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# Bringing the Camel into the Tent: State and Federal Power over Electricity Transmission

Cassandra Burke Robertson

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# BRINGING THE CAMEL INTO THE TENT: STATE AND FEDERAL POWER OVER ELECTRICITY TRANSMISSION

“The federal camel has a tendency to occupy permanently any state tent. That may be a wise course; but if so, Congress should make the decision.”<sup>1</sup>

CASSANDRA BURKE ROBERTSON<sup>2</sup>

I. INTRODUCTION .....	72
A. <i>FERC’s Historical Authority for Regulating Transmission</i> .....	73
B. <i>Energy Policy Act of 1992</i> .....	75
C. <i>Order 888</i> .....	75
D. <i>Order 2000</i> .....	77
II. LEGAL CONSIDERATIONS.....	77
A. <i>The Constitutional Basis for Federal Regulation of Transmission</i> .....	78
B. <i>Judicial Challenges to FERC’s Power</i> .....	79
C. <i>Jurisdiction Over Bundled and Unbundled Transmission</i> .....	80
D. <i>New York v. FERC: The Struggle to Define Interstate Transmission</i> .....	81
E. <i>New York v. FERC: The Controversy Over Bundled Retail Transmission</i> .....	82
F. <i>How Should the Supreme Court Decide the Issue in New York v. FERC?</i> .....	83
III. POLICY CONSIDERATIONS .....	85
A. <i>Efficiency</i> .....	86
1. <i>Permitting FERC to Maintain Jurisdiction Over Unbundled Retail Transmission</i> .....	87

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<sup>1</sup>Power Comm’n v. Florida Power & Light Co., 404 U.S. 453, 476 (1972) (Douglas, J., dissenting).

<sup>2</sup>B.A. 1993, University of Washington; M.P. Aff. 1998, LBJ School of Public Affairs, The University of Texas; J.D. candidate 2002, The University of Texas School of Law. I would like to thank Professor Jim Rossi for his guidance and assistance in producing this article. Of course, the opinions expressed in this article—and any mistaken suppositions involved—are mine alone. I would also like to thank the editorial staff of the Cleveland State Law Review for their diligent and thoughtful editing. Finally, I would like to thank my husband, Thom, for his constant love and encouragement.

2.	Extending FERC's Authority to Cover Bundled Retail Transmission.....	88
3.	Increasing the Number of Utilities Subject to FERC's Jurisdiction .....	89
4.	Regional Transmission Organizations.....	90
5.	Transmission Siting.....	92
B.	<i>Innovation</i> .....	93
C.	<i>Predictability and Consistency</i> .....	94
1.	Refunctionalization.....	94
2.	Municipalization.....	97
D.	<i>Fairness</i> .....	98
E.	<i>Federalism</i> .....	99
IV.	RECOMMENDATIONS.....	100
V.	CONCLUSION.....	103

### I. INTRODUCTION

Jurisdiction over electricity transmission has emerged as one of the critical issues in today's energy policy. As the electricity market opens to competition, generating companies want to ensure access to transmission lines at a reasonable price. Utilities owning transmission assets want to ensure a continuation of profits. For all utilities, regulatory action is a primary determinant of available prices and profits. Traditionally, the Federal Energy Regulatory Commission (FERC) has asserted jurisdiction over energy transmitted through interstate commerce, while state public service commissions have claimed jurisdiction over energy distributed to local consumers.

Restructuring has added a degree of uncertainty, however; as wholesale competition increases and as states "unbundle" the transmission of electricity from generation and distribution, questions arise as to whether such transactions should be regulated at the state or federal level. This jurisdictional uncertainty has contributed to reduced investment in new transmission facilities. Most experts agree that new transmission is needed to remedy the significant limitations in the current grid. According to one report, while "[w]ell-known bottlenecks on the grid are scattered around the East and Midwest,"<sup>3</sup> North American Reliability Council research "show[s] that only 6,588 miles of new transmission at 230-kv and above are planned in all of North America in the next 10 years."<sup>4</sup> This transmission-construction shortage is of fairly recent vintage. Before competition in the electric industry swept the United States in the nineties, "the construction of powerplants went hand-in-hand with construction of transmission lines and everybody knew the role of the generation with the transmission components."<sup>5</sup> Now, with "thousands of megawatts

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<sup>3</sup>Thomas F. Armistead, *Delivering a Shock to the System*, ENGINEERING NEWS-RECORD, July 12, 1999, available at <http://www.enr.com/new/c0712.asp> (last visited Oct. 25, 2001).

<sup>4</sup>*Id.*

<sup>5</sup>*Id.*

of non-utility generation capacity coming on line in 2001 and 2002,” the report says it is hard to know “where the stresses will be” in the transmission grid.<sup>6</sup> It is clear, however, that the stresses in the system will continue to grow: total transactions in one typical transmission control area have grown from 3,500 transactions in 1996 to approximately 45,000 transactions in 1999.<sup>7</sup>

There are currently two very distinct discussions taking place about the scope of federal jurisdiction over transmission. The first debate, taking place in the courts, seeks to determine the limits of FERC’s jurisdiction over transmission under current statutes. The second debate, centered in Congress, seeks to answer the question of what FERC’s jurisdiction over transmission *should* be and, more generally, what type of federal regulation over transmission would most benefit the country.

