough to afford any chance of profit."[63]

Later in the same year, Justice Hughes wrote the opinion for a unanimous Court in *New York Electric Lines Co.* v. *Empire City Subway Co.*, which posed the question of whether a franchise to use the streets of New York City to bury electrical lines constituted a contract and, if so, whether the contract had been unconstitutionally impaired.[64] On the existence of the contract, Justice Hughes wrote: "Grants like the one under consideration are not nude pacts, but rest upon obligations expressly or impliedly assumed to carry on the undertaking to which they relate. They are made and received with the understanding that the recipient is protected by a contractual right from the moment the grant is accepted and during the course of performance as contemplated, as well as after that performance."[65]

The Commission's NPRM failed to discuss the considerable relevance of all these Supreme Court precedents to the question of whether a regulatory contract exists between Comsat and the U.S. government. The agency's conclusion that the Satellite Act, and the Commission's explicit regulations issued pursuant to it, did not create a contract between Comsat and the U.S. government cannot, in light of those many Supreme Court precedents, be credited.

60. 233 U.S. 195, 210 (1914).
61. *Id.*
62. *Id.* at 204.
63. *Id.* at 205, 208.
64. 235 U.S. 179 (1914).
65. *Id.* at 193 (citations omitted).

C. *The Relevance of* Winstar *to Comsat's Regulatory Contract with the U.S. Government*

The Supreme Court's 1996 decision in *Winstar* supports the conclusion that the Commission's imposition of Level 3 direct access would make the U.S. government liable to Comsat for damages for breach of contract. Although *Winstar* does not address a regulated network industry, the decision does indicate how the Court would likely decide a case involving the recovery of stranded costs arising from breach of the regulatory contract in such an industry. Perhaps for that reason, public utilities commissions have been quick to assert, as the Commission does in its NPRM, that *Winstar* is irrelevant to the restructuring of the regulated network industries.[66] It is not. Indeed, the U.S. Department of Justice reportedly takes very seriously *Winstar*'s implications for the potential liability of the United States in diverse cases.[67]

To appreciate *Winstar*'s relevance to the regulatory contract, it is necessary first to review the essential facts of the case. Three thrifts sued the United States for breach of contract after they had been declared in violation of the capital requirements of the new Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA).[68] The thrifts argued that savings and loan regulators had promised to indemnify them from the type of regulatory change that FIRREA produced. During the savings and loan crisis of the 1980s, the Federal Home Loan Bank Board sought to induce healthy thrifts to merge with failing ones. The board signed agreements with the healthy thrifts that allowed them to count the excess of the purchase price over the fair market value of the acquired assets as an intangible asset—"supervisory goodwill"—that counted toward fulfilling capital reserve requirements. The board agreed to allow the healthy thrifts to amortize supervisory goodwill over twenty-five to forty years—an extended period that would give the healthy thrifts a reasonable opportunity to recover their costs of rehabilitating the sick thrifts. Without those regulatory agreements, the thrifts created by the mergers would have violated the capital reserve requirements. Thus, the healthy thrifts' investment in the sick thrifts never would have happened. Overall, however, the board's practice of encouraging such merged thrifts turned out to be a failure and promised to lead to the insolvency of federal deposit insurance funds for the thrifts. Eventually, Congress enacted FIRREA, which forbade thrifts from counting supervisory goodwill toward capital requirements. Regulators promptly seized and liquidated two of the three plaintiff thrifts in *Winstar* for failing to comply with the new capital reserve requirements; the third avoided seizure only

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66. For example, New Hampshire's commission stated in 1997:

> Although *Winstar* has become a new rhetorical arrow in our utilities' empty quiver, *Winstar* need not give us pause. In *Winstar*, the threshold question, "whether there were contracts at all between the government and respondents[,]" was not before the Court. Therefore the case is of no assistance in determining whether a contract exists.

Restructuring New Hampshire's Electric Utility Industry, DR 96-150 Order No. 22,514, 175 P.U.R.4th 193 (N.H. Pub. Utils. Comm'n Feb. 28, 1997) (quoting *Winstar*, 518 U.S. at 860). *But see* Electric Utility Industry Restructuring, Dkt. No. 95-462 (Maine Pub. Utils. Comm'n July 19, 1996) ("While not directly applicable, . . . *United States* v. *Winstar Corp.*, suggests, at least, that government should act responsibly in changing the 'rules of the game.'" (citation omitted)).

67. *See* Michael Grunwald, *Lawsuit May Cost U.S. Billions; 125 Claims Allege Breach of Contract*, WASH. POST, Aug. 10, 1998, at A1.

68. Pub. L. No. 101-73, 103 Stat. 183.

by aggressively recapitalizing.

A plurality of the Supreme Court upheld the determination by the U.S. Court of Appeals for the Federal Circuit that the government had breached contractual obligations to the thrifts and was liable for breach of contract. One of the government's defenses was the "unmistakability" doctrine, under which surrenders of sovereign authority, to be enforceable, must appear in unmistakable terms in a contract. Justices David H. Souter, John Paul Stevens, Sandra Day O'Connor, and Stephen G. Breyer found that the defense did not apply to the contracts at issue, because the plaintiffs were suing not to stop the government from changing capital reserve requirements applicable to thrifts, but only to compel the government to indemnify them for the effects of such changes.[69] Justices Antonin Scalia, Anthony M. Kennedy, and Clarence Thomas did not accept that distinction between injunctive relief and damages but nonetheless found that the particular contracts at issue established that the government had unmistakably agreed to indemnify the thrifts.[70] Chief Justice William H. Rehnquist dissented in an opinion joined by Justice Ruth Bader Ginsburg.[71]

Writing for the plurality, Justice Souter reasoned that application of the unmistakability defense "would place the doctrine at odds with the Government's own long-run interest as a reliable contracting partner in the myriad workaday transaction of its agencies."[72] The government would lose its ability to make credible commitments. "Injecting the opportunity for unmistakability litigation into every common contract action," Justice Souter wrote, "would . . . produce the untoward result of compromising the Government's practical capacity to make contracts, which we have held to be 'of the essence of sovereignty itself.'"[73] He further explained:

> The Court has often said, as a general matter, that the "rights and duties" contained in a government contract "are governed generally by the law applicable to contracts between private individuals." . . . This approach is unsurprising, for in practical terms it ensures that the government is able to obtain needed goods and services from parties who might otherwise, quite rightly, be unwilling to undertake the risk of government contracting.[74]

The plurality's reasoning in *Winstar* is directly analogous to the contractual issues that result from the mandatory unbundling of regulated network industries. Justice Souter noted that it is particularly important to treat the government's contracts with regulated firms as binding:

> It is important to be clear about what these contracts did and did not require of the Government. Nothing in the documentation or the circumstances of these transactions purported to bar the Government from changing the way in which it regulated the thrift industry. Rather . . . "the Bank Board and the FSLIC [the federal savings and loan

69. 518 U.S. 839, 843 (1996) (Souter, Stevens, O'Connor, Breyer, J.J., plurality). Justice Breyer also wrote a concurrence.
70. *Id.* at 919 (Scalia, Kennedy, Thomas, J.J., concurring).
71. *Id.* at 924 (Rehnquist, C.J., Ginsburg, J., dissenting).
72. *Id.* at 884.
73. *Id.* (quoting United States *v.* Bekins, 304 U.S. 27, 51–52 (1938)).
74. *Id.* at 912 (quoting Lynch *v.* United States, 292 U.S. 571, 579 (1934)).

> insurance fund] were contractually bound to recognize the supervisory goodwill and the amortization periods reflected" in the agreements between the parties. We read this promise as the law of contracts has always treated promises to provide something beyond the promisor's absolute control, that is, as a promise to insure the promisee against loss arising from the promised condition's nonoccurrence. . . . *Contracts like this are especially appropriate in the world of regulated industries, where the risk that legal change will prevent the bargained-for performance is always lurking in the shadows.*[75]

That admonition is compelling where the government wishes to use contract as an instrument of regulation: "Since the facts of the present case demonstrate that the Government may wish to further its regulatory goals through contract, we are unwilling to adopt any rule of construction that would weaken the Government's capacity to do business by converting every contract it makes into an arena for unmistakability."[76] Thus, Justice Souter's reasoning in *Winstar* would apply even more forcefully to a regulated telecommunications company such as Comsat, which has made enormous, nonsalvageable investments to build the INTELSAT system. It is permissible for Comsat to bind the U.S. government even to commitments that are not "unmistakable" if Comsat seeks not to enjoin a change in regulatory policy, but only to receive financial compensation for the harm resulting from that change.

