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Joel B. Eisen

University of Richmond, jeisen@richmond.edu

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REGULATORY LINEARITY, COMMERCE CLAUSE BRINKSMANSHIP, AND RETRENCHMENT IN ELECTRIC UTILITY DEREGULATION

*Joel B. Eisen**

*“One truism of historical evidence:
rules that constantly have to be repeated
and strengthened are no rules.”¹*

Regulators regulate. They control, command, dictate, adjudge, and enforce. Increasingly, often under pressure to reform regulation, they experiment with market mechanisms and other “reinvention” tools. What happens when an agency’s reinvention effort proves less than completely successful? If the agency admits the errors of its ways and drops back to the status quo ex ante, then it may face the same criticisms as it did before: it is stuck in an inefficient regulatory paradigm, slow to adapt to changing conditions, and so forth. If the agency persists with its original initiative in the face of mounting evidence that it is tilting at windmills, then it appears both obstinate and obtuse. Whatever the decision, the climate for reinvention at this point is probably a difficult one of stasis, where new ideas face serious challenges and perhaps even the prospect of immediate rejection. This is particularly likely if the agency has advanced relatively consistent proposals over time, rather than being flexible when its original ideas face trouble.

Deregulation of the electric utility industry—or “restructuring,”

* Professor of Law and Director, Robert R. Merhige, Jr. Center of Environmental Law, University of Richmond School of Law. I am grateful to the participants in the April 2004 University of Richmond School of Law Symposium, *The Blackout of 2003: What’s Next? Transmission Investment, Restructuring and the Future of the Electric Utility Industry*, for their insights and assistance, and to the staff and Judges of the Virginia State Corporation Commission for their support. I also thank students Anne Haith, Heather Lyons, and Christina MacIsaac for research assistance and the School of Law for research grants that supported the development of this Article.

1. DAVID S. LANDES, *THE WEALTH AND POVERTY OF NATIONS* 145 (1998).

as the industry is not being fully deregulated²—may well have reached this uneasy state. After over a decade of experimentation by the Federal Energy Regulatory Commission (“FERC”) and state Public Utility Commissions (“PUCs”), success is hard to find, and criticism of FERC and the states is abundant. Resistance to deregulation of the wholesale market for electricity is in full flower, particularly in Southern and Western states and in Congress, where various pending energy bills would virtually strip FERC of its ability to proceed with restructuring efforts. Formation of Regional Transmission Organizations (“RTOs”), the intermediaries at the core of FERC’s effort to promote a national wholesale market,³ has been fitful at best. Retail access, the vaunted ability of consumers to choose their own electricity supplier, is in full retreat. In states where it had initially been successful, it is less so now, and in many states, there are no viable competitors to incumbent utilities. The centerpiece of restructuring—design and implementation of wholesale markets for electricity—is happening quickly in some parts of the nation and is moribund in others, even after four attempts on FERC’s part to promote a nationwide solution.

Here we are at a crossroads with deregulation: so much promise, so much failure, and so many unanswered questions. Stakeholders have a high degree of frustration. Many view the situation as something of a regulatory “Gordian Knot,”⁴ where any path forward or backward has high negatives. Still, we cannot simply assume that the frustrating present situation in and of itself merits ending the experiment.

In this Article, I focus on the bumpiness of the restructuring process and what it suggests about the future. After describing in Part I the difficult current status of restructuring, I move on to

2. Jim Rossi, *Redeeming Judicial Review: The Hard Look Doctrine and Federal Regulatory Efforts to Restructure the Electric Utility Industry*, 1994 WIS. L. REV. 763, 781 n.70 [hereinafter Rossi, *Hard Look Doctrine*]. Professor Rossi states:

“Deregulation” is probably too strong a word to describe the desirable nature of regulatory reform in the electric utility industry. There is disagreement concerning the appropriate level of deregulation and privatization of bulk power generation. . . . Therefore, with a few exceptions, I generally describe what are commonly referred to as “deregulatory” efforts in bulk power generation markets—efforts more akin to incentive regulation to equalize or improve competition than pure deregulation—under the rubric of “restructuring.”

Id.

3. See *infra* Part I.

4. I am indebted to Sue Kelly of the American Public Power Association for this metaphor.

discuss the relevance of FERC's attempts to fine-tune its initiatives. In Part II, I discuss a theory that agencies that continue to promote their reinvention efforts notwithstanding serious obstacles, and that appear to resist adopting other potentially desirable means of achieving their goals, are stifling the very innovation they promise. I use the term "regulatory linearity" to refer to this specific behavioral pattern. "Linear," in this Article, has two of its common understandings: first, that an agency has been constrained in its thinking about the reinvention effort, and second, that it has seen the process in a "point-A-to-point-B" mentality that limits its ability to adapt to changing conditions.

We do not have a long-standing record of innovation in regulatory agencies, and consequently, we have a less well-developed body of literature on the process of incrementally testing out new ideas. So deciding whether an agency has been "linear" and not simply defeated by concerns beyond its control is going to involve a bit of guesswork. There are some bedrock principles I develop and apply to this situation. As one example, I discuss the role of flexibility. Because the agency is attempting to transcend its original regulatory mandate, I find it indispensable that it maintain a spirit of flexibility and adaptability, modifying its initiative to adapt to difficulties of implementation or macroeconomic or political concerns.

Sheer persistence in promoting an idea and difficulty or unwillingness to adapt it during the implementation period create an agency climate directly antithetical to a spirit of bringing about change. At that point, the agency has proven to be an ineffective actor for bringing about positive change, and the costs of proceeding with the innovation outweigh the likely benefits. One result of this is that stakeholders spend more time, effort, and money fighting over the original innovation rather than overcoming the current constraints on innovation. To test whether this is the case in restructuring at present, I examine a case study of the parrying back and forth between state regulators and FERC over the limits of each other's regulatory jurisdiction. This has created a condition of "Commerce Clause brinksmanship," in which progress is held hostage to a protracted debate over the constitutional balance of power between the federal government and the states.

My case study involves the litigation among FERC, state PUCs, and the American Electric Power Company ("AEP"), which is a major investor-owned utility ("IOU") in the Midwest and Southeast, over AEP's integration into PJM Interconnection (an RTO). FERC's novel argument for advancing the integration of AEP into PJM,

based on a little-known provision of the Public Utility Regulatory Policies Act of 1978 ("PURPA"),⁵ relied in turn on the core concept that AEP's integration into PJM would bring economic benefits to consumers. For this reason, the AEP case tested both the limits of federal jurisdiction and the proposition that restructuring will be economically beneficial. Not surprisingly, this garnered considerable attention for the case across the nation.

The evidence to date, including the record of AEP's integration into PJM, suggests that there is ample blame to go around for restructuring's problems, and ultimately, I find that FERC's pattern of regulatory behavior does not rise to the level of "linearity." In search of a way to break the current stalemate, I then outline three possible strategies in Part III. These include giving FERC bolstered authority to bring about restructuring, ending the restructuring effort, and continuing FERC's ongoing experimentation with market mechanisms (notably the formation of RTOs). I conclude that the central lesson of the current stalemate is that finding a new means of achieving the goals of deregulation that would generate momentum toward progress may be more appropriate than returning to traditional cost-of-service regulation (that is, abandoning deregulation altogether).

I. THE GORDIAN KNOT OF RESTRUCTURING

The story of restructuring's journey is a familiar one, and I will sketch it only briefly. Historically, the electric utility industry was the subject of a cozy regulatory compact. In return for exclusive monopolistic franchises, utilities assumed a duty to serve consumers in their territories and an obligation to subject themselves to regulation of rates and other matters by state PUCs.⁶ Until recently, these monopolists were vertically integrated concerns that handled the generation, transmission, and distribution of electricity. IOUs produced a major share of the nation's electricity, with municipal utilities, federally owned marketers, and cooperatives producing and distributing a smaller share.⁷ The Federal Power Act

5. Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117 (codified at 16 U.S.C. §§ 824a-1 to -4, 2601-2645 (2000)).

6. See generally Jim Rossi, *The Common Law "Duty to Serve" and Protection of Consumers in an Age of Competitive Retail Public Utility Restructuring*, 51 VAND. L. REV. 1233 (1998).

7. In 1998, IOUs generated 68% of the nation's electricity. ENERGY INFO. ADMIN., U.S. DEPT OF ENERGY, *THE CHANGING STRUCTURE OF THE ELECTRIC POWER INDUSTRY 2000: AN UPDATE* 23 (2000), available at http://www.eia.doe.gov/cneaf/electricity/chg_stru_update/update2000.pdf [hereinafter *THE CHANGING STRUCTURE 2000*]. By 2001, that percentage had dropped to 49.1% but still outweighed the contribution from nonutility generators, although that

("FPA") gave the federal government responsibility for regulation of the transmission of electricity in interstate commerce and the sale of electricity at wholesale.⁸ "Wholesale," a term of art in the electric utility field, means sales other than "retail" sales of electricity to end consumers, which have historically been regulated by the states, as the FPA prohibits federal regulation over retail sales and facilities used for the generation and local distribution of electricity.⁹

Until the 1980s, the industry existed in a safe, undisturbed world, with little or no competition in the production and distribution of electricity.¹⁰ The airlines and phone companies could break up and revolutionize the foundation of the economy. Electricity, however, was the last bastion of the natural monopoly.¹¹ Introducing some market character to the industry was an idea that had been percolating for decades,¹² and it began to get traction when federal statutory enactments opened the door to competition.¹³ The first of these was PURPA, which, in an attempt to encourage cogeneration and small power production, created a class of "Qualifying Facilities" ("QFs") whose power utilities were required to purchase under certain terms.¹⁴ This essentially invented a

percentage was increasing. Edison Elec. Inst., *Industry Statistics*, at http://www.eei.org/industry_issues/industry_overview_and_statistics/industry_statistics/index.htm (last visited Feb. 21, 2005).

8. 16 U.S.C. § 824(a) (2000).

9. *Id.* § 824(b)(1).

10. Joseph P. Tomain, *The Past and Future of Electricity Regulation*, 32 ENVTL. L. 435, 438 (2002) ("Traditional utilities were immune from competition in their monopoly protected service areas[,] . . . were rewarded for building, had a virtually guaranteed rate of return, and were immune from competition.").

11. Rossi, *Hard Look Doctrine*, *supra* note 2, at 779-80 ("Traditionally, most regulators considered the electric utility industry a paradigmatic natural monopoly."); see also Claire A. Watkins, *Nuclear Power Rate Regulation After Eastern Enterprises: Are Ratepayers Being Taken for a Ride?*, 28 B.C. ENVTL. AFF. L. REV. 191, 208 (2000) ("[T]he deregulation of the electric industry followed the deregulation of telecommunications, natural gas and the airline industries.").

12. Joseph T. Kelliher, *The Need for Mandatory Electric Reliability Standards and Greater Transmission Investment*, 39 U. RICH. L. REV. 717, 730 (2005) ("[C]ompetition has roots in federal electricity law that can be traced back to the 1930s.").

13. *Id.* ("It was Congress that introduced competition in wholesale power markets, not the Commission."); Tomain, *supra* note 10, at 438 ("With the stimulus of Congress, most notably through the Public Utility Regulatory Policies Act of 1978 (PURPA), the electricity industry began easing transmission access to nonutility electricity producers and, thus, the window to competition opened." (footnote omitted)).

14. Section 210 of PURPA, 16 U.S.C. § 824a-3, provides certain incentives for the development of cogeneration and small power production facilities and

market for generation where none had previously existed. The Energy Policy Act of 1992 further encouraged competition by promoting “wheeling” (transmission of generated power across the grid).¹⁵ During the 1990s, the wholesale market expanded rapidly. Merchant plants selling generated electricity to the grid came online, and more electricity traveled across the grid than before.¹⁶ Currently, over half of the electricity generated is exchanged first on the wholesale market.¹⁷

FERC did not originate the idea of competition but responded to changing conditions by attempting to promote competition. The core of FERC’s restructuring platform is a series of four different orders and rules advanced since 1996 that encompass different formulas for promoting deregulation in the wholesale market. Order No. 888 required all utilities that owned, controlled, or operated facilities used for transmission in interstate commerce to file open-access, nondiscriminatory transmission tariffs that contain minimum terms and conditions of nondiscriminatory service, take transmission service for their own wholesale sales and purchases of electric energy under the open-access tariffs, and develop and maintain a same-time information system that would give existing and potential transmission users the same access to transmission information as they had.¹⁸

gives FERC the authority to exempt such facilities from most aspects of public utility regulation. The FERC rules implementing section 210 of PURPA provide, among other things, that cogeneration and small power production facilities qualifying under section 210 (QFs) have a right to interconnect with utilities for the purposes of selling power to and purchasing power from electric utilities, with sales to be accomplished at the utilities’ “avoided costs.” Conservation of Power and Water Resources, 18 C.F.R. §§ 292.303-.304 (2004). For a discussion of PURPA’s contemporary impact, see Steven Ferrey, *Sustainable Energy, Environmental Policy, and States’ Rights: Discerning the Energy Future Through the Eye of the Dormant Commerce Clause*, 12 N.Y.U. ENVTL. L.J. 507 (2004).