This paper provides a framework for understanding the current controversy regarding jurisdiction over the power grid, and provides policy-oriented solutions to ensure an adequate, low-cost transmission supply. The main thesis of this paper—drawn from the introductory quote by Justice Douglas—is that sound transmission policy requires greater federal power, and that Congress is better equipped than the courts to enact such policy. To this end, Part I of the paper offers an historical outline of the problem and analyzes the statutes and regulations that form the backbone of both the federal and state jurisdictional claims. Part II looks at legal considerations regarding the scope of federal jurisdiction. It analyzes the constitutional basis for Congressional power, examines recent litigation challenging the scope of FERC’s jurisdiction, and concludes that the states have a stronger position than FERC with regard to the proper interpretation of the Federal Power Act. Assuming that the Supreme Court is not likely to award FERC its desired jurisdiction, Part III of the paper looks at the possibility of a Congressional solution. It examines transmission issues in light of various policy goals, including efficiency, innovation, predictability, fairness, and concepts of federalism. Finally, Part IV offers recommendations for future legislation that can facilitate these policy goals while remaining politically acceptable to all parties.

#### A. FERC’s Historical Authority for Regulating Transmission

The FERC draws its jurisdictional power from the Federal Power Act of 1935, which specified that FERC’s predecessor agency, the Federal Power Commission, could regulate “transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce.”<sup>8</sup> The Act went on to say, however, that such federal jurisdiction “extends only to those matters which are not subject to regulation by the States.”<sup>9</sup> Prior to the passage of the FPA, the Supreme

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<sup>6</sup>*Id.*

<sup>7</sup>*Assuring Reliability of Transmission Grids in Increasingly Competitive Electricity Market: Hearing Before the Senate Energy and Natural Resources Committee, 106th Cong. (1999) (statement of David R. Nevius, Vice President, North American Electric Reliability Council), available at [ftp://www.nerc.com/pub/sys/all\\_updl/docs/testimony/Senate\\_Testimony\\_July\\_15\\_1999.pdf](ftp://www.nerc.com/pub/sys/all_updl/docs/testimony/Senate_Testimony_July_15_1999.pdf) (last visited Oct. 25, 2001).*

<sup>8</sup>16 U.S.C. § 824 (a) (2001).

<sup>9</sup>*Id.*

Court had held that states were forbidden under the Dormant Commerce Clause from regulating interstate sales of electricity,<sup>10</sup> making such sales the natural base for the FPC's (and later for FERC's) jurisdiction. What was not so clear was how to define interstate transmission in a grid connected across among many states. The statute required that "electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof."<sup>11</sup>

Courts took an expansive view of FERC's authority, and interpreted the definition of "interstate commerce" more broadly than might be apparent from a plain reading of the statute. Even if a utility sold power to another utility in the same state, the Supreme Court was willing to classify the sale as a transaction in interstate commerce.<sup>12</sup> According to the Court, the question was not whether the federal agency could regulate only what the states were forbidden constitutionally from regulating, but rather whether Congress had intended to delegate such regulatory power to the states.<sup>13</sup> Consequently, the Court held that "all sales of electric energy at wholesale" could be subject to the FPC's jurisdiction.<sup>14</sup> The Court upheld this determination in *Federal Power Commission v. Florida Power & Light*,<sup>15</sup> which upheld federal jurisdiction even when FP&L's transmission lines were only connected to other Florida utilities, since the utilities were connected to a larger, interconnected grid, and the electricity in the grid would be commingled with electricity sold in interstate commerce.<sup>16</sup> According to one author, it was the "commingling of electricity flowing in interstate commerce [that] resulted in FP&L's engagement in interstate transmission and wholesales subject to the Commission's broad jurisdiction, notwithstanding FP&L's pleas about its facilities' intrastate locations, power flows, and the markets for its sales."<sup>17</sup>

Regulation over generation and distribution did not cause the same controversy. To the extent that states had the power to regulate the industry, this power generally came from Congressional delegation.<sup>18</sup> The FPA gave this authority exclusively to

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<sup>10</sup>See *Public Util. Comm'n of R.I. v. Attleboro Steam and Elec. Co.*, 273 U.S. 83 (1927).

<sup>11</sup>16 U.S.C. § 824(c) (2001).

<sup>12</sup>See *Federal Power Comm'n v. Southern California Edison Co.*, 376 U.S. 205, 210 (1964) (holding that the sale of energy from one California utility to another was a sale in interstate commerce).

<sup>13</sup>See *id.* at 220 ("[T]he legislative history of Part II of the Power Act demonstrates that Congress believed that *Attleboro* and the related cases compelled it to forego its assumption as to state regulation and displace it with comprehensive federal regulation.").

<sup>14</sup>*Id.* at 210.

<sup>15</sup>404 U.S. 453 (1972).

<sup>16</sup>*Id.*

<sup>17</sup>William H. Penniman & Paul B. Turner, *A Jurisdictional Clash Over Electricity Transmission: Northern States Power v. FERC*, 20 ENERGY L.J. 205, 216 (1999).

<sup>18</sup>Charles H. Koch Jr., *Control and Governance of Transmission Organizations in the Restructured Electricity Industry*, 27 FLA. ST. U. L. REV. 569, 589 (2000) ("Traditionally, the electric utility industry and, specifically, the transmission segment of the industry have been considered interstate commerce, and as a consequence, the state's regulatory authority over the industry derives purely from congressional delegation.").

the states, noting that the FPC “shall not have jurisdiction . . . over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce.”<sup>19</sup> As stated, however, the “transmission of electric energy in intrastate commerce” proved to be an exceedingly narrow category; courts were willing to view almost all transmission as occurring in interstate commerce.