More important than that distinction between remedies were Justice Souter's concluding remarks underscoring the Court's need to consider the contracts in the broader context of the parties' intent: "*It would . . . have been madness* for [the healthy thrifts] to have engaged in these transactions with no more protection than the Government's reading [of the contracts] would have given them, for the very existence of their institutions would then have been in jeopardy from the moment their agreements were signed."[77] As noted earlier, the same reasoning about contractual intent permeates the Court's interpretations of the regulatory contract in the late nineteenth and early twentieth centuries. Not surprisingly, in *Winstar* Justice Souter[78]—and Justice Breyer in his concurrence[79]—relied upon those decisions construing the regulatory contract. Although Justice Souter could "imagine cases in which the potential gain might induce a party to assume a substantial risk that the gain might be wiped out by a change in the law, *it would have been irrational* in this case for [one of the healthy thrifts] to stake its very existence upon continuation of current policies without seeking to embody those policies in some sort of contractual commitment."[80]

In his concurrence, Justice Scalia believed that an enforceable duty imposed on the government to pay damages in the event of breach would "constrain the exercise of sovereign power" as much as

75. *Id.* at 868–69 (quoting Winstar Corp. *v.* United States, 64 F.3d 1531, 1541–42 (Fed. Cir. 1995) (en banc) (emphasis added)).

76. *Id.* at 886.

77. *Id.* at 909 (emphasis added).

78. *Id.* at 864 (quoting The Binghamton Bridge, 70 U.S. (3 Wall.) 51, 78 (1866), for the proposition that the Court "refus[ed] to construe charter in such a way that it would have been 'madness' for private party to enter into it").

79. *Id.* at 910–11 (Breyer, J., concurring) (citing *The Binghamton Bridge*, 70 U.S. (3 Wall.) at 74; Russell *v.* Sebastian, 233 U.S. 195, 205 (1914); Detroit *v.* Detroit Citizens' Street Ry., 184 U.S. 368, 384 (1902)).

80. *Id.* at 863 (Souter, J., plurality) (emphasis added).

compelling the government to perform the contract.[81] He thought that the unmistakability doctrine "has little if any independent legal force beyond what would be dictated by normal principles of contract interpretation."[82] In Justice Scalia's view the doctrine "is simply a rule of presumed (or implied-in-fact) intent."[83] In reasoning reminiscent of the Court's early interpretations of regulatory contracts in cases such as *The Binghamton Bridge*,[84] *Walla Walla Water*,[85] *Russell* v. *Sebastian*,[86] and *Detroit Citizens' Street Railway*,[87] Justice Scalia agreed with the thrifts that "the very *subject matter* of these agreements, an essential part of the *quid pro quo*, was government regulation" and that "unless the Government is bound as to that regulation, an aspect of the transactions that reasonably must be viewed as a *sine qua non* of their assent becomes illusory."[88] Echoing as Justice Souter did the reasoning in the Court's early decisions on regulatory contracts, Justice Scalia stressed the relationship between cost recovery, contract duration, and consideration: "[I]t is quite impossible to construe these contracts as providing for only 'short term' favorable treatment, with the long term up for grabs: Either there was an undertaking to regulate [the healthy thrifts] as agreed for the specified amortization periods, or there was no promise regarding the future at all—not even so much as a peppercorn's worth."[89]

What conclusions does one therefore draw from reconciling Justice Souter's plurality opinion with Justice Scalia's concurrence? Only four Justices in *Winstar* would interpret the unmistakability doctrine to permit damage remedies in cases where it was not unmistakable that the government had contracted to retain an existing regulatory regime for the benefit of the regulated firm. Of far greater consequence for the Commission's imposition of Level 3 direct access to Comsat's share of capacity on the INTELSAT system, however, is the fact that *seven* Justices—Breyer, Kennedy, O'Connor, Scalia, Souter, Stevens, and Thomas—supported their divergent legal conclusions with the same economic reasoning that stressed cost recovery, incentive for investment, opportunism, and the government's need to make credible commitments. In that important respect, *Winstar* builds on the intellectual foundation that such justices as Holmes, Hughes, Harlan, and Taft laid more than a century earlier to construe the rights and remedies of public utilities under their regulatory contracts with municipalities. *Winstar* confirms the continued vitality of the reasoning in those early decisions.[90]

It is clear from the Commission's discussion of *Winstar* in its NPRM that the agency has not appreciated the larger meaning of the decision. The Commission observes that *Winstar* reiterates that "surrenders of sovereign authority must appear in unmistakable terms, and the rule that an agent's

81. *Id.* at 920 (Scalia, J., concurring).
82. *Id.*
83. *Id.*
84. 70 U.S. (3 Wall.) 51, 73 (1866).
85. Walla Walla City *v.* Walla Walla Water Co., 172 U.S. 1, 17–18 (1898).
86. 233 U.S. 195, 206–07 (1914).
87. Detroit *v.* Detroit Citizens' Street Ry., 184 U.S. 368, 385 (1902).
88. *Winstar*, 518 U.S. at 921 (emphasis in original).
89. *Id.* at 922.
90. Even if a court were to conclude that no contract existed upon which Comsat could recover damages for its lost expectation, Comsat still would have the equitable remedy of restitution against the U.S. government. *See* J. GREGORY SIDAK & DANIEL F. SPULBER, DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT: THE COMPETITIVE TRANSFORMATION OF NETWORK INDUSTRIES IN THE UNITED STATES 198–212 (Cambridge University Press 1997).

authority to make such surrenders must be delegated in express terms."[91] But in *Winstar*, the three thrift institutions did *not* claim that Congress was barred from passing FIRREA, or from making it applicable to them, but rather that FSLIC had in effect promised that the United States would pay them damages if the rule on supervisory good were changed. In *Winstar*, the promise at issue was not made in so many words. The transaction documents contained references to use of supervisory good will, and the question before the lower courts was whether these were "contractual commitments [or] mere statements of policy."[92] The courts found contractual commitments because of "the realities of the transaction,"[93] and the fact that "it would have been irrational" for the plaintiff thrifts to have proceeded without a contractual commitment.[94] Similarly, Comsat does not take the position that Congress has surrendered the authority to amend the Satellite Act to order Level 3 direct access or that the Commission, if it had already been lawfully delegated that authority by Congress, could not change its regulation of Comsat in this manner. Stated differently, no surrender of the power of the U.S. government to regulate commerce occurred by virtue of the U.S. government's decision to enter into a contract with Comsat to create the INTELSAT system.

Like the U.S. government in *Winstar*, the Commission disputes in the NPRM that the United States made any contractual promise to Comsat that it would enjoy exclusive access to INTELSAT.[95] Although the Satellite Act does not describe the relationship between the United States and Comsat as contractual, the two are nonetheless parties to an enforceable bargain. The Commission states: "Comsat cites to no contract negotiated with the U.S. Government akin to what private parties might negotiate. What does exist is regulation of Comsat."[96] But this logic begs the question of how Comsat came to exist at all, such that the Commission could subsequently subject it to regulation. Comsat from the forehead of Zeus did not, as Athena, spring. No conscription of private capital occurred in the United States in 1962 to build INTELSAT. The fact that Congress created through the Satellite Act that year a framework for regulating Comsat is itself demonstrable evidence that the U.S. government intended to induce private investors voluntarily to supply the capital necessary to bring INTELSAT into being. Specifically, Comsat, a private "corporation for profit," undertook to serve as the "sole operating entity of the United States for participation" in INTELSAT, to sign and become bound by the INTELSAT operating agreement, and to make the investments required by or pursuant to that agreement.[97] Under

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91. *Direct Access NPRM* at ¶ 34 (citing *Winstar*, 518 U.S. at 860 (citations omitted)).