15. See Energy Policy Act of 1992 § 721, 16 U.S.C. § 824j (2002).

16. Kelliher, *supra* note 12, at 717-18 (citing OFFICE OF MKT. OVERSIGHT AND INVESTIGATIONS, FERC, STATE OF THE MARKETS REPORT: ASSESSMENT OF ENERGY MARKETS FOR THE PERIOD JANUARY 1, 2002 THROUGH JUNE 30, 2003, at 64 (2004), available at <http://www.ferc.gov/legal/ferc-regs/land-docs/som-2003.pdf>).

17. See, e.g., ECONOMIC REPORT OF THE PRESIDENT, H. DOC 108-145, at 162 (2d sess. 2004) (“Today, more than half of all electricity generated is exchanged on the wholesale market before it is sold to consumers.”), available at http://usa.usembassy.de/etexts/econ/eop/2004/2004_erp.pdf.

18. Promoting Wholesale Competition Through Open Access Nondiscriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, 61 Fed. Reg. 21,540 (May 10, 1996) (to be codified at 18 C.F.R. pts. 35, 385).

Order No. 888 encouraged the use of "Independent Service Operators" ("ISOs"),¹⁹ entities that would ensure utilities would no longer monopolize their own transmission lines. The order set out a number of guidelines for FERC to approve an ISO, including governance structured in a fair and nondiscriminatory manner and financial independence of the ISO and its employees from the economic performance of any market participant.²⁰ The intent was to allow the ISO to make independent and fair decisions about access to the grid. A single ISO would operate as large a grid as possible, and the ISO would schedule all transmission on the portion of the grid it controlled.²¹ Additionally, it would have the primary responsibility of ensuring the short-term reliability of the grid and, through its pricing policies, promote the efficient use of and investment in transmission.²²

While Order No. 888 acknowledged the sweeping change underway in the electric power industry (with ISOs becoming managers of considerable portions of the transmission grid), FERC quickly found it needed to do more. In 2000, it promulgated a rule known as Order No. 2000²³ that had as its goal encouraging "all transmission-owning entities in the Nation, including non-public utility entities, [to] place their transmission facilities under the control of appropriate RTOs in a timely manner."²⁴ At the time of Order No. 2000, FERC had approved only five ISO proposals.²⁵ The five ISOs had considerable differences in operational responsibilities, geographic scope, and market operations.²⁶ Numerous efforts to create other ISOs had ended in failure. In FERC's view, this industry structure lacked the uniformity necessary to ensure reliability over the nationwide grid. FERC wanted Order No. 2000 to bring organization to the industry and

19. *Id.* at 21,551.

20. *Id.* at 21,596.

21. *Id.*

22. *Id.*

23. Regional Transmission Organizations, 65 Fed. Reg. 12,088 (Mar. 8, 2000) (to be codified at 18 C.F.R. pt. 35).

24. *Id.*

25. Regional Transmission Organizations, 65 Fed. Reg. 810, 815 (Jan. 6, 2000) (to be codified at 18 C.F.R. pt. 35). The five were the California ISO, PJM ISO, ISO New England, the New York ISO, and the Midwest ISO. *Id.*; see THE CHANGING STRUCTURE 2000, *supra* note 7, at 76-77 (providing a table of ISOs with their operating dates and other data); see also AM. PUB. POWER ASS'N, RESTRUCTURING AT THE CROSSROADS: FERC ELECTRIC POLICY RECONSIDERED 1 n.1 (2004) (noting that four of these five were later certified as RTO-compliant), available at <http://www.appanet.org/files/PDFs/APPWhitePaperRestructuringAtCrossroads1204.pdf>.

26. Regional Transmission Organizations, 65 Fed. Reg. at 815.

avoid repetition of the haphazard results achieved under Order No. 888.²⁷ The Commission found that “traditional management of the transmission grid by vertically integrated electric utilities was inadequate to support the efficient and reliable operation that is needed for the continued development of competitive electricity markets.”²⁸ FERC believed enhanced mega-grid controllers (RTOs) could improve grid management and reliability.²⁹

FERC set forth minimum standards for an RTO³⁰ but maintained a flexible approach that allowed industry participants to satisfy the standards in a number of ways.³¹ FERC required that by October 15, 2000 all public utilities that were not already participating in an ISO file with it a proposal for an RTO or a description of their efforts to join an existing RTO.³² The Commission repeatedly stressed that it was seeking voluntary compliance.³³ However, this was a serious shortcoming of Order No. 2000. Because it stopped short of ordering utilities under FERC’s jurisdiction to participate in RTOs, it left a vacuum in a number of regions into which few utilities were willing to jump. It is not

27. *Id.*

28. *Id.* at 811.

29. Regional Transmission Organizations, 65 Fed. Reg. 12,088, 12,089 (Mar. 8, 2000) (to be codified at 18 C.F.R. pt. 35). FERC envisioned efficiency of grid management improving “through improved pricing, congestion management, more accurate estimates of Available Transmission Capability, improved parallel path flow management, more efficient planning, and increased coordination between regulatory agencies.” Regional Transmission Organizations, 65 Fed. Reg. at 811 n.3. The idea of grid management and coordination is not new, of course; a seminal work on the subject is STEPHEN G. BREYER & PAUL W. MACAVOY, ENERGY REGULATION BY THE FEDERAL POWER COMMISSION (1974).

30. Regional Transmission Organizations, 65 Fed. Reg. at 12,102. The minimum standards were divided into minimum characteristics and minimum functions. Regional Transmission Organizations, 65 Fed. Reg. at 811. The minimum characteristics were independence, scope and regional configuration, operational authority, and short-term reliability. Regional Transmission Organizations, 18 C.F.R. § 35.34(j) (2004). The minimum functions were tariff administration and design, congestion management, parallel path flow, ancillary services, OASIS, Total Transmission Capability and Available Transmission Capability, market monitoring, planning and expansion, and interregional coordination. *Id.* § 35.34(k).

31. Regional Transmission Organizations, 65 Fed. Reg. at 12,102. No one form of organization for an RTO was prohibited, and RTOs could own transmission facilities. *Id.* at 12,089. FERC suggested that the characteristics and functions could be met through “ISOs, transcos, combinations of the two, or even new organization forms.” *Id.*

32. *Id.* at 12,109.

33. *See, e.g., id.* at 12,089.

surprising that utilities owning transmission systems were not falling over themselves to join RTOs voluntarily, as the transfer of operational control or ownership over transmission systems was frequently against their self-interest.

FERC's response was at once predictable and unpredictable. It issued a proposed rule effectively requiring utilities to join RTOs,³⁴ which was a not wholly unexpected response to Order No. 2000's shortcomings. This proposal became known as "SMD" (Standard Market Design)³⁵ after a series of central features that took it beyond Order No. 2000; for example, it sought to impose Locational Marginal Pricing ("LMP") on utilities by requiring market-based congestion management systems.³⁶ The marginal price of electricity at nodes in the transmission system would govern the transmission component of pricing and signal bottlenecks in the system. To help cope with congestion on the grid, RTOs would use Firm Transmission Rights ("FTRs"), designed to protect customers from the costs associated with congestion. They allow customers to schedule service to the paths covered in their rights without having to pay for congestion or running the risk of curtailment.³⁷ This enables market participants to enter into contracts with a locked-in price. FTRs, in FERC's view, allow for maximum utilization of valuable, scarce grid capacity and therefore lower costs to consumers.³⁸ The use of FTRs and other signals would in turn be used as the basis of a process to determine where additional transmission capacity would be built. How this would work was left for later.

The backlash to SMD has been well documented.³⁹ Perhaps its

34. Remediating Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design, 67 Fed. Reg. 55,452, 55,455 (Aug. 29, 2002) (to be codified at 18 C.F.R. pt. 35). FERC's mandatory RTO requirement effectively required all utilities to turn over control of their facilities to an "Independent Transmission Provider" ("ITP"). *Id.*

35. *Id.*

36. *Id.* at 55,480.

37. *Id.* at 55,476.

38. *Id.* at 55,455-56.

39. See, e.g., MARK COOPER, CONSUMER FED'N OF AM., ALL PAIN, NO GAIN: RESTRUCTURING AND DEREGULATION IN THE INTERSTATE ELECTRICITY MARKET, at iii (2002) ("FERC's Standard Market Design puts consumers further at risk."), available at <http://www.consumerfed.org/allpain.pdf>; HULLIHEN WILLIAMS MOORE, *Competition: The Wrong Goal*, 39 U. RICH. L. REV. 739 (2005). An excellent summary of how one state (Virginia) protested SMD is found in B. Paige E. Holloway, *Public Utility Law*, 38 U. RICH. L. REV. 195, 202 (2003) ("The [Virginia State Corporation Commission] takes issue with the FERC's proposed SMD Rule in its comments, concluding that 'both in concept and execution, the proposed rules are fundamentally flawed, and should be withdrawn by the

fullest expression can be found in the energy bill pending in Congress in 2004. House Resolution 6 would have imposed an outright moratorium on FERC's ability to promulgate SMD, created "sense of the Congress" language that RTOs should be formed voluntarily (reversing FERC's initiative), added language to call for "participant funding" of transmission upgrades,⁴⁰ created priority for "native load" in transmission service, and weakened FERC's merger review authority.⁴¹ It is hard to imagine a purer expression of the ferocity of anti-SMD sentiment. Whether or not these provisions see the light of day—and given the uncertain prospects for energy legislation generally, this is difficult to predict⁴²—FERC was put in a position where its opponents were (and continue to be) determined to make sure deregulation does not happen under its watch.

FERC's response to this backlash was a White Paper entitled "Wholesale Power Market Platform," issued in 2003.⁴³ In this brief document, FERC reiterated many of its goals for standardizing markets and ensuring reliability in the grid through uniform procedures, stating that "providing regulatory certainty for the industry and investors in order to build needed infrastructure is a critical need facing the energy industry and requires Commission action."⁴⁴ It restated that it would eventually promulgate a final rule that would require that all public utilities join an RTO. As in Order No. 2000 and SMD, that final rule will require that the RTO be the sole provider of transmission service.⁴⁵ Also, as provided in Order No. 2000, the RTO would be responsible for planning for the

[FERC] in favor of a thorough examination of the critical issues encompassed by them." (second alteration in original) (footnote omitted) (quoting Va. State Corp. Comm'n, Comments on Notice of Proposed Rulemaking, No. RM01-12-000 (Jan. 31, 2003))).

40. The proposal that "participants" (generators benefiting from transmission upgrades) should pay for new transmission capacity has been sharply criticized as "likely to delay needed construction and create new vested interests in maintaining congestion." Comments from Robert C. McDiarmid et al., Attorneys for Transmission Access Policy Group, to U.S. Dep't of Energy, Designation of National Electric Transmission Bottlenecks to the U.S. Department of Energy 15 (Sept. 20, 2004).

41. Energy Policy Act of 2003, H.R. 6, 108th Cong. (2004).

42. See, e.g., William A. Moore, *Electricity Reform*, NAT'L L.J., Mar. 15, 2004, at 39 ("[T]he prospects for final adoption by the Senate of an energy bill that is also acceptable to the House remain uncertain.").

43. FERC, White Paper: Wholesale Power Market Platform (Apr. 28, 2003), available at http://www.ferc.gov/industries/electric/indus-act/smd/white_paper.pdf.

44. *Id.* at 1.

45. *Id.* at 2.

siting of new transmission lines.⁴⁶ FERC further stated that “[r]egions should develop an approach to manage congestion that protects against manipulation, uses the grid efficiently, and promotes use of the lowest cost generation”⁴⁷ and that it would require RTOs to “have transparent market mechanisms with efficient price signals” in effect within one year.⁴⁸ FERC signaled that perhaps some approach other than LMP could be used to manage congestion in a given region.

While all this regulatory activity drags on, trouble looms ahead on a number of fronts. In the blackout of 2003, over 50 million people lost power.⁴⁹ The transmission system is vulnerable to outages of this sort, and the reasons for this are complex. Some suggest that the advent of competition was a major contributing factor in the blackout. This is not entirely accurate, as human errors in controlling the grid were far more important.⁵⁰ However, competition has played a part by making the system much more complex and hence more difficult to govern.⁵¹ The transmission system was not designed with a competitive market in mind, and we are asking the grid to do what it may not be able to do without attention to both improved grid management and bolstered physical infrastructure. The *2003 Long-Term Reliability Assessment* of the North American Electricity Reliability Council, the voluntary organization responsible for grid reliability, states that “North American transmission systems are expected to perform reliably in the near term,”⁵² but portions of the grid are reaching their reliability limits because of increased customer demand and increased power transfers brought on by competition.⁵³ The best indicator of this is probably the considerable increase in the amount of “Transmission Loading Relief” (“TLR”), a procedure used to allocate transmission capacity when requests for transmission

46. *Id.* at 7.

47. *Id.* at 9.

48. *Id.* at 10.

49. U.S.-CAN. POWER SYSTEM OUTAGE TASK FORCE, FINAL REPORT ON THE AUGUST 14, 2003 BLACKOUT IN THE UNITED STATES AND CANADA: CAUSES AND RECOMMENDATIONS 1 (2004), available at <http://www.ferc.gov/cust-protect/moi/blackout.asp> [hereinafter BLACKOUT TASK FORCE REPORT].

50. *Id.* at 17-21.