### B. Energy Policy Act of 1992<sup>20</sup>

The Energy Policy Act of 1992 sought to introduce wholesale competition in the electric industry; it ordered that FERC require utilities to deliver electricity for resale at “reasonable, nondiscriminatory, cost-based rates.”<sup>21</sup> While the EAct permitted FERC to order wholesale wheeling, it expressly forbade the FERC from mandating retail wheeling; it stated that FERC cannot require transmission “directly to an ultimate customer.”<sup>22</sup> According to one author, the EAct “largely contemplated discrete, transactional requests for transmission access.”<sup>23</sup> Taking advantage of its power to mandate wholesale wheeling, FERC decided to “advance transmission access nationwide significantly” by issuing Order 888.<sup>24</sup>

### C. Order 888

In 1996, the FERC issued Order 888.<sup>25</sup> The goal of Order 888 was to encourage wholesale competition by preventing transmission-owning entrenched utilities from charging higher prices for new generators to wheel power over their lines.<sup>26</sup> Based on the power given to FERC by the EAct, FERC required utilities to open their transmission lines to competing electricity generators at the same price as the utility would charge its own affiliate. Order 888 also required what is termed “functional

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<sup>19</sup>16 U.S.C. § 824 (b)(1) (2001).

<sup>20</sup>Energy Policy Act, Pub. L. No. 102-486, 106 Stat. 2776 (1992).

<sup>21</sup>Koch, *supra* note 18, at 577 n. 40.

<sup>22</sup>16 U.S.C. § 824k(h)(1) (2001).

<sup>23</sup>Virginia B. Rutledge, *Restructuring Of The Electric Utilities Industry: An Overview For Government Finance Officials*, GOV'T FIN. REV., Feb. 1997, at 19, available at LEXIS, News Library, ALLNEWS file.

<sup>24</sup>*Id.*

<sup>25</sup>See Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 61 Fed. Reg. 21,540 (1996); F.E.R.C. Statutes and Regulations ¶ 31,036 (1996); *order on rehearing*, Order No. 888-A, 62 Fed. Reg. 12,274 (1997); F.E.R.C. Statutes and Regulations ¶ 31,048, ¶ 31,780-83 (1997).

<sup>26</sup>Ben Lanka, *New York v. FERC, On The Docket—Medill School of Journalism*, available at <http://www.medill.northwestern.edu/docket/> (last visited Oct. 25, 2001).

unbundling”<sup>27</sup>—the separation of a utility’s transmission function from its “wholesale electricity merchant function.”<sup>28</sup> Specifically, Order 888 required that utilities:

- 1) [F]ile open-access, nondiscriminatory tariffs that contain minimum terms and conditions of nondiscriminatory service prescribed by FERC through its pro forma tariff;
- 2) [T]ake transmission service for their own, new wholesale sales and purchases of electric energy under the same terms and conditions as they offer that service to others;
- 3) [D]evelop and maintain a same-time information system that will give potential and existing transmission users the same access to transmission information that the utility enjoys (called the “Open Access Same-Time Information System” or OASIS); and
- 4) [S]tate separate rates for wholesale generation, transmission and ancillary services.<sup>29</sup>

Order 888 contains a seven-factor test for determining which facilities should be considered transmission assets (and therefore subject to the open-access requirements) and which facilities should be considered distribution, and therefore not subject to the requirements. The seven factors are:

- 1) Local distribution facilities are normally in close proximity to retail customers.
- 2) Local distribution facilities are primarily radial in character.
- 3) Power flows into local distribution systems; it rarely, if ever, flows out.
- 4) When power enters a local distribution system, it is not reconsigned or transported on to some other market.
- 5) Power entering a local distribution system is consumed in a comparatively restricted geographical area.
- 6) Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.
- 7) Local distribution systems will be of reduced voltage.<sup>30</sup>

One of the most controversial points of Order 888 is that it assumes that the FERC has jurisdiction over unbundled retail transmission; the implications of this assumption are discussed further in Subpart II(C).

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<sup>27</sup>See *Hearing Before the Virginia General Assembly Joint Subcommittee*, 1998 Leg. (Va. 1998) (statement of Shelton Cannon, Director, Office of Electric Power Regulation, Federal Energy Regulatory Commission), available at <http://dls.state.va.us/groups/sjr91/7998/79FERC.HTM> (last visited Oct. 25, 2001) (stating that the key components of functional unbundling are “1. Quot[ing] separate rates for wholesale generation and transmission service; 2. Tak[ing] wholesale (and unbundled retail) transmission service under its own transmission tariff; [and] 3. Provid[ing] and rely[ing] upon same time access to transmission information—through the OASIS”).

<sup>28</sup>*State Commissions Ask Supreme Court to Review FERC Order 888*, UTIL. INDUSTRY LITIG. REP., Dec. 2000, available at LEXIS, News Library, ALLNEWS file.

<sup>29</sup>*Id.*

<sup>30</sup>Order No. 888, Statutes and Regulations F.E.R.C. ¶ 31,780-83 (1997); Order No. 888-A, Statutes and Regulations F.E.R.C. ¶ 30,339-41.