92. 518 U.S. at 863.

93. *Id.*

94. *Id.* Contracts implied in fact can be enforced against the United States. *See* Baltimore & Ohio R.R. Co. *v.* United States, 261 U.S. 592, 597 (1923) (allowing enforcement of a contract "founded upon a meeting of the minds, which, although not embodied in an express contract, is inferred, as a fact, from conduct of the parties showing, in light of the surrounding circumstances, their tacit understanding").

95. *Direct Access NPRM* at ¶ 35. Elsewhere the Commission revealed that its did not understand the distinction between the government's sovereign power to regulate commerce and its obligation, under either the Takings Clause or the common law of contracts, to pay for damages to private parties whose investment-backed expectations under the law of property or contract it would destroy in the absence of payment of compensation or damages: "Comsat fails to show that there was an unmistakable or unambiguous surrender of sovereign authority, or that there was an express delegation to an agent to surrender such authority, that effectively vested a property right in Comsat with regard to access to INTELSAT satellites." *Id.* at ¶ 36.

96. *Direct Access NPRM* at ¶ 35.

97. 47 U.S.C. § 731, 752(a)(1).

the operating agreement that Comsat was required to enter into, Comsat's return on its investment would be determined by traffic in, to, and from the United States. The United States promised, in return, to allow the development and operation by INTELSAT of a "commercial communications satellite system" to "serve the communications needs of the United States and other countries,"[98] so as, among other things, to allow Comsat as "U.S. operating entity" the opportunity to earn a return on its investments in INTELSAT.

Ordinarily, federal statutes do not create contractual rights. But the Satellite Act is a special statute creating a bilateral economic relationship between the United States and a single, identified, private, for-profit corporation. The federal statute and regulations under which Comsat was created and operates constitute a contract with Comsat.[99] In enacting the act, Congress offered a bargain that Comsat's incorporators and Comsat accepted by forming Comsat, issuing its securities on the terms set forth in the act, and serving as the operating entity of the United States in INTELSAT. The United States induced Comsat and its investors to make substantial investments in INTELSAT to serve U.S. national interests. The heart of the bargain was that Comsat, as a for-profit corporation, would be contractually committed to make capital investments in and related to INTELSAT and would have the opportunity to receive a return of, and a competitive return on, those investments because INTELSAT would "serve the communications needs of the United States" as well as other countries. Under the circumstances, "it would have been irrational"[100] for Comsat to commit itself to make such investments without a credible promise from the U.S. government to continue to allow INTELSAT to serve the U.S market (or a promise by the United States to compensate Comsat in damages if the government changed its mind).

The Commission's unilateral imposition of Level 3 direct access would deliberately end that opportunity, in breach of the contract between the United States and Comsat. Comsat and its investors would never have entered into the INTELSAT agreements, or invested billions of dollars over the years in furtherance of U.S. policy and Comsat's statutorily prescribed mission, if the company had not been promised, in return, the opportunity to earn a return of, and a competitive return on, its invested capital. By preventing Comsat from earning a retail margin on the sale of services on a competitive satellite network in which it has invested, the Commission's imposition of Level 3 direct access would breach the bargain between the United States and this private company.

Unless accompanied by an offsetting cost-recovery mechanism, legislation that deprived Comsat of its exclusive franchise with respect to American access to INTELSAT would breach the regulatory contract between Comsat and the United States. In the form proposed by the Commission in its NPRM, the imposition of Level 3 direct access would therefore give Comsat a valid claim against the United States for breach of contractual promises, made in return for Comsat's commitments to invest in INTELSAT, to allow INTELSAT to provide telecommunications services to and from the United States, subject only to appropriate regulation. The United States would thus be liable to Comsat for damages, which can be recovered in the Court of Federal Claims, to which the Tucker Act grants "jurisdiction to

98. *Id.* § 701.
99. *See* SIDAK & SPULBER, DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT, *supra* note 90, at 109–13, 201–10.
100. *Winstar*, 518 U.S. at 863.

render judgment upon any claim against the United States founded . . . upon . . . any express or implied contract with the United States"[101]

D. *Comsat's Loss of an Investment-Backed Expectation*

As in any case of breach of contract, Comsat's measure of damages would be its lost expectation under the regulatory contract.[102] That expectation consisted of the reasonable opportunity to earn recovery of its investment in INTELSAT and a risk-adjusted, competitive return on that invested capital. Comsat's damages would be net of any costs that it would avoid by virtue of no longer making retail sales of space segment capacity on the INTELSAT system. If, however, Comsat's costs of making such retail sales were subject to economies of scale, and if Comsat did not exit the retail function entirely (that is, if it retained at least some small retail accounts), the diversion of Comsat's former customers to Level 3 direct access would enable Comsat to avoid its retail costs at less than a linear rate.

Because the Commission's imposition of Level 3 direct access would effect a permanent physical invasion of Comsat's property and thus trigger a per se taking, it would be superfluous to examine whether such action by the Commission would independently constitute a taking under lines of cases applied to regulatory takings and public utility rates cases. The result of such analyses, however, would mirror the analysis of Comsat's lost expectation interest under contract law. Those additional lines of takings cases ultimately turn on an examination of the effect of the government's action on the property owner's "investment-backed expectations" and the ability of the regulated firm to continue to attract capital, which can be shown in economic terms to be identical to expectation damages for breach of contract.[103]

Comsat's right to its lost expectation interest would not be an amorphous, self-serving standard. Comsat would have to substantiate its expectations by demonstrating that they were "investment-backed." That requirement is a means to impose a system of falsifiability on what could otherwise become an inherently subjective inquiry, and it comports with the Court's observation in *Ruckelshaus* v. *Monsanto Co.* that "[a] 'reasonable investment backed expectation' must be more than 'a unilateral expectation or an abstract need,'"[104] and its statement in *Usery* v. *Turner Elkhorn Mining Co.* that "legislation readjusting rights and burdens is not unlawful solely because it upsets otherwise settled expectations."[105] A private party may have expectations that are, objectively speaking, unreasonable. Comsat, however, does not fit that description because it objectively backed its expectations with the substantial investments described earlier.

101. 28 U.S.C. § 1491(a)(1).

102. *See* SIDAK & SPULBER, DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT, *supra* note 90, at 179–87.

103. *See id.* at 222–26, 240–46, 276–78, 393–402.

104. 467 U.S. 986, 1005–06 (1984) (quoting Webb's Fabulous Pharmacies *v.* Beckwith, 449 U.S. 155, 161 (1980)).

105. 428 U.S. 1, 16 (1976).

III. LEVEL 3 DIRECT ACCESS WOULD CONSTITUTE A PERMANENT PHYSICAL INVASION OF COMSAT'S PROPERTY AND THUS A PER SE TAKING OF PROPERTY OBLIGATING THE U.S. GOVERNMENT TO PAY COMSAT JUST COMPENSATION UNDER THE TAKINGS CLAUSE OF THE FIFTH AMENDMENT

The Commission asserted in its NPRM that Level 3 direct access would "permit[] use, but not permanent physical occupation, of INTELSAT satellites . . . . such that a property right of Comsat would [not] be taken within the meaning of the Fifth Amendment."[106] Later in its NPRM, the Commission similarly stated:

> A Commission rule or policy permitting other U.S. carriers and users to obtain Level 3 direct access to INTELSAT satellites arguably could be viewed as a form of governmental action resulting in a short-term physical invasion or economic regulation of the use of Comsat's and INTELSAT's property.[107]

In the following paragraph of its NPRM, the Commission stated: "A rule or policy permitting other U.S. carriers and users to obtain Level 3 direct access *would not compel physical use of Comsat's or INTELSAT's facilities.*"[108] Thus, within a span of three paragraphs, the Commission seemed to say, first, that Level 3 direct access would be a physical use of Comsat's private property but not a permanent occupation of such property and, next, that Level 3 direct access would not be any physical use at all of Comsat's private property, temporary or permanent. Before applying the relevant legal standard to the facts of Level 3 direct access, it is essential to correct the confusion and factual inaccuracy of the Commission's representation of what Level 3 direct access would entail.