51. *Id.*

52. NORTH AM. ELEC. RELIABILITY COUNCIL, 2003 LONG-TERM RELIABILITY ASSESSMENT: THE RELIABILITY OF BULK ELECTRIC SYSTEMS IN NORTH AMERICA 5 (2003), available at ftp://www.nerc.com/pub/sys/all_updl/docs/pubs/LTRA2003.pdf [hereinafter NAERC LONG-TERM ASSESSMENT].

53. *Id.*

exceed the system capacity.⁵⁴ TLRs are not a solution to the problem of congestion on the grid but demonstrate the need for increased capacity.

There has been no increase in transmission capacity to keep pace with the massive influx of new merchant power and the demands placed on the system.⁵⁵ The nation's transmission grid is overstressed.⁵⁶ This is not surprising, as throughout the 1990s it was more rewarding for private actors to build new merchant plants than transmission capacity. The trend is expected to continue. From 2002 to 2012, national electricity demand is expected to increase twenty percent,⁵⁷ but construction of high-voltage transmission facilities will not keep up. Investment in transmission has lagged for other reasons besides economic incentives that favor generation.⁵⁸ Building new transmission lines is complex, expensive, and politically sensitive,⁵⁹ as perhaps demonstrated most vividly in

54. See Linda G. Stuntz, Symposium Materials from the University of Richmond School of Law Symposium, *The Blackout of 2003: What's Next? Transmission Investment, Restructuring and the Future of the Electric Utility Industry* 12-13 (Apr. 2, 2004) (on file with author) (noting that the TLR record shows there is "[i]ncreasing congestion even in areas with RTOs"); see also U.S. DEPT OF ENERGY, NATIONAL TRANSMISSION GRID STUDY, at ix (2002), available at <http://www.pi.energy.gov/pdf/library/TransmissionGrid.pdf> [hereinafter NATIONAL TRANSMISSION GRID STUDY].

55. Kelliher, *supra* note 12, at 726 (noting that "transmission investment in circuit miles grew less than 0.5 percent annually between 1998 and 2001"); see also NAERC LONG-TERM ASSESSMENT, *supra* note 52, at 5; NATIONAL TRANSMISSION GRID STUDY, *supra* note 54, at 7; TRANSMISSION ACCESS POLICY STUDY (TAPS) GROUP, EFFECTIVE SOLUTIONS FOR GETTING NEEDED TRANSMISSION BUILT AT REASONABLE COST 4 (2004), available at <http://www.tapsgroup.org/sitebuildercontent/sitebuilderfiles/effectivesolutions.pdf> [hereinafter TAPS GROUP STUDY]. Industry executives are keenly aware of this stagnation in transmission investment. See, e.g., Gordon van Welie, Symposium Materials from the University of Richmond School of Law Symposium, *The Blackout of 2003: What's Next? Transmission Investment, Restructuring and the Future of the Electric Utility Industry* (Apr. 2, 2004) (on file with author) (stating that the CEO of now-RTO ISO-New England is calling for increased investment in transmission).

56. See NATIONAL TRANSMISSION GRID STUDY, *supra* note 54, at 24.

57. *Id.* at 4, 7.

58. NAERC LONG-TERM ASSESSMENT, *supra* note 52, at 5; Kelliher, *supra* note 12, at 726-29 (discussing stagnation in transmission investment and the need to promote investment in new capacity).

59. See Jim Rossi, *Moving Public Law Out of the Deference Trap in Regulated Industries*, 40 WAKE FOREST L. REV. 617, 636-48 (2005) [hereinafter Rossi, *Moving Public Law*]; see also Jim Rossi, *Transmission Siting in Deregulated Wholesale Power Markets: Re-imagining the Role of Courts in Resolving Federal-State Impasses*, 16 DUKE ENVTL. L. & POL'Y F. (forthcoming Spring 2005) (manuscript on file with author) [hereinafter Rossi, *Re-imagining*

recent years by the wrangling over the construction and operation of the Cross-Sound Cable between Connecticut and Long Island.⁶⁰

There is a lack of cooperative decision making for transmission planning. With the grid being essentially two large, interconnected systems,⁶¹ small changes to any one part of the system have magnified impacts throughout the industry,⁶² and a comprehensive plan for necessary improvements is essential.⁶³ Quite literally, however, there is fundamental disagreement over the bottom-line responsibility for building and maintaining adequate transmission capacity: is this the function of RTOs, incumbent utilities, the federal government, or all or none of the above? At present, there is no solution in place for long-run transmission planning.

Finally, no account of the uncertain state of restructuring is complete without a discussion of the retrenchment currently taking place in retail competition at the state level. Order No. 888 began the process of requiring utilities functionally to unbundle (separate) their transmission and generation services. The idea, as in the cable and phone industries, was that competitors would avoid building duplicative local distribution facilities. Instead, incumbent utilities would carry the power of independent generators over their lines. In the aftermath of competition's disastrous failure in the early 2000s in California,⁶⁴ states are beginning to slow, alter, or even

the Role].

60. Rossi, *Moving Public Law*, *supra* note 59, at 644-48; *see also* Kelliher, *supra* note 12, at 728 (discussing the current status of the Cross Sound Cable); Richard J. Pierce, Jr., *Environmental Regulation, Energy, and Market Entry*, 16 DUKE ENVTL. L. & POL'Y F. (forthcoming Spring 2005) (manuscript at 17-20, on file with author) [hereinafter Pierce, *Environmental Regulation*]; Rossi, *Re-imagining the Role*, *supra* note 59 (manuscript at 2-6).

61. *See* NATIONAL TRANSMISSION GRID STUDY, *supra* note 54, at 2.

62. *See* BLACKOUT TASK FORCE REPORT, *supra* note 49, at 30.

63. There is also the threat of terrorist acts to consider. We are dependent on electricity for almost every aspect of daily life. The transmission grid, due to its interconnected properties and overstressed condition, is vulnerable to an intentional attack. Although some sectors of the economy could function without the grid (some have their own sources of electricity through using, for example, generators), widespread loss of grid functions would still be devastating. The international task force reporting on the August 2003 blackout found it important to plan for improvements to the grid to alleviate these shortcomings. *See id.* at 139-70 (discussing recommendations to abate the scope of any blackout).

64. There are many excellent articles and books on the California crisis, and it would be difficult to cite any one without slighting the outstanding work of other authors. The National Council on Electricity Policy report takes a broad view of restructuring's future in the aftermath of California and contains a wealth of useful recommendations. MATTHEW H. BROWN & RICHARD P. SEDANO, NAT'L COUNCIL ON ELEC. POL'Y, A COMPREHENSIVE VIEW OF U.S.

reject progress toward restructuring, even where it had been embraced earlier.⁶⁵ As California's situation was somewhat unique, it would be inappropriate to blame the slow pace of retail competition across the nation wholly on that state's woes. Nonetheless, in many states, meaningful competition is not taking place and has been pushed off into the future. States such as Pennsylvania that moved early toward competition have seen a drop in the number of companies competing with incumbents; fewer competitive offers are being made and few residential customers are taking advantage of these offers. In others, such as my home state of Virginia, there are no meaningful opportunities for competitive choice at all, and none are likely to materialize for quite some time.⁶⁶

The current situation raises too many questions that lack easy answers, and any path forward or backward involves high risks. Moving forward with market mechanisms carries with it the omnipresent risk of Enron-like market manipulation. Who will monitor markets to ensure that manipulation does not recur, and what are these monitors doing? The difficulties encountered in developing adequate market monitoring mechanisms amply demonstrate that no one really knows how to shield consumers against manipulation, even FERC.⁶⁷ How exactly would the use of

ELECTRIC RESTRUCTURING WITH POLICY OPTIONS FOR THE FUTURE (2003), available at <http://www.ncouncil.org/restruc.pdf>. The California debacle had far-reaching ramifications—it became a factor in the opposition of groups as disparate as labor unions and other constituencies to the 2004 energy bill. See, e.g., UAW, *Energy and the Environment*, at <http://www.uaw.org/cap/04/issues/issue05.cfm> (last visited Feb. 18, 2005).

65. Many states have delayed restructuring or have retained “bundled” (traditional, non-deregulated) status. U.S. Dep’t of Energy, *Status of State Electric Industry Restructuring Activity—as of February 2003*, at http://www.eia.doe.gov/cneaf/electricity/chg_str/restructure.pdf (last modified Feb. 1, 2003); see also BROWN & SEDANO, *supra* note 64, at 25 (noting that only twenty-four states had moved toward competition as of 2000); Tomain, *supra* note 10, at 438.

66. See VA. STATE CORP. COMM’N, 2004 STATUS REPORT PART II: STATUS OF RETAIL ACCESS AND COMPETITION IN THE COMMONWEALTH, at i-ii (2004) (noting that “there is little competitive activity in the Commonwealth”), available at http://www.scc.virginia.gov/caseinfo/reports/2004_part_2.pdf. Recognizing that competition would take longer, Virginia recently amended its restructuring law to extend transitional rate caps until 2010. VA. CODE ANN. § 56-582(F) (Michie 2004); see also Carolyn Shapiro, *Va. Senate Vote Allows Power Deregulation to Progress, VIRGINIAN-PILOT*, at <http://home.hamptonroads.com/stories/story.cfm?story=65483&ran=65367> (Jan. 21, 2004) (quoting Sen. Frank W. Wagner’s statement that “[w]e haven’t gotten competition yet, and this bill is going to allow us to see whether competition will work”).

67. See, e.g., Moore, *supra* note 39, at 744 (“[C]an all aspects of the energy market be monitored in a timely and effective manner? This question is not

markets translate into the building of new transmission capacity? Should RTOs administer the transmission planning system or should state PUCs have a strong role? The unique characteristics of electricity warrant a system in which generation, transmission, and distribution are all independent, but with incumbent utilities continuing to own and control transmission facilities, what is to stop them from continuing to exercise market power?⁶⁸ Not surprisingly, without a good answer to this, incumbent utilities continue to have the ability to do just that.

II. REGULATORY LINEARITY AND COMMERCE CLAUSE BRINKSMANSHIP

Should restructuring simply end in favor of a return to traditional regulation? FERC would answer that question with an emphatic “no.” It is determined to bring about market innovation that would transform this historically regulated industry. That alone would not be enough to call its efforts into question. One would expect an agency to support its reinvention effort during a difficult implementation period. A crucial question in deciding whether the experiment should end is whether FERC’s actions have made it more difficult to deliver on the promise of innovation than would otherwise have been the case. As noted at the outset, the specific pattern of agency activity that I am concerned about falls into a category of “linearity.” In this pattern, an agency has been constrained in its thinking about the reinvention effort, and second, it has seen the process in a “point-A-to-point-B” mentality that limits its ability to adapt to changing conditions.

A. *The Core of “Linearity”*

It will help to begin by clarifying what I mean by a “linear” process. First, I only apply the term to agency actions that constitute departures from traditional regulatory programs. Regulatory myopia in implementing traditional programs has been

easy to answer and has not been answered.”). An entire symposium at the University of Houston Law Center is being devoted to this topic. See *Creating Competitive Wholesale Power Markets*, at <http://www.law.uh.edu> (last visited Feb. 21, 2005) (showing a conference invitation that states that “[t]he difficulties associated with electricity market design have shaken public confidence, causing regulators to shift focus from market design to market monitoring. Yet, issues linger: What behavior should be prohibited? What remedies should be implemented to prevent and restrain violations?”).

68. See, e.g., TAPS GROUP STUDY, *supra* note 55, at 6-7 (noting that the transmission system remains inherently uncompetitive as long as incumbent utilities own transmission assets).

thoroughly examined elsewhere and need not be taken up here. The size and scope of the proposed innovation will also be important. Some reinvention efforts—pilot projects, one-time exceptions to rules, and the like—would be so limited in scope as not to warrant this sort of systematic analysis. The critical characteristic of an initiative that deserves attention is that the agency is attempting to change its way of doing business in whole or large part.⁶⁹ By definition, if we seek a situation where stalemate has occurred in reinvention (stakeholders perceive that it would be better to start over than to go forward), then it is not possible when the agency is applying the existing regulatory scheme to most of the regulated community.

Another important factor is the extent to which the reinvention idea already has a track record of some sort. There must be some indicator that the agency has attempted more than once to implement its initiative—either it has floated one proposal and tried to advance it over a period of time, or it has made a number of attempts to fine-tune the initiative. Without the passage of time, there is no adequate record to use in judging the process.⁷⁰ I do not view the trepidation about commencing down the path of innovation through the same lens as the stalemate existing once reinvention has proceeded for some time. Reinvention might be less costly to a stakeholder than traditional regulation, but the stakeholder may not wish to take that gamble when viewing reinvention from a complete-uncertainty perspective.

Next, we face the difficulty of separating substance from process. Is there stalemate because the reinvention idea is controversial, difficult to implement, or flawed for some other reason? Or has the agency simply dropped the ball? In addressing this concern, there must be some explanation for the current disequilibrium that goes beyond implementation challenges. The electric power industry before the 1980s was a dinosaur, with the advent of competition representing a shock to the entrenched, comfortable culture of regulation. The transition to competition

69. I also assume the initiative's initial goals remain largely intact. For example, any regulatory inefficiencies that the reinvention effort would remedy should be continuing unabated. If fundamental industry conditions have stabilized and stakeholders are not clamoring for change, pursuing the reinvention effort further would be pointless.