*D. Order 2000*

In Order 2000, FERC issued its requirements for Regional Transmission Organizations (RTOs). RTOs have been described as structures “designed to consolidate control and delivery of electricity across various types of transmission systems within a particular region.”<sup>31</sup> FERC has stated that it expects several benefits to accrue from RTOs, including “increased efficiency through regional transmission pricing and the elimination of rate pancaking; improved congestion management; more accurate estimates of [available transmission capacity] . . . reduced transaction costs; facilitation of . . . state retail access programs; [environmental benefits] in states with retail access programs; improved grid reliability; and fewer opportunities for discriminatory transmission practices.”<sup>32</sup> According to FERC, this long list of benefits will culminate in one important outcome: “All of these improvements to the efficiencies in the transmission grid will help improve power market performance, which will ultimately result in lower prices to the Nation’s electricity consumers.”<sup>33</sup>

Specifically, Order 2000 required “all public utilities. . . that own, operate or control interstate transmission facilities” to “file with the Commission . . . a proposal for an RTO . . . or, alternatively, a description of efforts to participate in an RTO, any existing obstacles to RTO participation, and any plans to work toward RTO participation.”<sup>34</sup> Participation in the RTO itself remained voluntary, but FERC noted that some utilities had “argue[d] that mandatory filings, coupled with threats of withholding benefits and/or leveling penalties for those that do not choose to ‘voluntarily’ join an RTO, do not present a picture of a truly voluntary process.”<sup>35</sup> FERC stated, however, that while a utility’s decision to join an RTO is voluntary, “this does not mean that all aspects of this Rule are voluntary”<sup>36</sup> and utilities were still required to file statements with FERC or face penalties. Since Order 2000 was issued, the question of FERC’s ability to require participation in RTOs has been hotly contested, and the issue has often been discussed in the larger context of FERC’s jurisdiction over transmission in general.

## II. LEGAL CONSIDERATIONS

The lack of clarity separating state and federal jurisdiction over transmission has created a number of questions regarding the extent of FERC’s power. Some utilities have launched court challenges to restrict FERC’s ability to encroach on areas that

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<sup>31</sup>Will McNamara, *Utilities, FERC At Odds Over RTO Plans*, SCIENTECH ISSUE ALERT, May 4, 2001, available at <http://www.consultrci.com/issuealert/article.asp?id=709> (last visited Oct. 25, 2001).

<sup>32</sup>89 F.E.R.C. ¶ 61,285; 1999 FERC LEXIS 2692, \*114 (1999).

<sup>33</sup>*Id.*

<sup>34</sup>Regional Transmission Organizations, Notice of Proposed Rulemaking, 64 Fed. Reg. 31,390 (June 10, 1999); F.E.R.C. Statutes and Regulations ¶ 32,541 (1999).

<sup>35</sup>89 F.E.R.C. ¶ 61,285; 1999 FERC LEXIS 2692, \*140 (1999).

<sup>36</sup>*Id.* at \*150.



have traditionally been part of the states' domain.<sup>37</sup> These challenges have focused almost exclusively on statutory interpretation, rather than constitutional issues. Nevertheless, it is worth looking at the constitutional basis for regulation at the federal level.

A. *The Constitutional Basis for Federal Regulation of Transmission*

There is little doubt that transmission of electricity could meet the Commerce Clause definition of interstate commerce; as the Supreme Court noted in *United States v. Lopez*,<sup>38</sup> "Congress may regulate the 'channels' of interstate commerce, . . . the 'instrumentalities' of interstate commerce, . . . [and] those activities that substantially affect interstate commerce."<sup>39</sup> There is also little doubt that electricity transmission—even that within a single state—"substantially effects" interstate commerce. After all, the Supreme Court has previously held that even wheat grown and consumed on a single farm substantially affects interstate commerce because that consumption of wheat decreased the demand for wheat in general.<sup>40</sup> Likewise, electricity consumed by customers in Minnesota decreases the amount of electricity available to serve customers in Wisconsin.<sup>41</sup>

Furthermore, the interconnected grid could even be seen as an instrumentality of interstate commerce, for electricity travels through the grid to get from one state to another, just as goods in interstate commerce travel by railway from one state to another. In *Wabash, St. Louis and Pacific Railway Company v. Illinois*,<sup>42</sup> the Supreme Court held that even railway service within a single state should be regulated as interstate commerce because "when . . . each one of the States shall attempt to establish its own rates of transportation, its own methods to prevent discrimination in rates, or to permit it, the deleterious influence upon the freedom of commerce among the States and upon the transit of goods through those States cannot be overestimated."<sup>43</sup> If one substitutes "transmission" for "transportation" and "electricity" for "goods," this language could be applied directly to the debate surrounding jurisdiction over electricity transmission.

In *Wabash*, the Court found that states were prohibited by the dormant commerce clause from regulating railroads. In *New York v. FERC* and other cases challenging FERC's jurisdiction, however, none of the parties has raised a constitutional challenge. FERC has not argued that the dormant commerce clause prevents state regulation, and the states have not argued that intrastate transmission lacks a sufficient relationship to interstate commerce to allow for federal regulation. As

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<sup>37</sup>See *infra* text accompanying notes 45-86.

<sup>38</sup>514 U.S. 549 (1995).

<sup>39</sup>*Id.* at 558-59.

<sup>40</sup>*Wickard v. Fillburn*, 317 U.S. 111, 127-28 (1942).