Level 3 direct access would enable Comsat's current customers to occupy physically the circuit and transponder capacity of INTELSAT's satellites, of which Comsat is a co-owner. As in the case of the infrastructure employed in other network industries, the output of INTELSAT can be measured in terms of "capacity" (that is, the option to use) and "usage." Even when a circuit is not actively carrying electronic information, it is still continuously occupied if users taking advantage of Level 3 direct access have the option to engage that circuit at any moment. The effect of such an option to use is to deny Comsat, as owner of the circuit, the right to exclude a third party's use of Comsat's property. In that respect, the physical invasion of Comsat's property effected by Level 3 direct access would be permanent during the entire multi-year term of the user's direct contract with INTELSAT, rather than temporary or intermittent during that period, as the Commission incorrectly asserted as a factual matter in its NPRM.

Government policies that effect physical invasions of property elicit the greatest judicial protection of private property. The leading decision on takings arising from physical invasion of property is the Supreme Court's 1982 decision in *Loretto* v. *Teleprompter Manhattan CATV Corp.*, which defended that

106. *Direct Access NPRM* at ¶ 38.
107. *Id.* at ¶ 39.
108. *Id.* at ¶ 40 (emphasis added).

rule even in the case of "a minor but permanent physical occupation of an owner's property authorized by government."[109] The Court announced that "when the 'character of the governmental 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."[110]

At issue in *Loretto* was a New York statute that required a landlord to permit a cable television (CATV) company to install its CATV facilities upon her property, subject to payment of no greater than "reasonable" compensation set by a state commission. Exclusively franchised to build the CATV system within certain parts of Manhattan, Teleprompter wired Ms. Loretto's five-story apartment building, for which the commission deemed her to be entitled to a one-time payment of one dollar. Teleprompter's physical invasion of Ms. Loretto's building was minor and consisted of a cable "slightly less than one-half inch in diameter and of approximately 30 feet in length along . . . the roof top," plus some other, relatively unobtrusive paraphernalia.[111]

Although *Loretto* was in practical terms a simple case of access pricing, the Court chose to make the fact of physical invasion dispositive.[112] Justice Thurgood Marshall wrote for the majority that "when the physical intrusion reaches the extreme form of a permanent physical occupation, . . . 'the character of the government action' not only is an important factor in resolving whether the action works a taking but also is determinative."[113] Unlike the balancing analysis in a regulatory takings case, "a permanent physical occupation is a government action of such a unique character that it is a taking without regard to other factors that a court might ordinarily examine."[114] The Court likened its rule on permanent physical invasion to a per se rule in antitrust law.[115]

Under *Loretto*, the physical magnitude of the invasion of property does not matter. The Court said that "constitutional protection for the rights of private property cannot be made to depend on the size of the area permanently occupied."[116] The Court made light of the factual disagreement between the majority and the dissenters over the volume of the cable equipment attached to Ms. Loretto's building. "The displaced volume . . . . [is] not critical: whether the installation is a taking does not depend on whether the volume of space it occupies is bigger than a breadbox."[117] The Court noted in particular that "the owner has no right to possess the occupied space himself, and also has no power to exclude the occupier from possession and use of the space. The power to exclude has traditionally been considered one of the most treasured strands in an owner's bundle of property rights."[118]

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109. 458 U.S. 419, 421 (1982). The following discussion of *Loretto* is an abbreviated version of the analysis contained in SIDAK & SPULBER, DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT, *supra* note 90, at 226–40.

110. 458 U.S. at 434–35 (quoting Penn Central Transp. Co. *v.* New York City, 438 U.S. 104, 124 (1978)) (citation omitted).

111. *Id.* at 422.

112. *Id.* at 426 ("a permanent physical occupation authorized by government is a taking without regard to the public interests that it may serve").

113. *Id.*

114. *Id.* at 432.

115. *Id.* at 436.

116. *Id.* at 436 & n.13.

117. *Id.* at 438.

118. *Id.* at 435–36 (citing Kaiser Aetna *v.* United States, 444 U.S. 164, 179–80 (1979); RESTATEMENT OF PROPERTY § 7

In its discussion of takings caused by permanent physical invasions of property, the Commission stated in its NPRM:

> Pursuant to a service agreement with the direct access customer, INTELSAT agrees to make available its space segment capacity on a best efforts basis in return for payment from the customer. Other contractual terms and conditions also apply to the arrangement. The U.S. Government is not a party to the service agreement or in the arrangement.[119]

The Commission evidently reasoned that, because the U.S. government would not be a party to a sale of INTELSAT space segment capacity transacted pursuant to Level 3 direct access, the Supreme Court's precedent on takings by physical invasion would be inapplicable. The Commission's analysis, however, is incorrect and irrelevant to whether *Loretto* would apply to the Commission's imposition of Level 3 direct access. It does not matter that the party making the physical invasion of Comsat's circuits or transponder capacity on the INTELSAT network is a private company rather than the U.S. government itself. As the Court said in *Loretto*, "A permanent physical occupation authorized by state law is a taking without regard to whether the State, or instead a party authorized by the State, is the occupant."[120]

Five years after *Loretto*, the Court considered a similar case. The Pole Attachments Act authorized the FCC to regulate the rates, terms, and conditions of the attachment of cable television wires to utility poles if the state did not engage in such regulation, but the statute (at that time) did not mandate access.[121] An electric utility challenged the statute as a permanent physical invasion of private property, but the Court ruled in *FCC* v. *Florida Power Corp.* that *Loretto* did not apply.[122] The Court reasoned, again in an opinion by Justice Marshall, that the statute merely regulated prices in consensual transactions. Unlike the New York statute in *Loretto*, which contained the "element of required acquiescence . . . at the heart of the concept of occupation," the Pole Attachments Act did not compel the property owner to submit to an involuntary transaction.[123] In 1992 the Court reinforced that rationale in *Yee* v. *Escondido*: Property owners who "voluntarily open their property to occupation by others . . . cannot assert a per se right to compensation based on their inability to exclude particular individuals."[124]

Although it did not cite *Florida Power* in its NPRM, the Commission evidently believed that its characterization of Level 3 direct access as a "voluntary" transaction would end any further inquiry into whether any compulsory transaction would even occur that could support a takings claim by Comsat. The Commission stated that "Level 3 direct access is a voluntary contractual arrangement between a U.S. carrier or user and INTELSAT."[125] The Commission's peculiar characterization of voluntary exchange

(1936)).

119. *Direct Access NPRM* at ¶ 38 (footnote omitted).

120. 458 U.S. at 432 n.9.

121. Pub. L. No. 95-234, § 6, 92 Stat. 35 (1978) (codified at 47 U.S.C. § 224).

122. 480 U.S. 245 (1987).

123. *Id.* at 252.

124. 503 U.S. 519, 531 (1992).