70. It would be important to know here whether the agency proposes an idea for the first time, as the response may well be different from the reaction it would receive to a proposal of expanding a proven idea to a larger market or set of industries. As an example, an agency initiative to develop a trading scheme to reduce pollutant emissions might be rejected *ab initio*, but if it were, then we would certainly not conclude that the process in implementing it was faulty.

involves considerable issues such as the treatment of “stranded costs” (utilities’ investment in infrastructure during the period of traditional regulation).⁷¹ If grappling with these issues were all that was retarding the pace of innovation, then we would probably conclude that incremental progress would be salutary. So, the baseline character of the agency’s process itself must appear problematic.

How would we decide if an agency’s process were faulty? First, I assume an agency acted with the best of intentions but now finds itself stuck. If the reinvention effort was cynical or calculating, then there is no reason to bother analyzing it; it should simply end. As a crude measure of this, it would be important to know whether reinvention efforts had relatively broad support from diverse groups of stakeholders at the outset. There are some straightforward situations where this would not be the case. Some initiatives seem to have sprung directly from industry lobbyists’ pens. In those cases, it is not difficult to resist going forward if momentum stalls. An agency flagrantly unreceptive to certain stakeholder groups should not be allowed to continue its one-sided experimentation.⁷² Similarly, an agency acting contrary to existing law should not be allowed to continue disregarding it.⁷³

In other cases where substantial constituencies opposed reinvention from the outset and may well have played a part in slowing or ending it, those constituencies will obviously be satisfied by its downfall. In today’s charged climate for reinvention efforts—where many see the efforts as precursors to the end of regulation altogether—this could include groups that preferred the status quo. Some cases involve agencies that seem grounded in a controversial ideological base. In cases such as these, it can be exceedingly difficult to decide whether the agency’s actions or regulatory

71. See BROWN & SEDANO, *supra* note 64, at 18-20; J. Gregory Sidak & Daniel F. Spulber, *Givings, Takings, and the Fallacy of Forward-Looking Costs*, 72 N.Y.U. L. REV. 1068 (1997).

72. One suspects this would be particularly likely when the reinvention effort explicitly involves getting the agency out of the regulatory business—that is, deregulating completely. To represent that this is not what I have in mind, I will assume that “reinvention” continues to contemplate some form of oversight or other role for the agency.

73. The controversy involving the electric power industry and the “New Source Review” provisions of the Clean Air Act illustrates this, particularly in the Environmental Protection Agency’s advancement of a proposal that would set a threshold below which utilities could replace equipment without regulatory review. See generally Joel B. Eisen, *A Critique of the Regulations Revising the U.S. Clean Air Act’s New Source Review Program* (Aug. 2004) (paper presented at the 13th World Clean Air and Environmental Protection Congress and Exhibition, London, U.K., on file with author).

philosophy (or, for that matter, both) have fostered the climate of stalemate. Presumably, if it were predominantly the latter, then we would decide that active opposition from the start, not the agency's process, doomed the project.⁷⁴ So it would help to find cases where at the very least one could say that either the agency lacked a single-minded ideological bent, or, if it had one, it attempted to address opponents' concerns.

Another baseline concern is the scope of the agency's authority. By definition, because the agency is attempting to innovate, it may lack the clear statutory or regulatory authority to do so. It is possible, of course, that it is seeking this authority at the same time that it is promoting the reinvention effort. If there is a clear sense, from a judicial decision or other source, that the agency cannot proceed, then we might be better off examining what steps are necessary to pave the way for innovation rather than critiquing agency performance. But if the lack of clarity regarding authority is not an absolute bar to proceeding with innovation, then the agency probably will not be able to claim that it could not innovate because it was hamstrung in its ability to do so.

In some cases, then, it may be possible to attribute stagnation in large part to a specific external factor such as a lack of authority. Even when the agency may bear some blame, there must be some way to differentiate two fundamental types of cases from one another. In one, the agency is on the right track, and more effort is needed. In the other, the agency is on the wrong track, and continued effort would be counterproductive. We cannot distinguish these from each other by the mere fact that the agency has made multiple attempts at reinvention. Without knowing more, how would we guarantee that the fourth, fifth, or tenth time around would not be the charm? Perhaps reinvention is so difficult that it would take any agency, working diligently and responsively, numerous tries to get it right.

One starting point would be a search for an appropriate measurement of success. There must be some remaining sense on the part of some or all stakeholders that innovation is worthwhile (otherwise there is no reason to go forward), but the lack of success and the nature of the process have turned some of them against the agency. As on the children's soccer field, trying may be enough. If there is some reason to believe that gaining valuable experience

74. In these cases, process and substantive arguments simply blur together, with reinvention opponents criticizing the process and vice versa. The resulting discussion would echo that which took place when the agency embarked on the course of innovation. Updating this discussion might be useful, but it would not necessarily tell us much about process considerations.

allowed the agency to embrace the spirit of innovation, then a partial success may well be better than none at all. The agency could regroup to reassess the situation and pursue another initiative later. The situation looks quite different if one cannot contemplate this regrouping taking place. There is no use in encouraging the agency to go back to the drawing board if it would simply stick to its guns the next time around. There must be a sense of a developmental process that would eventually yield results.

A major difficulty in applying this yardstick is to determine who is empowered to judge a reinvention effort and what criteria they should use. After all, anyone dissatisfied with an agency's performance can charge that it is intransigent, ineffective, or unresponsive. The central attribute of this type of situation is that there are widespread assertions from former boosters that the process is now stuck. Thus, one useful measure of the deficiencies in agency process would be the dissatisfaction of a critical mass of previously supportive stakeholders. It would also be desirable for these stakeholders to have differing interests; if lobbyists for the industry consistently rail against the agency but others are content, then the process may not be deficient.

B. *The Centrality of "Flexibility"*

The extent to which the agency has used flexible reinvention strategies is vital to evaluating the sources of this dissatisfaction and possible remedies for it. Throughout the period of implementation, the agency should signal an openness and willingness to use different means of achieving its goals (and, indeed, a receptivity to modifying the goals if they prove unworkable). The pace and style of innovation should be as flexible as the initiative itself would be, viewed in comparison to traditional regulatory tools.⁷⁵ Reinvention, as the name implies, must constitute real change. The agency should change its corporate culture to do things differently, both in substance (remedying inefficiencies of traditional regulatory strategies, for example) and in process. It is impossible to discuss the idea of reinventing most regulatory programs of the modern administrative state without noting that the process of designing these programs has itself been a recurring source of controversy, due in no small part to its adversarial nature. If the reinvention process comes to resemble the confrontational dynamics of notice and comment rulemaking—the

75. This is not necessarily indispensable to reinvention. A doggedly determined agency could generate results, even if it took multiple attempts to do so. My point is that the agency *should* have an open, transparent, and flexible process.

agency proposes and the stakeholders dispose—then the agency has not truly changed.

This begs a larger question. The agency should not change its ways simply because its original way of doing business has been controversial. This might well suggest a posture of deference to the regulated community that may be unwarranted. An agency should also not change simply to depart from convention. Some “convention,” of course, may be existing law that constrains just how much an agency can change.⁷⁶ Nor should we assume it would necessarily be less costly for the agency to adopt flexibility in its process. Regulating has high costs (the transaction costs in litigation over most rules is but one source), but there is no guarantee that reinvention would not be costly. Every time the agency takes a step forward, it has to reinvent the wheel, crafting a new process. The agency’s time and effort in doing this must be accounted for, as must the costs of outside stakeholders’ input (if any) into process design.

Why, then, must the agency be flexible? The answer, I think, is a complicated one that reflects contemporary thought about organizational behavior. Modern life is complex and messy. Actors need to respond to this new reality. In particular, they need to manage constant change by pursuing strategies based on flexibility and adaptability. The inherent nature of current agency programs, particularly notice-and-comment rulemaking, is far removed from this, and agencies must evolve away from this dynamic. Flexibility is particularly essential in reinvention. It involves change, which by definition puts the agency in a situation of uncertainty and messiness. Also, the agency has made a commitment to doing things differently. It has signaled that it wants to depart from the norms it has followed until now. It cannot simply adhere to those norms when reinvention proves difficult. That, it seems, constitutes a central distinction between the process of developing traditional regulation and the course we follow here.

C. The Expectation of Openness and Transparency

There is one pragmatic concern to discuss further. The agency should pursue reinvention with a devotion to openness and transparency. It must sound unnecessary to say this, for a central idea of the modern state is to inject openness into the regulatory process. However, as the regulatory system has grown, there are

76. If the reinvention process is contrary to an existing statute (whether substantive or one that sets limits on agency procedure such as the Administrative Procedure Act) or a Constitutional norm, then it should not continue.

many junctions (internal development of a regulation, for example) where the agency can operate largely without scrutiny. A principal justification for many reinvention efforts, then, is that traditional regulatory strategies are unresponsive to stakeholders.⁷⁷ For that reason alone, they typically feature more involvement of stakeholders from the outset in designing the initiative and retooling it along the way than is typical otherwise.⁷⁸ There is often an expectation that this involvement will be present, and if that expectation is not met, then the initiative is less likely to be successful.

An agency that seems preoccupied with its innovative idea can appear oblivious to the consequences of continuing to pursue it. The nature of its public-outreach efforts might be telling in this regard. If its reinvention process does not include significant and meaningful participation by all interested parties, then the agency can seem indifferent or unreceptive to the concerns of those who did not take part—consumers or public interest groups, for example. A public-outreach process only has real meaning if the agency is genuinely responsive to reasonable concerns articulated to it. If the agency appears to slough off purported deficiencies in its strategy, then that raises concerns about the process. Another red flag is raised if the agency's justifications for innovation change over time as original arguments in favor of the reinvention effort are challenged. An agency that appears to be engaging in retrofitting its arguments to the idea, not retooling the idea, is unresponsive. In addition, it may eventually be left with indefensible arguments, having exhausted its best ones. This raises the cost to those outside the agency in challenging those arguments, when all might be better off pursuing a different course of innovation.

If the agency has committed itself to innovation but does not meet this expectation, it might well be the case that stakeholders discount all of its actions. We would eventually observe more time spent strategizing over and critiquing the idea of innovation than in undertaking the innovation. This is particularly true when actors have the power to tie up the agency in courts or elsewhere; they will spend time and effort to frustrate the agency's purpose when they can do so. Disenchanted stakeholders could retreat to a simple defensive posture (resisting all agency entreaties until the agency builds a positive record of success) or a more confrontational position of distrust. The latter is probably more likely if an adversarial

77. See, e.g., David W. Case, *The EPA's Environmental Stewardship Initiative: Attempting to Revitalize a Floundering Regulatory Reform Agenda*, 50 EMORY L.J. 1, 88 (2001).

78. See, e.g., *id.*

relationship existed between the regulatory agency and outside stakeholders when the reinvention effort started. If this climate of distrust comes about, stakeholders will view the process in superficial terms, where every argument is reducible to its lowest common denominator. In this era of instantaneous means for information dispersal, it does not take long for dissatisfaction to be translated into the very public staking out of adversarial positions.

By the time this happens on a widespread basis, progress is unlikely. It creates a climate where stakeholders would be distrustful that the agency truly intended to change its corporate culture, which is of course directly antithetical to the mindset needed for progress. Thus, those outside the agency would probably react more strongly against the idea of innovation than might otherwise be the case. This has another unfortunate effect. If those outside the agency see an approach to innovation that appears calculated to downplay any ideas other than the agency's original ones—whether or not that is in fact the case—they are unlikely to generate new ideas of their own to break the stalemate. Instead of engaging in productive planning and thinking about the future, groups will stereotype each other with negative sound bite terms: “free market ideologues,” “reactionaries,” and so forth. That, of course, suggests quite clearly that we have arrived at a climate of linearity. It would be better to start over.

D. Evaluating FERC Under This Linearity Test

A threshold question in applying this linearity test to FERC is whether its movement toward the market is the sort of reinvention worthy of testing. After all, as FERC Commissioner Joseph Kelliher recently stated, the industry remains regulated even as it restructures.⁷⁹ But it would be difficult to dispute that restructuring has introduced so much change to the industry that it ought to be viewed as an entirely new regulatory paradigm.⁸⁰ That brings restructuring more clearly under the tent of reinvention initiatives.

With that in mind, is linearity present in electricity restructuring? Unfortunately, it is hard to tell because the evidence is mixed. It is difficult to attribute the stalemate to one singular cause; so much has gone wrong (including the “perfect storm” of California and Enron)⁸¹ that it is hard to lay the blame completely at

79. Kelliher, *supra* note 12, at 728.

80. See, e.g., Moore, *supra* note 39, at 741 (calling “FERC’s vision . . . a public policy initiative that fundamentally re-orders and restructures an industry that is the life blood of our economy”).

81. But see Nancy B. Rapoport, *Enron, Titanic and The Perfect Storm*, 71 *FORDHAM L. REV.* 1373, 1375 (2003) (contending that although many authors

FERC's doorstep. One problem is that, from the beginning, deregulation has attracted an unusual coalition opposing it. With regional differences being much more important than ideological ones, this may well be one of the very few contemporary fields in which certain "red" Southern states and "blue" states in the Pacific Northwest see eye to eye. This reflects the realities that what is best for the Northeast may not work in the Pacific Northwest.