<sup>41</sup>See *Northern States Power v. FERC*, 176 F.3d 1090 (8th Cir. 1999).

<sup>42</sup>118 U.S. 557 (1886).

<sup>43</sup>*Id.*

noted above, it seems clear that the connection to interstate commerce is strong enough to permit Congressional action. A dormant commerce clause challenge is also unlikely to succeed because as Congress stated in the statute “[n]othing in this subsection shall affect any authority of any State or local government under State law concerning the transmission of electric energy directly to an ultimate consumer.”<sup>44</sup> Clearly, Congress intended to permit the states to continue to play a role in transmission regulation. Subsequently, disagreements over the scope of state power have focused on statutory interpretation—i.e., how *much* power Congress intended to delegate—rather than constitutional powers.

### B. Judicial Challenges to FERC’s Power

Some utilities take the position that FERC has usurped too much power in its regulation of transmission and wholesale wheeling. Others believe that the FERC has not gone far enough in asserting jurisdiction over bundled transmission. Several lawsuits have attempted to clarify the scope of FERC’s authority.

In *Northern States Power Co. v. FERC*,<sup>45</sup> a utility challenged FERC’s power to require curtailment of transmission to both retail and wholesale customers in the event of a power shortage. The utility argued that it should be allowed to curb power to the wholesale customers first, since those customers would have the option of buying power elsewhere, and the utility should be allowed to continue supplying the needs of the retail customers who had no other options.<sup>46</sup> FERC, on the other hand, maintained that such distinction between wholesale and retail customers constituted invalid discrimination in favor of the retail consumers.<sup>47</sup> The court held in favor of the utility, finding that FERC “ha[d] transgressed its Constitutional authority which limits its jurisdiction to interstate transactions. . . . [I]ts attempt to regulate the curtailment of electrical transmission to native/retail consumers is unlawful.”<sup>48</sup>

On remand, FERC narrowly tailored its order to permit Northern States Power to implement its curtailment plan only in the situation where “NSP has exhausted all of its network/native load generation redispatch options, and the firm point-to-point transmission customer whose firm service is being curtailed still has options with which to avoid having to shed load.”<sup>49</sup> NSP later withdrew its tariff application, so the curtailment policy never went into effect.<sup>50</sup> Nevertheless, the case raised questions about the scope of FERC’s authority: to what extent can FERC actions over wholesale transmission affect retail sales of electricity?

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<sup>44</sup>16 U.S.C. § 824(k)(h).

<sup>45</sup>176 F.3d 1090 (8th Cir. 1999).

<sup>46</sup>*Id.*

<sup>47</sup>*Id.*

<sup>48</sup>*Id.* at 1096.

<sup>49</sup>*Northern States Power Co.*, 89 F.E.R.C. ¶ 61,178; 1999 FERC LEXIS 2410 (1999).

<sup>50</sup>*Northern States Power Co.*, 89 F.E.R.C. ¶ 61,299; 1999 FERC LEXIS 2657 (1999).

Authors Penniman and Turner have taken issue with the Eighth Circuit's decision in *Northern States Power*, stating that FERC traditionally "has indirectly regulated the allocation of transmission embedded in wholesale and retail sales."<sup>51</sup> They cite FERC's action in such areas as approving "wholesale contracts that specify the degree of reliability will be equal to that of native load," "review[ing] transmission provider services," and "approv[ing] service priorities that give transmission-only service a priority on par with native sales load."<sup>52</sup> Penniman and Turner therefore believe that the Eighth Circuit incorrectly determined that the indirect effect on native load was improper, and believe that the court should have found in favor of FERC.

### C. Jurisdiction Over Bundled and Unbundled Transmission

In *Northern States Power*, the central issue focused on FERC's ability to indirectly affect retail transactions. Recent court challenges of FERC's power have focused on FERC's ability to directly regulate certain transactions—most notably, FERC's power to regulate unbundled retail transmission service. With the promulgation of Order 888, FERC "concluded that it has jurisdiction not only over bundled and unbundled wholesale transmission services by public utilities in interstate commerce, but also over unbundled retail transmission services, by public utilities in interstate commerce."<sup>53</sup>

State challenges to federal jurisdiction over unbundled retail transmission were litigated in *Transmission Access Policy Study Group v. FERC*.<sup>54</sup> In this case, several state utility commissions argued that FERC had no right to regulate unbundled retail transmission. The plaintiffs argued that the Federal Power Act gave FERC the right to regulate only "transmissions of electricity consumed in a state other than that in which the electricity was generated."<sup>55</sup> Conversely, Enron Power Marketing argued that FERC should maintain jurisdiction not just over unbundled retail transmission, but over bundled electricity sales as well;<sup>56</sup> FERC had not asserted jurisdiction over the transmission component of bundled sales, finding rather that "once the transmission service is bundled with generation and local distribution, it becomes merely a component of the retail sale itself, over which FERC has no jurisdiction."<sup>57</sup>

The D.C. Circuit Court of Appeals upheld FERC's decisions against the challenges of both Enron Power Marketing and the states.<sup>58</sup> With regard to the states'

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<sup>51</sup>William H. Penniman & Paul B. Turner, *A Jurisdictional Clash Over Electricity Transmission: Northern States Power v. FERC*, 20 ENERGY L.J. 205, 222 (1999).

<sup>52</sup>*Id.* at 222-30.