125. *Direct Access NPRM* at ¶ 38.

was not inadvertent, for the agency repeated this argument two paragraphs later in its NPRM when it stated that "a rule or policy [mandating Level 3 direct access] would be permissive because a carrier's or user's direct access to INTELSAT's facilities would be based on a voluntary contractual arrangement entered into between a carrier or user and INTELSAT."[126] The Commission view of consent, however, would turn the concept of voluntary exchange on its head, for *Comsat* would have voluntarily agreed to nothing in a transaction for Level 3 direct access. Whether AT&T or CBS voluntarily agrees with INTELSAT to bypass Comsat is irrelevant to the question in *Florida Power* or *Yee* of whether property owners "voluntarily open their property to occupation by others."[127]

Florida Power has itself become a curio because the Telecommunications Act of 1996 made it *mandatory* for utilities to provide access to their poles, ducts, conduits, and rights of way; furthermore, the statute specified the formula for computing compensation for such mandatory access.[128] Thus, in the latest wave of pole attachment cases, *Florida Power* is no longer dispositive. In *Gulf Power Co.* v. *United States*,[129] a federal district court held in March 1998 that the pole attachment provisions of the Telecommunications Act of 1996 were a unconstitutional taking per se under *Loretto*. The court stated that "'the facts that an industry is heavily regulated, and that a property owner acquired the property knowing that it is heavily regulated, do not diminish a physical taking to something less than a taking.'"[130] The court emphasized that the Supreme Court's result in *Florida Power* was "based on one significant factor which distinguished it from *Loretto*—in *Florida Power* the element of 'required acquiescence' was entirely absent from the statute."[131] That difference, the court found, supported the finding of a per se taking:

> Unlike the landlord in *Loretto*[,] by contracting with the cable company to provide access, the utility voluntarily relinquished its exclusion rights, effectively inviting the cable company to occupy space on its poles. However, in making this distinction, the Court signaled that it might have reached a different result had a mandatory access provision been implemented by the FCC.
>
> That day is upon the Court, and it now finds that the per se rule of *Loretto* is applicable to the instant case. A utility as defined by the Act is required to provide any cable television system or telecommunications carrier with nondiscriminatory access to its poles and conduits. Such access is a permanent physical occupation of property, effectively divesting a utility of its right to exclude. Furthermore, because the element of "required acquiescence" is present in the nondiscriminatory provision, distinguishing

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126. *Id.* at ¶ 40.

127. *Yee*, 503 U.S. at 531.

128. Pub. L. No. 104-104, § 703, 110 Stat. 56, 150 (1996) (codified at 47 U.S.C. § 224(e)).

129. 998 F. Supp. 1386 (N.D. Fla. 1998).

130. *Id.* at 1394 (quoting GTE Northwest Inc. *v.* Public Util. Comm'n, 321 Or. 458, 900 P.2d 495, 504 (1995), and citing J. Gregory Sidak & Daniel F. Spulber, *Deregulatory Takings and Breach of the Regulatory Contract*, 71 N.Y.U. L. REV. 851, 951–52 (1996)).

131. *Id.* at 1395 (citing *Florida Power*, 480 U.S. at 245, 252 & n.6; Sidak & Spulber, *Deregulatory Takings and Breach of the Regulatory Contract*, *supra* note 130, at 946–54).

> the case at bar from *Florida Power*, the permanent occupation of a utility's poles and conduits amounts to a per se taking of property under *Loretto* and the Fifth Amendment.[132]

The Commission's ordering of Level 3 direct access to the space segment capacity of INTELSAT would be a more egregious per se taking of Comsat's private property in the INTELSAT system than were the takings effected by the imposition of the cable television equipment in *Loretto* and the pole attachments in *Gulf Power*. The physical invasion in *Loretto* did not displace paying tenants and thus deny the landlord the opportunity to continue to use her apartment building for its intended purpose. Similarly, the pole attachments in *Gulf Power* did not require the displacement of Gulf Power's own use of its poles. In Comsat's case, however, Level 3 direct access would create a mutually exclusive use of Comsat's space segment capacity on Intelsat. Comsat would be ejected from its own property. As noted earlier, involuntary, physical invasion of a network facility may manifest itself not only in terms of volume or square footage, but also in terms of electronic or photonic capacity that the property owner (such as Comsat) is effectively prevented from using any longer. In short, if the Commission were to order Level 3 direct access to the space segment capacity of INTELSAT, *Loretto* would apply, the U.S. government would be per se liable to Comsat for a takings of its property, and the question of measuring the sufficiency of damages for just compensation would present itself.[133]

IV. THE COMMISSION'S NPRM WOULD FAIL TO PROVIDE COMSAT JUST COMPENSATION FOR THE TAKING OF ITS PROPERTY OR EXPECTATION DAMAGES FOR BREACH OF ITS REGULATORY CONTRACT WITH THE UNITED STATES

The central economic and legal difficulty with mandatory access regimes is that they rest upon involuntary exchange rather than the voluntary exchange that is so much more familiar to a capitalist economy. In takings law, compensation for government confiscation of property is deemed to be constitutionally "just" if it equals the price to which a willing buyer and a willing seller would agree. Just compensation is equivalent to the compensation that could be derived from voluntary exchange.[134] The economic reasoning that just compensation should replicate the outcome of voluntary exchange corresponds to the general principle in both American constitutional law[135] and English common law for determining fair compensation for a taking.[136]

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132. *Id.* (citations omitted).

133. In addition, Comsat might be entitled to a permanent injunction blocking enforcement of any Commission rule ordering Level 3 direct access that failed to include a mechanism ensuring Comsat the reasonable opportunity to recover the cost of, and a competitive return on, its investment in INTELSAT. *See* Eastern Enterprises *v.* Apfel, 118 S. Ct. 2131 (1998).

134. *See* SIDAK & SPULBER, DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT, *supra* note 90, at 273-81; RICHARD A. EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN 182 (Harvard University Press 1985).

135. *E.g.*, Olson *v.* United States, 292 U.S. 246, 255 (1934); United States *v.* Reynolds, 397 U.S. 14, 16 (1970).

136. English jurists have emphasized that the purpose of compensation is to "give[] to the owner compelled to sell . . . the right to be put, so far as money can do it, in the same position as if his land had not been taken from him." Horn *v.* Sunderland Corp., 1 All E.R. 480, 491 (C.A. 1941) (Scott, J.); *accord*, Maidstone Borough Council *v.* Secretary of State for the Env't, 3 P.L.R. 66 (C.A. 1995).

A. *The Role of Opportunity Cost in Defining Just Compensation*

What, then, is the price that the property owner would demand before he would voluntarily part with his asset? Another way of phrasing the question is to ask what the full cost would be to the property owner of parting with the asset. The critical insight to answering that question comes once again from Professor Alchian's classic definition that "the cost of an event is the highest-valued opportunity necessarily forsaken."[137] This understanding of cost finds wide, if not universal, acceptance in economic thought. For example, Joseph E. Stiglitz, the former chairman of the Council of Economic Advisers, writes in his textbook that "when rational firms and individuals make decisions—whether to undertake one investment project rather than another, whether to buy one product rather than another—they take into account *all* of the costs, the full opportunity costs, not just the direct expenditures."[138] The property owner, therefore, would demand the asset's opportunity cost—which, in the absence of regulatory distortions, will usually equal the asset's market value.[139] Because just compensation mimics the outcome of voluntary exchange, it requires that the property owner be fully compensated for his opportunity cost.

Economically sophisticated jurists also recognize that opportunity cost is the proper economic definition of cost. Chief Judge Richard A. Posner has observed in his treatise, "Cost to the economist is 'opportunity cost'—the benefit forgone by employing a resource in a way that denies its use to someone else."[140] The U.S. Court of Appeals for the D.C. Circuit has recognized that definition of cost as well. In a unanimous 1997 opinion by Judge Douglas H. Ginsburg in a rate case involving landing fees at airports, the court chided a regulator, the Secretary of Transportation, for interpreting "cost" in a way that ignored opportunity cost.[141] The court noted that when the Supreme Court, in *FPC* v. *Natural Gas Pipeline Co.*,[142] overruled *Smyth* v. *Ames*,[143] it "did not rule fair market value out of cost-of-service rate making; it held only that 'the Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas.'"[144] That subtlety has direct relevance to the use of opportunity cost to approximate the fair market value of the regulated firm's assets:

> Nor has the Court ever held that historic cost represents the only true measure of cost and the Secretary points to no law, regulation, or agency decision to that effect. On the contrary, agencies that regulate utility rates have recognized "opportunity cost" as a factor to be considered when setting rates designed to cover the actual costs incurred to provide a particular service. Economists, too, have argued that opportunity costs should

137. Alchian, *supra* note 42, at 404.

138. *See* JOSEPH E. STIGLITZ, ECONOMICS 44 (W.W. Norton & Co. 1993) (emphasis in original); *accord*, DAVID L. KASERMAN & JOHN W. MAYO, GOVERNMENT AND BUSINESS: THE ECONOMICS OF ANTITRUST AND REGULATION 32 (Dryden Press 1995).

139. *See, e.g.*, RICHARD A. BREALEY & STEWART C. MYERS, PRINCIPLES OF CORPORATE FINANCE 98 (McGraw-Hill, Inc., 4th ed. 1991).

140. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 6 (Little, Brown & Co., 4th ed. 1992).

141. City of Los Angeles Dep't of Airports *v.* United States Dep't of Transp., 103 F.3d 1027 (D.C. Cir. 1997).

142. 315 U.S. 575 (1942).

143. 169 U.S. 466 (1898).

144. 103 F.2d at 1032 (quoting *Natural Gas Pipeline*, 315 U.S. at 586).

> be considered in ratemaking.[145]

The court rejected "the view that an opportunity cost is not an 'actual cost,' in law or in economics, because it does not appear as a cash expenditure in the account books of the [regulated firm]."[146] The court remanded the case to the Secretary of Transportation to "confront[] the question of how properly to measure cost under a compensatory fee regime."[147] In particular, the court directed the Secretary to give "express consideration" to "the testimonial evidence of Professor Kenneth Arrow, a Nobel laureate in economics, to the effect that the methodology [that the City of Los Angeles] adopted for [Los Angeles International Airport] would cause the landing fees paid by the airlines to reflect the true cost of the airfield land; namely, 'the value [the City] could have obtained in the best alternative use.'"[148] The court stated: "This would, the City maintained, ensure that the actual costs of the airfield are borne by those receiving the benefits of the airfield and would create the proper incentive for the City to allocate land to airport use."[149]

In several recent proceedings, the Commission has embraced the idea that a price for mandatory access to a facility should incorporate opportunity cost. The Commission's rules for leased access on cable systems and open video systems illustrate the agency's correct reliance on the concept of opportunity cost to formulate an optimal price for mandatory access. With respect to the pricing of mandatory leased access of cable television channels, the Commission said in March 1996: "We generally agree with Time Warner that the value of leased access channels 'is the opportunity cost imposed on the operator from the lost chance to program these channels.'"[150] The Commission defined opportunity cost in that situation as follows:

> The portion of the maximum rate for leased access channels included in a tier of programming which we propose be paid by the leased access programmer . . . would be based on the reasonable costs (including reasonable profits) that leased access imposes on the operator. These costs are specific to the channels designated for leased access. Some of these costs are associated with removing or "bumping" non-leased access programming to accommodate leased access programming; others are the direct costs associated with the specific leased access programmer or its programming. To simplify this discussion, we will refer to all of these costs as opportunity costs.[151]

145. *Id.* (citing Pennsylvania Elec. Co., 60 F.E.R.C. ¶¶ 61,034, 61,120 & n.1 (1992), *aff'd sub nom.* Pennsylvania Elec. Co. *v.* FERC, 11 F.3d 207 (D.C. Cir. 1993); WILLIAM J. BAUMOL & J. GREGORY SIDAK, TRANSMISSION PRICING AND STRANDED COSTS IN THE ELECTRIC POWER INDUSTRY 139 *et seq.* (AEI Press 1995)).

146. *Id.*

147. *Id.* at 1033.

148. *Id.* at 1033–34 (quoting Declaration of Kenneth J. Arrow (Mar. 13, 1995)).

149. *Id.* at 1034.

150. Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation Leased Commercial Access, Order on Recons. of the First Report and Order and Further Notice of Proposed Rulemaking, MM Dkt. No. 92-266, CS Dkt. No. 96-60, 11 F.C.C. Rcd. 16,933, 16,958–59 ¶ 61 (1996) (quoting Time Warner comments).

151. *Id.* at 16,961 ¶ 69.

The Commission further concluded that "any profit which is generated from subscriber revenue could be viewed as an opportunity cost imposed on the operator who forgoes these profits when this channel is used to carry leased access programming."[152]

In May 1996 the Commission again embraced efficient component pricing in a rulemaking concerning open video systems (OVS).[153] The Telecommunications Act of 1996 added section 653 to the Communications Act, which "establishes a new framework for entry into the video programming delivery marketplace—the 'open video system.'"[154] The OVS proceeding considered how a LEC seeking to enter the video marketplace pursuant to Title IV regulation would have to price its carriage of unaffiliated video programming. The Commission concluded that "the most effective way to evaluate whether a rate is just and reasonable is to compare it to an imputed carriage rate associated with the open video system operator or its affiliate."[155] The agency called that method the "imputed rate approach" and characterized it as "an application of the Efficient Component Pricing Rule to open video systems."[156] The FCC considered the efficient component-pricing rule (ECPR) to be the appropriate rule for pricing "just, reasonable, and nondiscriminatory" access to such facilities:

> This approach is particularly applicable to circumstances where a new market entrant, the open video system operator, will face competition from an established incumbent, the cable operator. A competitive environment facilitates this approach as market forces limit the ability of the open video system operator to increase its imputed carriage rate. The open video system operator must obtain programming and seek subscribers in a competitive environment, thereby providing a sound basis of comparison to determine whether the unaffiliated rate is just and reasonable. The prices that determine the revenues and costs that make up the imputed carriage rate are effectively set in a competitive market.[157]

In effect, the Commission was describing the ECPR, as constrained by the price of existing competitive alternatives to the input in question.

In contrast to the Commission's leased access and OVS orders, the *First Report and Order* on local interconnection[158] discussed efficient component pricing only in the circumstance in which the

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152. *Id.* at 16,964 ¶ 78.

153. Implementation of Section 302 of the Telecommunications Act of 1996; Open Video Systems, Second Report and Order, CS Dkt. No. 96-46, 11 F.C.C. Rcd. 18,223 (1996).

154. *Id.* at 18,226 ¶ 1.

155. *Id.* at 18,290 ¶ 125.

156. *Id.* ¶ 126 (citing William J. Baumol & J. Gregory Sidak, *The Pricing of Inputs Sold to Competitors*, 11 YALE J. ON REG. 171 (1994); Alfred E. Kahn & William Taylor, *The Pricing of Inputs Sold to Competitors: A Comment*, 11 YALE J. ON REG. 225 (1994)).

157. *Id.*

158. Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers, First Report and Order, CC Dkt. Nos. 96-98, 95-185, 11 F.C.C. Rcd. 15,499 (1996) [hereinafter *First Report and Order*], *vacated sub nom.* Iowa Utils. Bd. *v.* FCC, 120 F.3d 753 (8th Cir. 1997), *cert. granted*, 118 S. Ct. 879 (1998).

Commission believed that no price competition existed. In that decision, the FCC defined opportunity cost to "include the revenues that the incumbent LEC would have received for the sale of telecommunications services, in the absence of competition from telecommunications carrier [*sic*] that purchase elements."[159]

B. *Monopoly Rent, Opportunity Cost, and Just Compensation*

The Commission's reason for rejecting opportunity cost as a component of the price of an unbundled network element in the *First Report and Order* is not applicable to Level 3 direct access to Comsat's space segment capacity on the INTELSAT system. Comsat's opportunity cost of forgoing its retail margin on sale of access to INTELSAT does not include monopoly rent. The Commission excused Comsat from regulation as a dominant carrier because the agency found that Comsat operates in a competitive market, unlike the market that the Commission concluded existed for an incumbent local exchange carrier's sale of unbundled network elements. Indeed, even on the few remaining routes over which the Commission still considers Comsat "dominant," Comsat charges its customers the same rates as it charges over its competitive, nondominant routes.

The Commission did not recognize the relevance of Comsat's nondominance for either the agency's assertion of the public purpose to be achieved by the imposition of Level 3 direct access or its reasoning concerning the putative sufficiency of implicit compensation that Comsat supposedly would receive. The Commission asserted that its imposition of Level 3 direct access "would serve the important Commission objective of promoting competition"[160] and conjectured that "Comsat may lose the benefit of monopoly rents in markets where Comsat is now dominant."[161] With respect to the takings questions raised by the NPRM, those statements are *non sequiturs*.