As Professor Pierce notes, many states ferociously resisted FERC's initiatives.⁸² In the words of a prominent industry expert, these states treated SMD and the "Wholesale Power Market Platform White Paper" ("WPMP"), which is discussed later in this subpart, as a "Federal plot to deprive states of regulatory jurisdiction [over 'their' utilities,] . . . facilitate retail access in states that did not want it [, or] . . . to take away transmission rights from 'native load' and give them to [someone else]."⁸³ This is hardly the sort of climate in which innovation is likely or even possible, but is this the reason restructuring has failed (and thus, FERC could not be called linear)? Some would say yes;⁸⁴ those from the anti-restructuring states would say that an approach that lets different approaches work in different regions, instead of attempting to make one solution work for the nation as a whole, could have overcome the doubters.⁸⁵ So it is not immediately apparent whether the political power of Southern and Western states is the root cause of the current problem, and I will have more to say about this in the next subpart.⁸⁶

Looking solely at FERC's conduct, and leaving aside the political and public relations damage caused by FERC's handling of the California electricity crisis,⁸⁷ FERC's strategy of implementing

have referred to it in this way, it is a misnomer to refer to the Enron situation as a "perfect storm").

82. See Pierce, *Environmental Regulation*, *supra* note 60 (manuscript at 14).

83. Sue Kelly, Symposium Materials from the University of Richmond School of Law Symposium, *The Blackout of 2003: What's Next? Transmission Investment, Restructuring and the Future of the Electric Utility Industry* (Apr. 2, 2004) (on file with author).

84. See, e.g., Pierce, *Environmental Regulation*, *supra* note 60 (manuscript at 13-20).

85. A recurring criticism of FERC's restructuring effort is that it takes a "one-size-fits-all" approach to the entire nation in an industry with substantial regional variations. See, e.g., *Hearing Before the S. Comm. on Energy & Natural Res.*, 107th Cong. 43-54 (2002) (statement of Marilyn Showalter, Chairwoman, Wash. State Utils. and Transp. Comm'n); AM. PUB. POWER ASS'N, *supra* note 25, at 20.

86. See *infra* Part II.E.

87. Kelly, *supra* note 83 (noting that "FERC took a huge PR beating—it

restructuring has made anti-deregulation hawks even out of many who previously did not oppose it. One obvious red flag was raised when it retooled the restructuring framework several times. The process of putting forth new proposals in a relatively short period of time (Orders Nos. 888/889 and 2000, SMD, and WPMP) caused unnecessary confusion and resentment and made FERC look as if it were giving out unreliable signals. Of course, FERC continued to insist that markets would shake out any bugs that would spring up in the transition from the current system to a competitive one.⁸⁸

If market mechanisms are truly superior to traditional cost-of-service regulation as a regulatory paradigm for the electric power industry, then by continuing to issue SMD, WPMP, and the like, the agency would eventually be vindicated. But FERC's ability to make this case was simply overwhelmed by the political backlash to its proposals. In particular, issuing SMD was a major process disaster for FERC because it extrapolated the PJM-LMP model to the rest of America. SMD's size also backfired on FERC. Even in a 600-page rulemaking, many major issues were left to chance. On one hand, FERC could be seen as advocating a one-size-fits-all framework for national electricity policy and, on the other, leaving vast uncertainties to be worked out later.

SMD's breathtaking scope, contrasted with its frequent lack of detail, virtually guaranteed a negative reaction. The innovation FERC championed would extend virtually to the entire nation⁸⁹ and would govern pricing of the nation's most essential commodity. As for expanding transmission capacity, a substantial body of literature bolsters the notion that markets would signal transmission providers to build capacity,⁹⁰ but this has not translated to success as yet.⁹¹

was perceived as failing to protect the public and being too wedded to pro-competition ideology to take needed action").

88. Not surprisingly, there are doubters. See COOPER, *supra* note 39; Moore, *supra* note 39, at 742-49 (detailing risks associated with reliance on market mechanisms).

89. Except, of course, to nonjurisdictional utilities (utilities over which FERC does not have jurisdiction), but FERC encouraged them to join in. Remedying Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design, 67 Fed. Reg. 55,452, 55,455 (Aug. 29, 2002) (to be codified at 18 C.F.R. pt. 35).

90. Perhaps the best-known proponent of this idea is Harvard economist William Hogan. See William W. Hogan, Transmission Market Design (Apr. 4, 2003) (paper presented at *Electricity Deregulation: Where to from Here?*, Conference at Bush Presidential Conference Ctr., Tex. A&M Univ.), available at http://ksghome.harvard.edu/~whogan/trans_mkt_design_040403.pdf.

91. See AM. PUB. POWER ASS'N, *supra* note 25, at 10 (noting that "[t]he Achilles heel of the LMP/FTR system described above is that it, taken alone,

The LMP pricing models have not been tested on a widespread scale, and there is no reason to believe manipulation and simple price spiking are not possible. Economists might well put their faith in the efficiency of the markets, but that might force a consumer in Denver to pay one dollar per kilowatt-hour for electricity on a hot summer day. If wholesale electricity prices spike and that price increase must be passed on to consumers, then there will be major negative repercussions in the economy.⁹² Complex issues about restructuring are being worked out in various committees, public meetings, and the like, but there is no guarantee that safeguards put in place would prevent a recurrence of the California energy crisis or other malfunctions of the marketplace. On the contrary, there are concerns that markets would not be efficient in “load pockets”⁹³ and that nondiscriminatory access to the transmission grid is a recurring issue.⁹⁴

When confronted with this, FERC continues to insist that a standardized market will work. The WPMP issued on the heels of SMD’s rejection simply reiterates that FERC intends to promote a national marketplace for electricity, without evidencing any notion that it has adapted to the sting of rejection. The WPMP reads like an executive summary of the SMD rulemaking. Rather than serve as a basis for constructive discussion—as the name “white paper” would imply—it is the politically maladroit, stillborn proposal of an agency that has been put on the defensive.

By advancing a standardized formula for the design of electricity wholesale markets that involves a considerable amount of guesswork, FERC asks for trust from stakeholders with a limited

does not ensure construction of adequate transmission infrastructure”).

92. See Moore, *supra* note 39, at 746 (noting that in the move to LMP, “[t]here is risk of significant price increase and price volatility”).

93. One constrained area with which I am familiar is the Delmarva Peninsula in the Mid-Atlantic region. See Letter from Allen Todd, President, Mun. Elec. Power Ass’n of Va., to David R. Eichenlaub, Assistant Dir. of Econ., Va. State Corp. Comm’n, Comments on Topics to Be Addressed in Third Annual Report to LTF 4 (May 20, 2003) (terming “the cost of congestion that Old Dominion Electric Cooperative (“ODEC”) and other transmission dependent utilities experienced in the Delmarva Peninsula under PJM’s system of locational marginal pricing and fixed transmission rights . . . [as] a major factor driving the 2003 [Virginia restructuring] legislation”), available at <http://www.scc.virginia.gov/division/eaf/comments/facil03/mepav052003.doc>; see also Pierce, *Environmental Regulation*, *supra* note 60 (manuscript at 17) (terming the New York metropolitan area a classic load pocket and calling for transmission solutions).

94. AM. PUB. POWER ASS’N, *supra* note 25, at iii (“APPA member[] [public power systems] are unable to obtain or even retain long-term firm transmission service at just and reasonable rates [in RTO regions].”).

record of success to back it up. So the hallmark of linearity—that stakeholders have lost faith in the agency in large part because of its process—would appear to be squarely presented in this situation. Parties are reacting strongly against the idea of restructuring, and the predominant flavor of the debate is so pernicious that few stakeholders are advocating comprehensive solutions for escaping the current predicament. Too much time is spent on opposing ideas and not enough is being spent on generating new ones. And much of this, to some, is directly traceable to FERC. As one observer notes, “very few industry participants [liked SMD]—almost everyone saw something they did not like and which threatened their ability to do business. Instead of simply going back and fixing the primary flaw in Order No. 2000 (which might have had the support of at least some), FERC instead raised more hackles.”⁹⁵

E. The States' Role in the Retrenchment of Restructuring

*“[W]e remain extremely concerned that FERC is aggressively moving forward . . . [to] coerce RTO participation, preempt state law, and exceed the commission’s own statutory authority.”*⁹⁶

But I return in what must seem almost circular fashion to where I started. No story of the retrenchment in restructuring is complete without a fuller explanation of how some states have been able to exploit localized concerns and the split of jurisdiction with the federal government to their advantage. As another contributor to this dedicated issue, Professor Jim Rossi, noted quite presciently several years ago, “federal competition policy, even if limited to wholesale supply markets, cannot peacefully coexist with balkanized, protectionist regulation by individual states.”⁹⁷ He advocates the use of the dormant commerce clause and federal preemption as means to control the states’ tendency to parochialism and other excesses.⁹⁸ Not surprisingly, observers such as Professor

95. Kelly, *supra* note 83.

96. Letter from S. Governors’ Ass’n, to George W. Bush, President, United States of Am. 1 (Feb. 3, 2004), available at <http://www.psc.state.ga.us/electric/federal/RM01-12/President%20letter%20020304.doc>.

97. Jim Rossi, *The Electric Deregulation Fiasco: Looking to Regulatory Federalism to Promote a Balance Between Markets and the Provision of Public Goods*, 100 MICH. L. REV. 1768, 1789 (2002) (reviewing CHARLES R. GEISST, *MONOPOLIES IN AMERICA* (2000), RICHARD F. HIRSCH, *POWER LOSS* (1999), and PAUL W. MACAVOY, *THE NATURAL GAS MARKET* (2000)) [hereinafter Rossi, *The Electric Deregulation Fiasco*].

98. Rossi, *Moving Public Law*, *supra* note 59, at 632-48 (discussing the dormant commerce clause); see also Rossi, *The Electric Deregulation Fiasco*,

Pierce would require the states to relent, blaming them for focusing myopically on their own interests at the expense of national policy. To Professor Pierce, that is unpatriotic.⁹⁹

Unquestionably, the states have statutory mandates to protect their consumers. Thus, state regulators must do better than engage in guesswork on the pivotal issue of whether their ratepayers will fare better under competition. Many wonder legitimately if their consumers will be protected if major concerns about electricity policy are addressed by FERC, not their PUCs.¹⁰⁰ This apprehension has played out notably in the context of a debate over the contours of shared jurisdiction. As noted above, the federal government regulates electricity at “wholesale”; the states regulate it at “retail.” This split sounds easy to fathom. Certainly, I know the difference between a retail sale of a sweater to me by Target and a wholesale sale to the store by a clothing maker. When one begins to get a sense of what the terms of art “wholesale” and “retail” mean in this context, things get muddier. While a sale of electricity by a generator to a utility is technically at “wholesale” because it is not to the eventual consumer, the ability to regulate that sale carries with it the ability to dictate terms and conditions that can frequently carry over into the retail arena.

The language employed by both sides has added to the confusion. The debate over jurisdiction to regulate electricity is frequently cast as one of great Constitutional gravity, as if it were yet another example of the “states’ rights” versus “efficiency of regulation” battle all too common these days.¹⁰¹ But the rhetoric

supra note 97, at 1785 (noting that “[b]ecause interest groups are more readily able to capture the state regulatory process, as well as states’ deregulation policies, state laws could potentially thwart full evolution of markets in electric power”).

99. See Pierce, *Environmental Regulation*, *supra* note 60 (manuscript at 17).

100. See Moore, *supra* note 39.

101. See Adam D. Thierer, *Electricity Deregulation and Federalism: How Congress and the States Can Work Together to Deregulate Successfully*, BACKGROUND, June 23, 1997, at 1, available at <http://www.heritage.org/Research/Regulation/BG1125.cfm>. Thierer states:

Most of the parties involved in this debate do not realize that the controversy involves much more than just the electricity market: It strikes at the heart of the constitutional balance of power between the federal government, the states, and individual Americans. Instead of causing the parties to study the proper constitutional jurisdiction for the administration of electricity deregulation, however, the debate has become mired in political platitudes. One side chants “states’ rights” while the other preaches “economic efficiency.” The issue of deregulation is much more complicated than these two philosophies, and it deserves far greater study.

being employed in the pitched controversy over regulatory federalism, the backfilling and reinterpreting of the limits of modern regulatory programs after *Lopez*¹⁰² and *Morrison*¹⁰³ cast doubt on their Commerce Clause underpinnings, is a poor fit here. In the regulatory federalism debate, there is a historic clash between titanic forces—one bent on returning all authority to the states, and one determined to preserve the citadels of modern regulation. This situation is different and should be acknowledged as such.

The Supreme Court's decision in *New York v. FERC*,¹⁰⁴ despite some assertions to the contrary, is extraordinarily clear about what the retail/wholesale split means. The Court upheld FERC's claim in Order No. 888 of jurisdiction over the transmission component of "unbundled" retail sales (sales in states that have taken on the task of separating generation from transmission and distribution, that is, restructuring).¹⁰⁵ In practical terms, this means the federal government could assert jurisdiction all the way to a consumer's toaster if it so chose, excepting such exclusively intrastate matters as the siting of power plants. The electricity grid is a virtually seamless web of interconnected networks, and it is impossible to state in this day and age where transmission begins and ends. As the retail price of electricity by definition therefore includes a transmission component (except where it can be said, as in Texas, that electricity is generated, transmitted, and distributed on systems that are wholly self-contained and out of FERC's reach), FERC could strip state PUCs of their historic powers or at least demand to share them.