<sup>53</sup>People's Electric Cooperative, F.E.R.C. Op. No. 426, 84 F.E.R.C. ¶ 61,229 (1998).

<sup>54</sup>225 F.3d 667 (D.C. Cir. 2000).

<sup>55</sup>*Id.* at 692.

<sup>56</sup>*Id.*

<sup>57</sup>*Id.*

<sup>58</sup>*Id.*

challenge, the court found *Florida Power & Light*<sup>59</sup> and *Southern California Edison Co.*<sup>60</sup> to be dispositive. Because the Supreme Court had ruled that the “commingling” of electricity from various states in the transmission grid could create a transaction in interstate commerce, the D.C. Circuit felt itself to be “bound by the High Court’s dictates to conclude that the FPA gives FERC the authority to regulate the transmissions at issue here, whether retail or wholesale.”<sup>61</sup> With regard to the challenge by Enron Power Marketing, the court was willing to defer to FERC’s position. The court found that the statute was not clear regarding the demarcation of jurisdiction, and that FERC’s decision to cede jurisdictional authority over bundled sales to the state was a “statutorily permissible policy choice.”<sup>62</sup>

*D. New York v. FERC: The Struggle to Define Interstate Transmission*

The D.C. Circuit’s decision has not ended the controversy regarding jurisdiction over unbundled and bundled power sales. In February 2001, the Supreme Court granted certiorari and scheduled oral argument for October 2001 term to hear the case on appeal from the D.C. Circuit.<sup>63</sup> Two basic questions are at issue in *New York v. FERC*: first, did FERC have the right to assert jurisdiction over unbundled retail transmission? And second, if FERC did have the right to such jurisdiction, then did it have the right to refuse to assert jurisdiction over bundled retail transmission?

The biggest point of contention between FERC and New York is how “transmission in interstate commerce” should be defined. New York and the states argue that FERC has no power to regulate unbundled retail sales because they are intrastate transmission and therefore outside of FERC’s realm. FERC argues that these transactions are part of interstate—not intrastate—transmission, which it has the power to regulate. The main question, then, is whether such transmission is better characterized as “intrastate” or “interstate.”

New York argues that the appropriate test to determine jurisdiction over retail transmission is whether energy is “transmitted from a State and consumed at any point outside thereof.”<sup>64</sup> New York makes this argument based on its reading two sections of the Federal Power Act. The original grant of jurisdiction to FERC in Section 201(b)(1) provides that “[t]he provisions of this Part shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce, but . . . shall not apply to any other sale of electric energy”<sup>65</sup> and Section 201(c) provides that “electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at

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<sup>59</sup>404 U.S. 453 (1972).

<sup>60</sup>376 U.S. 205, 210 (1964).

<sup>61</sup>Transmission Access Policy Study Group v. FERC, 225 F.3d 667, 694 (2000), *cert. granted sub nom* New York v. FERC, 531 U.S. 1189 (2001).

<sup>62</sup>*Id.* at 694-95.

<sup>63</sup>*Id.*

<sup>64</sup>Petition for a Writ of Certiorari of the People of the State of New York and the Public Service Commission of the State of New York at 15, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-568) (quoting 16 U.S.C. 824(c)).

<sup>65</sup>16 U.S.C. § 824(b)(1) (2001).

any point outside thereof.”<sup>66</sup> New York argues that reading these sections together shows that “FERC cannot preempt state regulation of transmission from a generator to a retail customer in the same state.”<sup>67</sup>

FERC, on the other hand, argues that the commingling theory adopted in *Florida Power & Light* demonstrates that “[w]ith transmission interconnection, some of the electricity generated and transmitted in one State is almost inevitably consumed ‘outside thereof.’”<sup>68</sup> In FERC’s interpretation, intrastate transmission applies only to states like “Alaska, Hawaii, and most areas of Texas” that “have no interconnection that would permit the physical transmission of power outside of a State.”<sup>69</sup> New York believes that the commingling theory of *Florida Power & Light* should have “no application to FERC’s authority to regulate retail transmission” because the Court in that case was only determining whether FERC had the right to “look at [the utility’s] books” and FERC “was not trying to regulate an FP&L service.”<sup>70</sup>

*E. New York v. FERC: The Controversy over Bundled Retail Transmission*

Enron Power Marketing, like the state of New York, also appealed the D.C. Circuit’s decision. Enron Power Marketing took a position directly opposite of New York’s, though; it argued that not only does FERC have jurisdiction over unbundled retail transmission, but that it also has jurisdiction over the transmission portion of bundled sales. Enron Power Marketing’s position is based on some of the same points argued by FERC; it relies on *Florida Power & Light* for the proposition that the interconnected nature of the grid makes virtually all transmission part of interstate commerce.<sup>71</sup> Given this definition of transmission in interstate commerce, Enron Power Marketing sees no reason to distinguish between bundled and unbundled sales; the company noted that the grant of jurisdiction in FPA Section 201(b)<sup>72</sup> “contains no words limiting FERC’s jurisdiction over retail transmissions to unbundled transmissions.”<sup>73</sup> In opposition, FERC noted that the Federal Power Act

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<sup>66</sup>16 U.S.C. § 824(c).

<sup>67</sup>Petition for a Writ of Certiorari of the People of the State of New York and the Public Service Commission of the State of New York at 16, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-568).