First, the Commission's order granting Comsat nondominant status over certain routes rested on the conclusion that those INTELSAT routes have become competitive. If the Commission were now to order Level 3 direct access over such routes, and if a customer of Comsat such as AT&T or CBS purchased direct access from INTELSAT over such routes, it could not be the case that the reason that AT&T or CBS was doing so was because Comsat's retail price for those transmission services was not competitive. In other words, any demand that exists among Comsat's customers to purchase Level 3 direct access for competitive routes must be motivated by the desire to receive *less* than that competitive price for such service. That result would correspond to Comsat's being denied the opportunity to recover its quasi-rents in the INTELSAT system—that is, its cost of doing business in excess of its variable costs. Thus, despite the Commission's rhetoric in the NPRM, it is clear that the objective that the agency would be advancing by ordering Level 3 direct access would not be "promoting competition."

Second, Comsat charges the same rates on all routes, both thick and thin. Hence, the routes of over which Comsat supposedly remains dominant are routes for which Comsat charges the same rates as it does in nondominant markets. Given the familiar literature on the incentives for firms under any

159. 47 C.F.R. § 51.505(d)(3) (vacated), in *First Report and Order*, 11 F.C.C. Rcd. at 16,219 app. B.
160. *Direct Access NPRM* at ¶ 40.
161. *Id.* at ¶ 41.

market structure to engage in inverse-elasticity pricing, the Commission cannot justify on takings grounds its imposition of Level 3 direct access without first demonstrating that the rates that Comsat charges on its supposedly dominant routes deviate from the competitive rates that it charges on its nondominant routes.

Third, the Commission fails to explain how its continuing regulation of Comsat's rates over dominant routes can produce for Comsat "the benefit of monopoly rents."[162] Competition prevents Comsat from earning monopoly rents over routes for which the firm is nondominant, and rate regulation prevents Comsat from earning monopoly rents over routes for which it is dominant. Comsat cannot earn monopoly rents over dominant routes unless the Commission has authorized monopoly prices for those routes. If the Commission has done so, then the obvious policy response is for the agency to reform the process by which it approves Comsat's rates. It is demagogic for the Commission to conclude in April 1998 that its continuation of rate regulation is in the public interest with respect to certain of Comsat's routes, and then, notwithstanding such rate regulation, to assert in October 1998 that Comsat may be earning monopoly rents over those routes.

The Commission's NPRM would use Level 3 direct access as a substitute for maximum rate regulation. The logical justification for maximum rate regulation is to control market power. Contrary to such reasoning, the Commission solicited comment "on the desirability of allowing direct access to INTELSAT with respect to all product and geographic markets[,] *including those markets that we have found to be competitive and for which we have found that Comsat is non-dominant.*"[163] Where no market power is being exercised, however, maximum rate regulation or Level 3 direct access cannot prevent monopoly rents that the market already makes impossible to earn. In that circumstance, Comsat's per unit opportunity cost (and hence the standard by which to measure its claim for just compensation or expectation damages for breach of the regulatory contract) would be the difference between its tariffed retail price for space segment capacity on INTELSAT and the INTELSAT utilization charge, less any unit costs that Comsat actually avoided as a result of its loss of such sales to direct access. This analysis of just compensation and contract damages also answers the Commission's question, not expressly posed in the agency's discussion of legal issues associated with the imposition of Level 3 direct access, "whether as a matter of law and policy, Comsat should have an opportunity to recover any of the costs it currently recovers from its mark-up over the IUC . . . ."[164] As noted earlier, Comsat may not experience significant avoided costs of retailing if it such costs are subject to economies of scale and Comsat retains some retail customers.

162. *Id.*
163. *Id.* at ¶ 54 (emphasis added).
164. *Id.* at ¶ 48.

C. *"Givings," Takings, and Just Compensation for Imposing Level 3 Direct Access on Comsat*

A firm's economic profits are zero when total revenues equal total costs, inclusive of a competitive return on capital. Comsat's return on capital equals the sum of the return on capital for its incremental costs and common costs. Comsat earns zero economic profit on its regulated activities when its prices for its regulated services are established so that, on average, Comsat earns zero economic profits on the entire array of regulated services that it supplies. That is, Comsat's regulated rates should be established so that, on average, it earns zero economic profits on its regulated services as a whole. Of course, random market factors may cause the Comsat's actual profits to exceed or fall below that value in any particular period.

The only profit that is relevant for takings purposes is the profit on Comsat's *regulated* services. The profit that Comsat earns from sales on unregulated routes is not relevant to whether the Commission has allowed Comsat a reasonable opportunity to earn zero economic profit on the aggregation of its regulated routes. The Supreme Court long ago announced as a matter of takings jurisprudence in *Brooks-Scanlon Co.* v. *Railroad Commission of Louisiana* that it is impermissible to judge whether rate regulation is confiscatory by including the returns to unregulated operations of the company in question.[165] In Comsat's case, it earns a return of, and on, capital that it has invested in the INTELSAT system. The Commission concluded that "just compensation to Comsat, which would normally be required, is not an issue here . . . . [and] is not required because Comsat will still have a reasonable opportunity to earn a fair financial return *from its INTELSAT investment.*"[166] That reasoning, however, is internally inconsistent with the Commission's earlier conclusion in its NPRM that the agency lacks the authority to regulate that investment relationship between Comsat and INTELSAT.[167] Consequently, the Commission cannot count Comsat's "fair financial return from its INTELSAT investment" as an offset to the net revenues that Comsat would forgo as a result of the Commission's imposition of Level 3 direct access.

Furthermore, if by definition Comsat is forced, by the Commission's order of Level 3 direct access, to forgo a competitive retail margin on sales of space segments capacity on the INTELSAT system, the only way for Comsat to earn a competitive return overall, given its activities in unregulated markets, is for Comsat to earn supracompetitive returns from those unregulated activities. But if those competitive services are by hypothesis currently earning only a competitive return for the firms providing them, then Comsat would be averaging a competitive return on capital in unregulated services and a less-than-competitive return on capital in its sale of space segment capacity. The result of that averaging is by arithmetic necessity an overall return to Comsat that is below the competitive return on capital. In short, the Commission's quid pro quo logic is plausible only if firms in supposedly competitive markets currently and consistently can earn supracompetitive returns, which is self-contradictory.

165. 251 U.S. 396, 399 (1920) (Holmes, J.) ("The plaintiff may be making money from its sawmill and lumber business but it no more can be compelled to spend that than it can be compelled to spend any other money to maintain a railroad for the benefit of others who do not care to pay for it."). *See also* Norfolk & W. Ry. *v.* Conley, 236 U.S. 605, 609 (1915) (Hughes, J.).

166. *Direct Access NPRM* at ¶ 43 (emphasis added).

167. *Id.* at ¶¶ 15, 19.

The Commission implied, but did not explicitly state, that Level 3 direct access would, by reducing for end users in the United States the price of securing space capacity on the INTELSAT system, expand demand for use of INTELSAT's facilities. The Commission stated that "Comsat would continue to have a reasonable opportunity to earn a fair return on its investment from INTELSAT in connection with the voice, data, and video traffic that Comsat *and other U.S. direct access customers* originate and terminate via the INTELSAT system."[168] The Commission, however, failed to explain (1) why INTELSAT's return to investors would be subject to increasing (rather than constant or decreasing) returns to scale and (2) why the asserted increase in Comsat's return on its investment in INTELSAT (as a result of the incremental expansion in demand for INTELSAT capacity due to the price decrease mandated by Level 3 direct access) would be large enough to offset Comsat's forgone net revenues from its loss of retail sales of INTELSAT space segment capacity. Indeed, the Green-Houthakker-Brattle Study demonstrates that INTELSAT's return to investors would fail to provide Comsat a compensatory return. In announcing its tentative conclusion, the Commission failed to prove as a theoretical matter, and certainly did not demonstrate as an empirical proposition, that the agency's "givings" to Comsat in the form of assertedly higher levels of traffic on the INTELSAT system after the agency's imposition of Level 3 direct access would at least equal the agency's taking of Comsat's competitive retail margin on sales of INTELSAT space segment capacity.

V. MISCELLANEOUS ADMINISTRATIVE AND JURISPRUDENTIAL QUESTIONS

The Commission's discussion of takings and regulatory contract issues in its NPRM raises several miscellaneous administrative and jurisprudential questions.