This is not a situation where jurisdiction is predicated on migratory birds flying across state lines and landing in mud flats.¹⁰⁶ Electricity involves a national marketplace that reaches every American and cannot be carved into neatly defined or clearly distinct markets and regulatory jurisdictions. It is perhaps the clearest case of unfettered Commerce Clause jurisdiction extant today (at least in a situation where some parties believe the federal government does not have it). There is no reason after *New York v. FERC* to squabble over whether the federal government can

Id. at 2.

102. *United States v. Lopez*, 514 U.S. 549 (1995).

103. *United States v. Morrison*, 529 U.S. 598 (2000).

104. 535 U.S. 1 (2002).

105. *Id.* at 23-24.

106. Of course, this is a reference to the well-known SWANCC case. *Solid Waste Agency of N. Cook County v. U.S. Army Corps of Eng'rs*, 531 U.S. 159 (2001). For one of the many articles about the case, see Robert R.M. Verchick, *Toward Normative Rules for Agency Interpretation: Defining Jurisdiction Under the Clean Water Act*, 55 ALA. L. REV. 845 (2004).

regulate most matters relating to electricity. It can. By revamping the FPA (starting by giving FERC authority to regulate reliability),¹⁰⁷ FERC could have all the authority it needs. One considerable irony here is that Supreme Court Justices who are the most skeptical about modern regulatory programs are also those who believe FERC has and should be more proactive. The Court in *New York v. FERC* virtually invites FERC to take over regulation of all transmission of electricity.¹⁰⁸

Thus, the fight over the Commerce Clause implications of SMD, WPMP, and the like was not over whether the federal government has the authority to regulate the electric utility industry. Instead, it centered on a much more subtle question of law and politics: whether it *chooses* to exercise that authority. Anti-deregulation states invoked the Constitution in opposition to FERC and its initiatives, but these states and their allies in Congress (where the pending energy bill would strip FERC of virtually any authority to impose SMD or a similar market-based structure) were at times engaging in “Commerce Clause brinksmanship”: they made it appear as if there is a real Constitutional problem with FERC’s initiatives where there most likely is not one at all. To say the least, this not only is not conducive to progress but also makes it more difficult to identify the real problem.

F. A “Commerce Clause Brinksmanship” Case Study: States Resist FERC and Question Restructuring’s Economics (The New PJM Cos.)

The New PJM Cos.,¹⁰⁹ litigation involving a who’s who of utility industry players, is an excellent example of this ongoing battle. Due to its truly unusual posture, it focused on both federalism concerns and restructuring’s merits. In this case, American Electric Power Service Corp. (“AEP”), one of the nation’s largest IOUs, sought to transfer control of its transmission facilities to PJM Interconnection, an RTO based in Pennsylvania that serves the Northeast and Mid-Atlantic Region.¹¹⁰ FERC made AEP’s integration into an RTO a condition to its request to merge with another utility.¹¹¹ With the clock running on that order, two states (Kentucky and Virginia) used their power effectively to prevent AEP from transferring

107. Kelliher, *supra* note 12, at 720-24 (calling for “enforceable reliability standards”).

108. 535 U.S. at 17 (stating that there is no language in the Federal Power Act “limiting FERC’s transmission jurisdiction to the wholesale market” (emphasis removed)).

109. 105 F.E.R.C. ¶ 61,251.

110. *Id.* ¶¶ 61,251.2, .13, at 62,307, 62,309-10.

111. *Id.* ¶ 61,251.5, at 62,308.

control.¹¹² Thus, the case revisited the federalism argument introduced in *New York v. FERC*, with FERC this time using a relatively obscure statutory provision to order AEP's integration into PJM and bypass state law. Because this provision only gives FERC's authority over situations where integration would "obtain economical utilization of facilities and resources,"¹¹³ the case also became a laboratory to test the central premise of restructuring: that it would achieve economic efficiency and benefit consumers.

The case arose in an unusual way. Under the FPA, FERC has authority to review and approve mergers involving utilities under its jurisdiction.¹¹⁴ In 2000, FERC approved the proposed merger between AEP and Central and South West Corporation on the condition that AEP transfer operational control of its transmission facilities to a fully functioning FERC-approved RTO by December 15, 2001.¹¹⁵ AEP then made two unsuccessful attempts to join an RTO. FERC denied RTO status to the Alliance Companies, a group of companies (including AEP),¹¹⁶ and subsequently, AEP negotiated unsuccessfully to join the Midwest Independent System Operator.¹¹⁷ In April 2002, FERC ordered AEP to state which RTO it intended to join,¹¹⁸ and in response, AEP filed with FERC a document stating its intent to join PJM. Later that year, AEP filed for approval to transfer control of its transmission facilities to PJM, and FERC approved the application on April 1, 2003.¹¹⁹

AEP serves eleven states and needed approval from the PUCs

112. *Id.* ¶¶ 61,251.110-114, at 62,325-26.

113. *Id.* ¶ 61,251.121, at 62,327 (quoting PURPA section 205(a)).

114. 16 U.S.C. § 824b (2000).

115. See 105 F.E.R.C. ¶¶ 61,251.2-54, at 62,307-16 (discussing case background). The merger condition came about in part as a result of a public hearing in which several interested parties voiced their opinion that FERC should not approve the merger because AEP and Central and South West had not made "a meaningful commitment to join an Independent System Operator (ISO) of sufficient size or scope to mitigate their market power." *Id.* ¶ 61,251.3, at 62,307-08.

116. See *Alliance Cos.*, 99 F.E.R.C. ¶ 61,105, at 61,431 (2002); NATIONAL TRANSMISSION GRID STUDY, *supra* note 54, at 27 (listing Alliance among RTO applications denied by FERC); THE CHANGING STRUCTURE 2000, *supra* note 7, at 77. The downfall of the Alliance Companies' attempt to form an RTO shows just how difficult it is to get an RTO organized. While one company (AEP) had every incentive to make it work, others pulled out along the way.

117. See *The New PJM Cos.*, 106 F.E.R.C. ¶ 63,029, ¶63,029.14, at 65,300 (2004) [hereinafter 2004 AEP-PJM Order], *aff'd*, 107 F.E.R.C. ¶ 61,271 (2004).

118. See *Alliance Cos.*, 99 F.E.R.C. ¶ 61,105, at 61,545.

119. See *Am. Elec. Power Serv. Corp.*, 103 F.E.R.C. ¶ 61,008, ¶ 61,008.1, at 61,025 (2003).

in those states before control could be transferred.¹²⁰ Two of those states—Kentucky and Virginia—took actions to block or delay the transfer. On April 2, 2003 (one day after FERC approved AEP's application to transfer control to PJM), Virginia amended its Restructuring Act to preclude Virginia incumbent electric utilities from transferring control of their transmission facilities to RTOs until July 1, 2004 but, interestingly, to require that they do so by January 2005.¹²¹ Three months later, the Kentucky Public Service Commission ("KPSC") denied AEP's request to transfer control of its Kentucky transmission facilities to PJM.¹²²

At this point, the case became *sui generis*. AEP had been ordered to join an RTO (itself unusual) but then had been unable to do so. It now faced conflicting deadlines that could not be resolved. AEP was in a pickle, to say the least. In response, FERC initiated an inquiry designed "to gather sufficient information for moving forward in resolving the voluntary commitment made by several entities to increase regional coordination by joining RTOs' and to 'explore ways to resolve the interstate disputes . . . and enhance regional coordination to establish a joint and common market in the Midwest and PJM region.'"¹²³ On November 25, 2003, FERC used section 205(a) of PURPA¹²⁴ to make preliminary findings that the proposed transfer should be approved.¹²⁵ This subsection authorizes FERC to exempt electric utilities, in whole or in part, from any provision of state law or regulation which prohibits "the voluntary

120. See The New PJM Cos., 105 F.E.R.C. ¶¶ 61,251.2-.11, at 62,307-09.

121. 2004 AEO-PJM Order, *supra* note 117, ¶ 63,029.15, at 65,300; VA. CODE ANN. § 56-579(A)(1) (Michie 2004).

122. 2004 AEP-PJM Order, *supra* note 117, ¶ 63,029.16, at 65,300.

123. *Id.* ¶ 63,029.17, at 65,300 (alteration in original) (quoting The New PJM Co., 104 F.E.R.C. ¶ 61,274, ¶ 61,274.1-.2, at 61,916 (2003)).

124. 16 U.S.C. § 824a-1(a) (2000).

125. 2004 AEP-PJM Order, *supra* note 117, ¶¶ 63,029.1-.2, at 65,297. The important preliminary findings were as follows:

AEP's voluntary commitment to join PJM is designed to obtain economical utilization of facilities and resources in the Midwest and Mid-Atlantic areas, as set forth in Section 205(a) of PURPA.

. . . The laws, rules or regulations of Virginia and Kentucky are preventing AEP from fulfilling both its voluntary commitment in 1999, as part of merger proceedings, to join an RTO, and its application to join an RTO pursuant to Commission Order No. 2000.

. . . The aforementioned provisions of Kentucky or Virginia law or rule or regulation are neither (1) required by any authority of Federal Law, nor (2) designed to protect public health, safety or welfare, or the environment or conserve energy or are designed to mitigate the effects of emergencies resulting from fuel shortages, such that the Commission may exempt AEP from those provisions of Kentucky and Virginia law or rule or regulation.

Id. ¶ 63,029.2, at 65,297 (footnote omitted).

coordination of electric utilities” if FERC determines that such voluntary coordination is “designed to obtain economic utilization of facilities and resources in any area.”¹²⁶ It contains a savings clause limiting FERC’s authority to provide this exemption if the state law or regulation “is designed to protect public health, safety, or welfare, or the environment or conserve energy or is designed to mitigate the effects of emergencies resulting from fuel shortages.”¹²⁷

Because FERC had thrown down the gauntlet to states using their power to oppose its drive toward mandatory RTO formation, the case quickly became a lightning rod for pro-deregulation and anti-deregulation states. Some, already suspicious of FERC’s market initiatives, saw FERC’s trumping of state law as diminishing their authority to regulate the industry and leading to a loss of cost control—historically the province of state regulators.¹²⁸ The novel use of PURPA section 205(a) to achieve this purpose led other states to criticize FERC’s reasoning.¹²⁹ A number of Northern and Midwestern states (including Michigan, Indiana, Illinois, Pennsylvania, and New Jersey), however, supported FERC and called for regional coordination to take place without delay, which would prevent the benefits to be gained from integrating utilities into RTOs.¹³⁰ The Texas PUC, not a player in this debate because of its unique status in the electricity regulatory environment,¹³¹ joined the battle anyway, arguing that RTOs “are a critical element for vibrant wholesale competition.”¹³²

In March 2004, a FERC Administrative Law Judge (“ALJ”)

126. 16 U.S.C. § 824a-1(a).

127. *Id.* § 824a-1(a)(2).

128. See 2004 AEP-PJM Order, *supra* note 117, ¶ 63,029.10, at 65,299. Although Virginia and Kentucky were the only states that prevented legal and procedural obstacles to AEP’s integration into PJM, other states, including North Carolina, Arkansas, Mississippi, Alabama, and Louisiana, supported them. *Id.*

129. These included the Washington Utilities and Transportation Commission, the Public Utilities Commission of California, and the New Mexico Attorney General. *Id.*

130. *Id.* ¶ 63,029.9, at 65,299.

131. Texas’s electricity grid is not integrated with those of the rest of the nation and is therefore subject to limited federal jurisdiction. See, e.g., CTR. FOR GLOBAL STUDIES, HOUSTON ADVANCED RESEARCH CTR. & ENERGY INST., UNIV. OF HOUSTON, GUIDE TO ELECTRIC POWER IN TEXAS 2 (2d ed. 1999), available at <http://www.harc.edu/powerguide.html>.

132. 2004 AEP-PJM Order, *supra* note 117, ¶ 63,029.9, at 65,299. While generally concerned about federal preemption (which of course could not affect it), the Texas PUC also argued that Virginia and Kentucky could effectively preempt other states from enforcing their own orders and thereby “frustrate state initiatives designed to achieve . . . regional coordination.” *Id.*

made an order rejecting the arguments of Virginia and Kentucky. The Virginia State Corporation Commission ("VSCC") had argued that PURPA was inapplicable, stating that "voluntary coordination" under PURPA meant only "the cost-based, tight power pools then known to the industry."¹³³ The ALJ rejected this argument, stating that the transfer would create exactly the type of coordinated effort that Congress contemplated when it enacted PURPA a quarter-century earlier.¹³⁴ The ALJ also rejected arguments by Virginia and Kentucky that AEP's decision to join was not voluntary because AEP had made other RTO proposals,¹³⁵ stating it was "far more reasonable" to conclude that AEP was maneuvering to avoid "jurisdictional conflict."¹³⁶ Virginia and Kentucky also claimed that the decision was not voluntary because AEP was forced to accept RTO membership as a merger condition.¹³⁷ This argument, too, was rejected, with the ALJ noting that AEP was free to contest FERC's position in the courts.¹³⁸

Next, the ALJ turned to the central issue of whether the transfer would "obtain economic utilization of facilities and resources" in any area.¹³⁹ This issue had generated reams of testimony from those (including the VSCC staff) who argued about the benefits of RTO membership. The ALJ disagreed with the VSCC on the proposed merger's benefits, finding that that there was

133. *Id.* ¶ 63,029.36, at 65,303. Howard M. Spinner, Director of the VSCC's Division of Economics and Finance, had claimed on this basis that AEP's proposed transfer of control of its transmission facilities to PJM did not constitute coordination or an agreement for central dispatch. *Id.*

134. *Id.* ¶ 63,029.39, at 65,304. The ALJ relied heavily on the testimony of Philip R. Sharp, who served as an expert witness for Exelon in the proceeding. Sharp, a former member of the House of Representatives, was active in the development of PURPA. Sharp testified that section 205(a) grew out of the continuing debate about increasing efficiency and gaining reliability benefits from greater coordination among utilities, and therefore encompassed actions such as the AEP-PJM transfer that would be designed to achieve the same goal. *Id.*

135. *Id.* ¶¶ 63,029.48-.49, at 65,306.