<sup>68</sup>Brief for the Federal Energy Regulation Commission in Opposition to a Writ of Certiorari at 13 n.9, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-568).

<sup>69</sup>*Id.*

<sup>70</sup>Reply Brief in Support of Petition for Certiorari of the People of the State of New York and the Public Service Commission of the State of New York at 2, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-568).

<sup>71</sup>Brief Of Enron Power Marketing, Inc. at 29, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-809).

<sup>72</sup>16 U.S.C. § 824(b)(1).

<sup>73</sup>Brief Of Enron Power Marketing, Inc. at 24, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-809).

gave states jurisdiction over “local distribution facilities and retail sales” and that the statute was not clear about where the line should be drawn.<sup>74</sup> FERC also sought refuge in the D.C. Circuit’s finding that FERC’s “decision to treat bundled transmission as part of retail sales” was “a statutorily permitted policy choice.”<sup>75</sup>

Enron Power Marketing does not agree that the choice was “statutorily permitted.” Enron Power Marketing noted that FERC had found evidence of discriminatory activity taking place even within bundled sales; the company quoted a FERC statement from Order 888: “We conclude that unduly discriminatory and anticompetitive practices exist today in the electric industry and, more importantly, that such practices will increase as competitive pressures continue to grow in the industry, unless the Commission acts now to prevent such practices.”<sup>76</sup> Enron Power Marketing further noted that Congress had “command[ed FERC] to adopt a remedy for all discrimination that it finds” in Section 206 of the FPA, which states that “[w]hensoever [FERC] . . . shall find that any rate, charge, or classification . . . collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission . . . is unjust, unreasonable, unduly discriminatory or preferential, [FERC] shall determine the just and reasonable rate . . . and shall fix the same by order.”<sup>77</sup> Enron Power Marketing argued that “Section 206 is mandatory. Congress directed that FERC ‘shall’ determine and fix a remedy, not that it ‘may’ do so. An agency is required to follow such directives.”<sup>78</sup> FERC, however, simply responded that it “permissibly determined that an exercise of its jurisdiction was not necessary to achieve nondiscriminatory open access to transmission services.”<sup>79</sup>

*F. How Should the Supreme Court Decide the Issue in New York v. FERC?*

The Supreme Court decision is likely to focus on statutory interpretation rather than policy considerations. As California noted in its amicus brief in support of New York, “[t]here are policy arguments . . . that control of the electricity transmission system should be shifted to the Federal Government. The issue [in this case] is not policy.”<sup>80</sup> The D.C. Circuit felt constrained by the Supreme Court’s decision in

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<sup>74</sup>Brief for the Federal Energy Regulation Commission in Opposition to a Writ of Certiorari at 20 n.9, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-568).

<sup>75</sup>Brief for the Federal Energy Regulation Commission in Opposition to a Writ of Certiorari at 21, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-568) (quoting *Transmission Access Policy Study Group*, 225 F.3d at 694-95).

<sup>76</sup>Brief Of Enron Power Marketing, Inc. at 36, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-809) (quoting Order No. 888 at 31,682).

<sup>77</sup>16 U.S.C. § 824e(a) (2001).

<sup>78</sup>Brief Of Enron Power Marketing, Inc. at 35, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-809).

<sup>79</sup>Brief for the Federal Energy Regulation Commission in Opposition to a Writ of Certiorari at 21, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-568).

<sup>80</sup>Brief of Amici Curiae the State of California and the Public Utilities Commission of the State of California in Support of Petitioners at 30, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-568).

*Florida Power & Light*, and therefore felt that it was obligated to find that unbundled transmission was part of interstate commerce under the Federal Power Act. The Supreme Court, however, has an opportunity to limit *Florida Power & Light* to its facts and interpret the Federal Power Act in accordance with New York's views. Even though I argue that more federal power over transmission is needed,<sup>81</sup> New York appears to have a stronger case.

Congressional intent in enacting the Federal Power Act appears to favor New York. Certainly, Congress intended for the states to continue to play a significant role in utility regulation; in fact, many people argue that the FPA was only intended to fill the "Attleboro Gap" that came from the Supreme Court decision forbidding states from regulating interstate sales.<sup>82</sup> Section 201(b) of the FPA supports this point of view: "[t]he provisions of this Part shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce," but that they "shall not apply to any other sale of electric energy or deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a State line."<sup>83</sup> By explicitly maintaining state jurisdiction over some energy transmitted across state lines, the provision implies that Congress expected states to retain jurisdiction over transactions that did not cross state lines and further, that Congress expected that there would be a significant number of transactions that did not cross state lines.

In fact, this expectation was borne out: for many decades, states continued to regulate in-state transmission as part of bundled sales. Even after the *Florida Power & Light* decision, when Justice Douglas warned that "the Commission's commingled tracing assumption will effectively eliminate electric utility regulation by States,"<sup>84</sup> the states continued to regulate these sales. If *Florida Power & Light* were accepted for the proposition that all transmission is in fact in interstate commerce, then this regulation should not have happened.

If, however, the Court finds that *Florida Power & Light* does stand for the proposition that all transmission is interstate commerce, then consistency would dictate that the Court grant Enron Power Marketing's challenge, for the Federal Power Act is clear that "FERC's jurisdiction over interstate transmission is exclusive"<sup>85</sup> and, as Enron Power Marketing correctly notes, the FPA makes no distinction between bundled and unbundled sales.<sup>86</sup>

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<sup>81</sup>See *infra* Parts III and IV.