A. *The Statutory Reservation of Rights in the Satellite Act Does Not Excuse an Uncompensated Taking of Property or Breach of the Regulatory Contract*

The Commission regards it as evidence that no regulatory contract exists between Comsat and the U.S. government that "Congress expressly reserved the 'right to repeal, alter, or amend' the Satellite Act as part of a pervasive program to regulate international satellite communications, and the Commission is free to amend its regulatory scheme as permitted by its governing statutes."[169] This point about the reservation of rights is true, but it proves nothing. "No person," wrote Justice Mahlon Pitney in 1917 in *New York Central Railroad* v. *White*, "has a vested interest in any rule of law entitling him to insist that it shall remain unchanged for his benefit."[170] That passage is cited in regulatory proceedings more frequently than it is understood. No serious student of the issue would assert that the regulatory contract entitles the regulated firm to insist that the law shall remain unchanged for the firm's benefit. Rather, that contract—to paraphrase Justice Oliver Wendell Holmes's famous aphorism about contracts generally and

168. *Id.* at ¶ 43. Later in the same paragraph, the Commission concluded that, "even if other carriers and users obtain Level 3 direct access to INTELSAT satellites, Comsat will have a reasonable opportunity to earn a fair financial return from its INTELSAT investment, independent of the issue of just compensation." *Id.*

169. *Direct Access NPRM* at ¶ 36 (citing 47 U.S.C. § 732; Bowen *v.* Public Agencies Opposed to Social Security Entrapment, 477 U.S. 41, 54 (1986); Delaware *v.* Cavazos, 723 F. Supp. 234, 241 (D. Del. 1989), *aff'd*, 919 F.2d 137 (3d Cir. 1990)).

170. 243 U.S. 188, 198 (1917).

damages for breach of contract—merely entitles the regulated utility to the payment of damages if the state chooses to breach the contract.[171] As Judge Richard A. Posner has recognized, there is the fundamental symmetry between the logic underlying Justice Holmes's observation and the proposition that the government avoids a taking by paying just compensation for its changes in regulation:

> The essence . . . of a breach of contract is that it triggers a duty to pay damages for the reasonably foreseeable consequences of the breach. If the duty is unimpaired, the obligation of the contract cannot be said to have been impaired. In Holmes's vivid formulation, the obligation created by a contract is an obligation to perform or pay damages for nonperformance, and if the second alternative remains, then, since it is an alternative, the obligation created by the contract is not impaired. The analogy to the principle that government does not violate the takings clause if it stands ready to pay compensation for its takings should be evident.[172]

Judge Posner's insight applies directly to deregulatory takings and breach of the regulatory contract. It is up to the government to decide whether to exercise its police power or commerce power in a manner that abrogates the regulatory contract, subject to the resulting obligation to compensate the utility for its lost expectation of cost recovery. The existence of a regulatory contract thus clarifies the distinction between the Takings Clause and the government's police (or commerce) power to impose or remove entry regulation.

It is therefore self-evident that Congress has the right to amend the Satellite Act at any time. The act itself states that the "private corporation"—Comsat—shall be "subject to appropriate governmental regulation,"[173] which would obviously be subject to change from time, and the act expressly reserves the right of amendment or repeal.[174] But the reserved right "to repeal, alter, or amend" the act[175] does not give Congress (or, by extension, the Commission) the right to take Comsat's property without the payment of just compensation. Nor does that reservation of rights empower Congress or the Commission to breach the regulatory contract between Comsat and the U.S. government without any liability for damages for Comsat's lost expectancy. As the Supreme Court noted in the *Sinking Fund Cases* in 1878, "[t]he simple words . . . 'that Congress may at any time alter, amend, and repeal this act' . . . . cannot be used to take away property already acquired under the operation of the charter, or to deprive [a private] corporation of the fruits actually reduced to possession of contracts lawfully made . . . ."[176] Like the thrifts in *Winstar*, Comsat need not (and could not successfully) claim that the United States somehow bound itself not to change its public law. Rather, like the claims of the thrifts in *Winstar*, the

171. Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897) ("The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it—and nothing else.").

172. Horwitz-Matthews, Inc. *v.* City of Chicago, 78 F.3d 1248, 1251 (7th Cir. 1996) (citing Ruckelshaus *v.* Monsanto Co., 467 U.S. 986, 1016 (1984); Coniston Corp. *v.* Village of Hoffman Estates, 844 F.2d 461, 463 (7th Cir. 1988); citation to Holmes, *supra* note 171, omitted).

173. 47 U.S.C. § 701(c).

174. *Id.* § 731.

175. *Id.* § 732.

176. 99 U.S. 700, 720 (1878) (quoting 13 Stat. 356 (1864)); *accord*, United States *v.* Winstar Corp., 518 U.S. 839, 869 (1996).

claim that would arise from the Commission's imposition of Level 3 direct access is that the United States promised to indemnify Comsat against such an occurrence—that is, the denial of the opportunity to provide telecommunications services in the United States.

B. *A Court Would Not Defer to the Commission's Determinations Concerning the U.S. Government's Liability for Damages for an Uncompensated Taking of Property or Breach of the Regulatory Contract*

The Commission notes, but does not analyze, "the legal issue of whether the Commission or the U.S. Court of Claims would be the proper entity to determine what constitutes just compensation."[177] A related question is whether the Commission's findings of fact and law concerning takings and regulatory contract issues are entitled to deference by a reviewing court or by a district court hearing *de novo* Comsat's takings and regulatory contracts claim in the event that the Commission imposes Level 3 direct access.

Two jurisprudential considerations support the conclusion that the Court of Claims must decide the sufficiency of compensation and that that court (or any other court) should not defer to the Commission's findings of law on this question. First, constitutional adjudication is outside the Commission's expertise and cannot be constitutionally delegated to the Commission by Congress. Second, the Commission has an inherent conflict of interest when rendering legal conclusions as to whether the agency's adoption of a particular policy, such as Level 3 direct access, would subject the U.S. government to liability for an uncompensated confiscation of private property or breach of contract. Although contemporary courts do not require that an initial determination of the amount of just compensation be made by a court rather than a legislature or regulatory agency as long as the possibility of judicial review exists,[178] the Supreme Court has long emphasized that the measure of just compensation is a judicial function:

> By this legislation, Congress seems to have assumed the right to determine what shall be the measure of compensation. But this is a judicial and not a legislative question. The legislature may determine what private property is needed for public purposes—that is a question of a political and legislative character; but when the taking has been ordered, then the question of compensation is judicial. It does not rest with the public, taking the property, through Congress or the legislature, its representative, to say what compensation shall be paid, or even what shall be the rule of compensation. The Constitution has declared that just compensation shall be paid, and the ascertainment of that is a judicial inquiry.[179]

From such language, two conclusions flow naturally: A court owes no deference to the Commission's determination that its imposition of Level 3 direct access would not cause Comsat any uncompensated

177. *Direct Access NPRM* at ¶ 43 n.119.
178. Gulf Power Co. *v.* United States, 998 F. Supp. 1386, 1396-97 (N.D. Fla. 1998).
179. Monongahela Navigation Co. *v.* United States, 148 U.S. 312, 327 (1893).

taking of private property or damages for breach of contract; and the Court of Claims is the better forum for undertaking such a determination in the first instance.

CONCLUSION

For the foregoing reasons, the Commission's proposed imposition of Level 3 direct access to the INTELSAT system would breach the regulatory contract into which the U.S. government entered with Comsat Corporation and violate the Takings Clause of the Fifth Amendment of the U.S. Constitution. Therefore, if the Commission were to adopt its proposed rule, Comsat would be entitled to damages from the U.S. government in the amount of its lost expectation of recovering the cost of, and a competitive return on, its investment in the INTELSAT system. That amount would equal, on a per unit basis, the difference between its tariffed retail price for space segment capacity on INTELSAT and the INTELSAT utilization charge, less any unit costs that Comsat actually avoided as a result of its loss of such sales to direct access.

Sincerely,

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BAR ADMISSIONS

California (1982); District of Columbia (1989); Supreme Court of the United States (1989).

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