136. *Id.* ¶ 63,029.56, at 65,307.

137. *Id.* ¶ 63,029.57, at 65,307.

138. *Id.* ¶ 63,029.55, at 65,307. The ALJ found:

There is no evidence of coercion here. This is an entity that knows its rights and is fully capable of defending them. If it did not want to join an RTO, or believed the Commission was acting in excess of its authority, AEP knows how to pursue avenues to obtain relief. One can only conclude from the evidence presented on this record that AEP saw substantial benefits from membership in a Commission-approved RTO, found PJM to its liking after the Alliance initiative imploded, and signed on voluntarily.

Id.

139. *Id.* ¶ 63,029.60, at 65,307.

“an impressive array of consistent expert testimony as to the benefits of the planned integration of AEP into PJM.”¹⁴⁰ Unfortunately, none of this testimony consisted of hard evidence. Instead, the ALJ relied on estimates from witnesses for PJM and AEP who argued that the proposed integration would result in a net efficiency gain under every conceivable forecasting scenario.¹⁴¹ The VSCC staff also argued that the costs of implementing the transaction had to be considered.¹⁴² The ALJ agreed with the VSCC staff and concluded that “consideration of the costs . . . that will result from the planned integration is a relevant and necessary element of a determination whether the planned coordination is designed to obtain economic utilization,”¹⁴³ but declined to find that this cost outweighed the benefits to be derived from integration.

The second major issue in the case—whether the state laws, rules, or regulations of Virginia and Kentucky were preventing AEP from fulfilling its voluntary commitment to join an RTO—was also decided in FERC’s favor. The ALJ noted that while PURPA did not allow FERC to mandate coordination, it did grant FERC authority to prevent states from “blocking or frustrating coordination efforts.”¹⁴⁴ The ALJ concluded that the Virginia state law clearly impeded AEP from joining PJM and was “precisely the kind of state action that PURPA Section 205(a) was enacted to prevent—a state law, rule, or regulation which prohibits or prevents the voluntary coordination of electric utilities for the benefit of regional and national interests.”¹⁴⁵ The ALJ also concluded that while Kentucky did not directly prevent the transfer of control, its statement that it would not act in contravention of a state statute requiring preference to be given to native load customers “freezes integration

140. *Id.* ¶ 63,029.95, at 65,314.

141. *Id.* ¶¶ 63,029.101-103, at 65,315-16.

142. *Id.* ¶¶ 63,029.92-94, at 65,314. Later in 2004, Dominion Virginia Power, the largest IOU in Virginia, generated controversy by announcing its intent to pass on costs related to its own pending transfer of transmission control to PJM to Virginia consumers. Greg Edwards, *Utility Wants Charge Gone; Virginia Power Wants Its Pilot Program for Retail Competition More Attractive*, RICHMOND TIMES-DISPATCH, Apr. 7, 2004, at C1.

143. 2004 AEP-PJM Order, *supra* note 117, ¶ 63,029.100, at 65,315.

144. *Id.* ¶ 63,029.41, at 65,304. The ALJ concluded:

It is clear that Congress intended to empower this Commission with the authority to decide what constitutes the “coordination of electric utilities, including any agreement for central dispatch” within the meaning of Section 205(a) of PURPA, and to resolve disputes regarding this issue with the collective public interest in mind.

Id. ¶ 63,029.42, at 65,304.

145. *Id.* ¶ 63,029.178, at 65,330.

in its tracks.”¹⁴⁶

In June 2004, FERC affirmed the ALJ’s decision,¹⁴⁷ and the case took on an entirely new twist. Kentucky settled out of the case.¹⁴⁸ The VSCC approved the integration of AEP into PJM, as its hands were effectively tied under Virginia’s restructuring statute.¹⁴⁹ At that point, a casual observer would be forgiven for thinking the case had become moot. But the VSCC, understandably, remained troubled by the existence of precedent under PURPA that would support orders to other utilities to join RTOs. It offered to settle the case with FERC, *if* FERC would vacate the opinion affirming the ALJ’s decision.¹⁵⁰ The VSCC argued that, “[i]f not vacated, Opinion No. 472 would represent an unfortunate precedent that will continue to contribute to federal-state tension and mistrust that will harm ongoing collaborative efforts between this Commission[, FERC,] and state utility commissions.”¹⁵¹

146. *Id.* ¶ 63,029.193, at 65,333. The KPSC’s statement in its order granting a rehearing of AEP’s application to join PJM in which it stated its “willingness to consider additional evidence in [t]he form of analysis of cost and benefits of membership in PJM” stated that the ALJ “should not be misinterpreted as indicating that the Commission will not carry out its statutory responsibility to enforce KRS 278.214.” *Id.* ¶ 63,029.191, at 65,332.

147. *The New PJM Companies*, 107 F.E.R.C. ¶ 61,271 (2004).

148. *FERC Affirms That It Has the Authority to Overrule State Roadblocks to RTO Participation, but Refrains from Doing So for Now; Approves Kentucky Settlement*, FOSTER ELECTRIC REP., June 23, 2004, at 8. The report noted:

AEP had already reached a settlement with the Kentucky Public Service Commission (KPSC) regarding the company’s Kentucky Power Co. subsidiary’s participation in PJM, and a related June 17 order approved the settlement. Under that deal, Kentucky Power is allowed to transfer operational control of its transmission facilities to PJM provided the KPSC retains jurisdiction over retail rates and the utility’s participation in PJM’s energy markets is voluntary.

Id. at 8-9.

149. As noted above, while Virginia’s restructuring statute precluded AEP from acting before mid-2004, it required incumbent utilities in Virginia (including AEP) to join RTOs before January 2005. The decision approving the integration of AEP into PJM was issued on August 30, 2004. Order Granting Approval at 21, Commonwealth of Virginia *ex rel.* State Corp. Comm’n, No. PUE-2000-00550 (Va. State Corp. Comm’n Aug. 30, 2004), available at <http://docket.scc.virginia.gov:8080/vaprod/main.asp>; see also Greg Edwards, *Path Cleared for Deal on Electric Lines*, RICHMOND TIMES-DISPATCH, July 28, 2004, at C1. The VSCC staff had cited the statutory mandate to join by 2005 as further evidence that Virginia law was not frustrating the AEP-PJM transfer. This, to the ALJ, did not address the original problem: the statute also precluded action until 2004, while FERC required it sooner. 2004 AEP-PJM Order, *supra* note 117, ¶¶ 63,029.169-178, at 65,328-30.

150. *The New PJM Cos.*, 110 F.E.R.C. ¶ 61,009, ¶61,009.6, at 61,023 (2005) [hereinafter FERC Order Dismissing Rehearing Request].

151. *Id.* ¶ 61,009.6, at 61,023 (first alteration in original).

The VSCC's offer received a considerable number of comments from state PUCs and utility companies, including those that had intervened in the case originally. The intervenors generally supported the VSCC, arguing for the most part that FERC had achieved what it set out to do when Virginia approved the AEP-PJM integration and that leaving the opinion on the books was not necessary.¹⁵² Other commenters supported Virginia's position that vacating the decision would ameliorate federalism concerns and argued that because it had not been cited in any forum, vacating the decision would create a "no harm, no foul" case.¹⁵³

Not surprisingly, FERC disagreed. It issued an order dismissing the rehearing requests due to mootness, rejecting the settlement offer, and refusing to vacate the opinion.¹⁵⁴ It also stated that "[o]ur decision not to vacate Opinion No. 472 does not reflect a retreat from our commitment to federal-state comity on RTO or other issues,"¹⁵⁵ which of course is a statement the VSCC and its allies are unlikely to endorse. But if the VSCC was to proceed further at this point, it would face a serious hurdle. PURPA section 205(a) gives administrative deference to FERC, allowing the exemption from state law which prohibits voluntary coordination of electric utilities "if the Commission determines" that such coordination is designed to obtain said benefits.¹⁵⁶ And, of course, that is exactly what FERC has done. For this reason, the FERC staff's findings, confirmed by the ALJ, would almost certainly be given great latitude in any federal-court proceedings. It may well take another case to decide whether the evidence about problems in load pockets and potential price spikes in wholesale markets outweigh the forecasts of pro-deregulation proponents.

This hardly means, however, that this case was unimportant. In holding that the Virginia and Kentucky laws did not fit the PURPA savings clause, the ALJ revealed that the states disagreed strongly with FERC about the costs and benefits of RTO membership and thus highlighted a central issue. The ALJ believed Virginia wanted to amend its restructuring statute "essentially to prevent the integration of AEP into PJM"¹⁵⁷ and "protect the economic interests of Virginia ratepayers by shielding them from the impact of the Commission's Standard Market Design . . . [and to] maintain the preferential treatment for Virginia consumers in the

152. *Id.* ¶ 61,009.8, at 61,023.

153. *Id.* ¶¶ 61,009.9-.11, at 61,023-24.

154. *Id.* ¶¶ 61,009.12-.13, at 60,124.

155. *Id.* ¶ 61,009.16, at 60,124.

156. 16 U.S.C. § 824a-1(a) (2000) (emphasis added).

157. 2004 AEP-PJM Order, *supra* note 117, ¶ 63,029.289, at 65,347-48.

operation of an interstate transmission grid by securing an opportunity to second-guess the Commission's decisions on RTOs."¹⁵⁸ The ALJ also held that the record demonstrated that "the primary reason KPSC denied AEP's application to join PJM was the KPSC's belief that costs to Kentucky's ratepayers would increase."¹⁵⁹ According to the ALJ, the "KPSC's denial of AEP's application to transfer functional control of transmission assets from AEP to PJM was largely based upon AEP's alleged failure to show that Kentucky ratepayers would receive any benefits from such transfer."¹⁶⁰ The ALJ further concluded that "while economic regulation may be a valid exercise of traditional state utility regulatory authority, in this proceeding, such state regulatory actions cannot be allowed to fall under the savings clause because those actions would prevent the voluntary coordination that is the purpose of PURPA Section 205(a)."¹⁶¹

Because PJM uses LMP to make fundamental decisions, Virginia and Kentucky clearly viewed AEP's integration into PJM as the lamb lying down with the lion. The core of FERC's argument was the notion that RTOs yield economic benefits to consumers. But the ultimate point is not whether or not this will happen. It is that the parties are fighting at great length and over a period of years about whether RTOs will yield benefits. This fight is costly to ratepayers. The time and effort spent litigating this battle—not to mention the time and effort spent in earlier efforts to integrate AEP into an RTO—could have been spent far more productively in crafting an alternative scenario that would have been more palatable to the utility, FERC, and other stakeholders.

Looking at this outcome, Professor Pierce and others would probably blame the Southern states and their allies for dilatory tactics.¹⁶² The proceedings in *The New PJM Cos.* might indeed afford some support for this view that the protracted litigation was an example of state regulators captured by parochial interest groups. On reflection, that conclusion might be worth some re-examination. The states, it would seem, are not without blame. But neither is FERC. Its estimates that RTOs will yield benefits to the industry are just that—estimates—and have been challenged strongly.¹⁶³ In the face of hard evidence, states should be entitled to

158. *Id.*

159. *Id.* ¶ 63,029.305, at 65,350.

160. *Id.*

161. *Id.*

162. See Pierce, *Environmental Regulation*, *supra* note 60 (manuscript at 14-15).

163. See Moore, *supra* note 39.

assert their statutory and regulatory mandate to ensure that their ratepayers are protected.

It is perhaps even more revealing to look at the fate of the VSCC's settlement offer. Section 205(a) of PURPA is "obscure"¹⁶⁴ and had not been relied upon in any recorded case since the 1980s, when the electric utility industry was far different from that of today. In these earlier cases, it was not used for the purpose advanced by FERC in *The New PJM Cos.*¹⁶⁵ and of course could not have been, as the development and implementation of the concept of a regional transmission entity was still many years away.¹⁶⁶ Even when the case was essentially over, it was not; FERC insisted on letting its decision stand as a message to later negotiators and litigants. And the message this sends is clear. FERC has exacerbated the difficulties of moving toward the market by taking the PJM model, making it the basis for the "one-size-fits-all" market design and promoting it to the rest of the country. The VSCC (and even the FERC ALJ, for that matter, in confirming some of the states' arguments) made it clear that the severe disagreements about this issue have been brought about in part by FERC's insistence on marginal price-based models for electricity markets. But its stance in this case is a signal from FERC that it believes in the economics of SMD so strongly that it will contest them in any forum—even with ill-fitting arguments if necessary—with anyone who disagrees.¹⁶⁷ That only guarantees more time and effort will be spent hashing out this issue, rather than working toward constructive solutions.

164. Stuntz, *supra* note 54, at 9.

165. *Electric Consumers Resource Council v. FERC*, 747 F.2d 1511 (D.C. Cir. 1984), and *City of Batavia v. FERC*, 672 F.2d 64 (D.C. Cir. 1982), are the most recent cases to invoke PURPA section 205(a) and are not related to the current controversies.

166. In the 2005 order, FERC acknowledged that its argument was a new one, stating that "[t]his case was the first time in which the Commission has considered whether to invoke PURPA Section 205." FERC Order Dismissing Rehearing Request, *supra* note 150, ¶ 61,009.15, at 61,024; *see also supra* note 133 and accompanying text (containing testimony of VSCC staff member Howard Spinner).

167. On a comparable note, *see AM. PUB. POWER ASS'N*, *supra* note 25, at 19 (calling for FERC to "abandon its ['RTO-or-nothing'] approach to transmission policy").

III. WHAT NOW?

*“Thomas Jefferson would probably have approved of our electricity regulation scheme; Alexander Hamilton would likely have preferred the nuclear regulatory scheme.”*¹⁶⁸

By now two things should be clear to the reader. First, the current stalemate appears much more like that Gordian Knot than the work of an obtuse band of regulators. Stakeholders in restructuring are operating in a climate of deep distrust (when the word “mistrust” is used in a federal filing, one can only assume it is the tip of the iceberg), and the prevailing mood in restructuring is one of battle fatigue. The most visible initiatives amount to obstruction (the energy bill) or delay (the PJM litigation) of innovation. In the meantime, there is little measurable progress. The situation is a true logjam where everyone sees different but interrelated problems, all of which appear intractable.

There is an unusually disparate group of vectors operating on the industry to retard progress: FERC’s actions, states’ parochialism, skittishness after California and Enron, and split jurisdiction between the states and the federal government, to name a few.¹⁶⁹ States were not lining up on one side or the other of *The New PJM Cos.* to contest the meaning of PURPA’s arcane provisions. Two issues galvanized the participants: the states’ rebuff to FERC and the uncertainties surrounding the economics and future of SMD. It is pointless to single out any one of these issues—or any set of actors—as the most prominent barrier to progress.

If it were possible to start with a clean sheet of paper, three strategies present themselves.¹⁷⁰ The first is to allow the continuation of voluntary experiments with RTOs that began with Order No. 2000, with FERC’s regulatory role being limited to ensuring basic fairness. There are those who believe that we can learn from early failures and move on with better market mechanisms, specifically RTOs. We could allow RTOs where they work, not force their establishment elsewhere (as, for example, in

168. Kelliher, *supra* note 12, at 738.

169. See, e.g., AM. PUB. POWER ASS’N, *supra* note 25, at 1 (noting that, for these reasons and others, “[e]lectric restructuring has turned out to be a more complex, difficult and uncertain undertaking than most people imagined when FERC issued Order No. 888”).

170. See, e.g., Stuntz, *supra* note 54, at 15 (showing a presentation slide that notes possibilities for “The Future” including going “[b]ack to the 50s[-era]” re-regulation, “[a] Federal Solution,” “[a] Hodgepodge” allowing experimentation, and more events like the “Blackout of 2004 et al.”).

the Pacific Northwest),¹⁷¹ and deal with remaining implementation issues as they arise.

This would recognize that FERC made a political mistake by expanding Order No. 2000 by attempting to force utilities into RTOs. Allow utilities to do so if they choose, or perhaps even encourage it along the lines of what FERC has tried so far, and then the industry will evolve in productive directions. For that matter, RTOs might well be able to act as true independent third-party neutrals if utilities turn over complete control of their transmission facilities to them. That is a big “if,” as we have discovered over the course of the past decade. AEP’s case, as noted above, is unusual in that FERC could and did order this in the course of a utility merger; in other cases, we may find ourselves with a nationwide set of diverse arrangements,¹⁷² some superior to the current situation and some not. As we have learned from natural-gas deregulation, partial deregulation is sometimes difficult to prefer unconditionally to the status quo ex ante.¹⁷³

A problem with this approach is that a variety of stakeholders would oppose any RTO (created voluntarily or not) where the core mechanism for dealing with transmission pricing and congestion is LMP.¹⁷⁴ Also, the remaining regions of the country without RTOs are different from those where RTOs have been formed.¹⁷⁵ Still another problem with continuing voluntary experimentation is that FERC embarked on SMD precisely because it realized that utilities were not readily joining RTOs. *The New PJM Cos.* is an unusual case, where a utility found itself under the gun to join an RTO; for other utilities, the road to RTO formation has been extremely bumpy and frustrating for all involved. Muddling through might make matters worse.

171. The American Public Power Association’s recent report on restructuring calls for regional diversity in the type of organizational entity responsible for transmission access. AM. PUB. POWER ASS’N, *supra* note 25, at 2.

172. Kelliher, *supra* note 12, at 728 (noting that “[t]he reality is that for some time we will have both organized and nonorganized wholesale power markets”); Stuntz, *supra* note 54, at 15.

173. See, e.g., Michael J. Doane et al., *Evaluating and Enhancing Competition in the Interstate Natural Gas Transportation Industry*, 44 NAT. RESOURCES J. 761 (2004) (criticizing FERC’s market-based rate policy in the natural gas transportation market).

174. AM. PUB. POWER ASS’N, *supra* note 25, at 3 (noting that “APPA’s early optimism” about RTOs “has dimmed . . . [as they] morphed into vehicles for implementing centralized markets for day-ahead and real-time power and ancillary services, and the use of . . . [LMP] to deal with transmission congestion”).

175. *Id.* at 6.

Another possibility is to end restructuring altogether.¹⁷⁶ It may well be, as was thought to be the case until just recently, that electricity is best off remaining as an industry of regulated natural monopolies. This might just put bad wine back in bad, old bottles. As Professor Rossi has noted, the alternative to restructuring may be worse than continuing down the current fitful path: “[R]egulatory backlash in reaction to failed deregulatory policies may risk recreating some of the very same problems that gave rise to regulatory reform, coopted by deregulation advocates over the last thirty years.”¹⁷⁷ Another problem here is that restructuring’s central premise—whether a national marketplace for electricity would benefit consumers—has not been sufficiently tested. If the current stalemate, as discussed above, is in any way attributable to process blunders (FERC went about restructuring the wrong way, breeding a climate of obstruction or delay) and not to a central flaw in the idea of deregulation, then the irony is that FERC might eventually be right but might currently lack the institutional capability and credibility to reach out to stakeholders to bring about true competition.

Still another possible solution is to expand FERC’s authority to bring about full restructuring. One could look at FERC’s recent attempt to outline its restructuring policy—WPMP—somewhat more sympathetically in light of its current predicament. It realizes it overreached with SMD and is doing the best it can in light of the backlash to promote competition. Of course, it has not found a compelling way to remedy what some see as the primary problem in restructuring—that it is “restructuring” and not “deregulation.” To some, the power industry still rewards incumbent utilities that own both transmission and generation.¹⁷⁸ Solve that problem, and incumbent utilities will be less able to favor themselves in transmission bottleneck situations. But FERC lacks the authority to do this at present, and of course, if it did have this power and ordered divestiture in the industry (that is, true separation of generation, transmission, and distribution), then the resulting storm of protest would make the backlash from SMD pale by comparison.

Thus, to give FERC a new or enhanced mandate to pursue restructuring through statutory or regulatory means may simply

176. I am hardly the first person to suggest this as a possibility. See, e.g., BROWN & SEDANO, *supra* note 64, at 81-82 (outlining a return to traditional cost-of-service regulation as a policy option).

177. Rossi, *The Electric Deregulation Fiasco*, *supra* note 97, at 1789.

178. See AM. PUB. POWER ASS’N, *supra* note 25, at iv (calling for “[j]oint ownership of transmission facilities by all load-serving utilities in a region” to address this problem).

recognize that the FPA was not designed to do what it is being asked to do today. When I was invited to contribute to this dedicated issue of the *Wake Forest Law Review*, I was asked whether the current unhappy situation of deregulation could be traced to a lack of appropriate statutory or regulatory authority for FERC to bring about change in the marketplace. This idea has some decided appeal.¹⁷⁹ Commissioner Kelliher stated recently:

In my view, the time has come to make reforms to the Federal Power Act

. . . At the time it was written, there was virtually no . . . interstate transmission grid, virtually all generation was built in load centers, and all aspects of the business—generation, transmission, and distribution—were presumed to be natural monopolies. . . .

The electricity market has changed dramatically since 1935. Today, interstate commerce in electricity has exploded: the transmission grid is not only interstate, but international; much generation is located remotely from load centers, not even necessarily in the same state; and it has been demonstrated that there is no natural monopoly in generation. . . .

. . . It is clear . . . that many of the assumptions that governed development of the Act are no longer valid. There is a need to reform federal electricity laws to reflect the dramatic changes that have swept across the industry. . . .¹⁸⁰

As this suggests, it is time for a change, and a different way of proceeding is needed. After multiple failed attempts to design the

179. The thick gorse of New Deal-era statutes such as the Public Utility Holding Company Act ("PUHCA") creates a pervasive sense that statutes designed for yesteryear are ill fitting to today's utility industry. See, e.g., Thierer, *supra* note 101, at 4. Thierer notes:

Federal action is needed because many of the problems associated with the modern electric industry were created by federal statutes and regulations. The final and most obvious justification for federal action is that many federal statutes and regulations distort or disallow competition in this industry. The Federal Power Act, the Public Utility Holding Company Act (PUHCA), the Public Utilities Regulatory Policies Act (PURPA), and other Federal Energy Regulatory Commission (FERC) orders must be repealed or radically reformed for true competition to flourish.

Id. (emphasis omitted).

180. Kelliher, *supra* note 12, at 718-19.

conditions under which a market will arise in this industry, it is time to acknowledge that there may be a different solution. That solution would reject the logic that has so far failed to get traction. But any new regulatory architecture of this sort has to confront a basic paradox. On the one hand, regulatory design must be flexible enough to encourage innovation and progress toward establishing regional or even national markets, if indeed that is desirable; on the other, it must not be so fragmented that it would encourage the sort of muddling through that has us at the current stalemate.¹⁸¹ The prevailing model of deregulation cannot be a market system whose rules are dictated in a “one-size-fits-all form” by FERC, whose moves are creating antagonism. Yet in some systematic way, regulators would need to find some way to accomplish true divestiture; otherwise market power will be a perennial problem. In addition, the solution would need to accommodate regional differences that created powerful pro- and anti-deregulation coalitions. It would also need to put any progress toward a market for electricity in the context of a unified effort to strive toward safe and efficient operation of the grid.¹⁸²

IV. CONCLUSION

The state of the electric power industry in 2004 across the nation is truly paradoxical. The infamous quote after the blackout of 2003 that we have a “Third World transmission grid”¹⁸³ is not accurate. Marvelous feats of engineering have given us a delivery system that provides electricity to millions of customers, with outstanding day-to-day reliability. But muddling through the application of different competition schemes has led to an unclear and incoherent regulatory structure, a great deal of uncertainty in the industry, a lack of uniformity in governing mechanisms, and a haphazard and incomplete transition to a fair and competitive marketplace.¹⁸⁴

In such an environment, there are those who would call for the experiment in restructuring to end. The point of this Article is that if an agency has reached this point in the lifetime of its reinvention

181. Perhaps if we are not going to end restructuring altogether, then it would be fruitful to contemplate a more radical solution: the transfer of power from FERC to another entity or set of entities with more credibility. This would require statutory overhaul, of course, but that is in the cards in any event.

182. Kelliher, *supra* note 12, at 720-24 (calling for mandatory reliability standards).

183. Jerry Taylor & Peter VanDoren, Cato Inst., *Outside the Grid*, at <http://www.cato.org/dailys/08-22-03-2.html> (Aug. 22, 2003).

184. NATIONAL TRANSMISSION GRID STUDY, *supra* note 54, at 24.

efforts by being "linear," then the experiment should end. In the case of restructuring, that is not the case, but two aspects of the situation make it exquisitely difficult to see this: an agency that is trying the same ideas repeatedly (FERC) and a complex set of variables that has hampered restructuring activity. Through this fog, the final point to be made is that if moving beyond the current stasis requires change, this should be contemplated. This industry is famously resistant to change, but if change is going to happen at all, it cannot take place the way it is doing so now.

It is irresponsible to throw up our hands and refuse to deal with the situation. Electricity is America's most important commodity. The network of interconnected electric power facilities is national in scope, and the present problems with it cry out for a national solution. As others have noted in this dedicated issue, untangling its current problems may require too much change to expect in the short term, given how we are stumbling through to solutions. We may be in a second-best environment for the foreseeable future, but leaving the status of the system for making and distributing electricity in its current piecemeal status does no one any good.