<sup>82</sup>Petition for a Writ of Certiorari of the People of the State of New York and the Public Service Commission of the State of New York at 3, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-568).

<sup>83</sup>16 U.S.C. § 824(b)(1).

<sup>84</sup>*Florida Power & Light*, 404 U.S. at 475 n.4 (Douglas, J., dissenting).

<sup>85</sup>Brief for Respondent Electric Power Supply Association in Support of Petitioner Enron Power Marketing Power Marketing, Inc. at 3, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-568).

<sup>86</sup>*Id.*

A better solution would be for the Supreme Court to limit *Florida Power & Light* to its facts. It does not have to be entirely overruled; as New York noted, the case did not deal with regulation of the utility's services, but merely declared that the utility fit the statutory definition of a "public utility."<sup>87</sup> Ruling in favor of New York would certainly not end the debate of the proper scope of federal power. However, it would allow Congress to craft a solution that would be clear, unambiguous, and take into account many of the policy issues that California rightly noted were "not the issue" before the Court. As Justice Douglas noted in his dissent to *Florida Power & Light*, "[t]he federal camel has a tendency to occupy permanently any state tent. That may be a wise course; but if so, Congress should make the decision."<sup>88</sup>

### III. POLICY CONSIDERATIONS

Whatever the outcome in *New York v. FERC*, Congress still has the ability to re-write the Federal Power Act to clarify its intent.<sup>89</sup> Few people disagree that Congress could choose to grant a great deal of power to the FERC to regulate electricity transmission. Even Justice Douglas, in his dissent in *Florida Power & Light*, wrote that while he disagreed with the "commingling" theory adopted by the court, he had "no doubt that Congress has constitutional power to regulate under the Commerce Clause the interstate 'commingling' of electric power."<sup>90</sup>

Like Justice Douglas, most members of Congress appear to take for granted the ability to mandate a full scheme of federal regulation over transmission. Indeed, most of the debate centers not on whether Congress has the ability to pass such legislation, but rather on whether enacting a stronger scope of federal jurisdiction would be beneficial to the country.<sup>91</sup> In fact, at the same time that *New York v. FERC* was being appealed, most House members agreed on a provision in a bill that would codify FERC's jurisdiction over unbundled retail transmission; the bill faltered, however, when a more controversial provision was added that would have extended FERC's jurisdiction to cover bundled retail sales.<sup>92</sup>

In the past two Congressional sessions a variety of proposals have been put forward. Each of these proposals would change the scope of federal regulation over transmission—some to a greater extent than others—but all would affect the general regulatory scheme. In the 106th Congress, for example, there was a proposal to

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<sup>87</sup>Reply Brief in Support of Petition for Certiorari of the People of the State of New York and the Public Service Commission of the State of New York at 2, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-568).

<sup>88</sup>404 U.S. 453, 476 (1972) (Douglas, J. dissenting).

<sup>89</sup>See *supra* text accompanying notes 38-44.

<sup>90</sup>404 U.S. 453, 469-70 (1972) (Douglas, J., dissenting).

<sup>91</sup>See *Electricity Competition and Reliability Act of 1999: Hearing on H.R. 2944 Before the Subcommittee on Energy and Power of the House Comm. on Commerce*, 106th Cong. (1999), available at <http://com-notes.house.gov/ccheard/hearings106.nsf/20c324c6a1a1950a8525680f0067184a/5aa27673532e03ae85256992007b1644?OpenDocument> (last visited Oct. 25, 2001).

<sup>92</sup>*Bliley-Barton Feud Rages, Putting Outlook For Compromise In Doubt*, ELECTRIC UTIL. WK., July 10, 2000, available at LEXIS, News Library, ALLNEWS file.



allow the federal government to exercise eminent domain to site transmission lines;<sup>93</sup> another proposal, developed in response to the Eighth Circuit's decision in *Northern States Power*, would have forbidden utilities from providing preferences to native load customers over wholesale customers.<sup>94</sup> A second proposal would have required utilities to join RTOs.<sup>95</sup> Additionally, as noted, there was also a proposal to "clarify" the FERC's power to regulate unbundled retail transmission as well as a proposal to extend the FERC's jurisdiction to cover bundled retail transmission.<sup>96</sup> In 2001, in the 107th Congress, there were proposals to "require[] federal agencies with rights-of-way authority to report to the Department of Energy and Federal Energy Regulatory Commission on ways to support new transmission lines or capacity expansions"<sup>97</sup> and "forthcoming" proposals to "to address interstate transmission and participation in transmission companies."<sup>98</sup>

Assuming that Congress does indeed have the power to regulate all transmission, what type of transmission bill should Congress pass? This section examines various policy goals as they relate to transmission decisions. It evaluates the sometimes-competing considerations of efficiency, innovation, predictability, fairness, and the federalist system, and analyzes how these goals play out in the search for the ideal transmission policy.

#### A. Efficiency

A concern for transmission efficiency includes a concern that electricity get to where it is needed most, as cheaply and as easily as possible. Many people believe that the more transmission comes under FERC jurisdiction, the better able FERC will

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<sup>93</sup>Victoria K. Green, *Looming Power Outages Prompt Senate, House To Intensify Work on Electric Restructuring*, THE OIL DAILY, May 23, 2000, available at LEXIS, News Library, ALLNEWS file.

<sup>94</sup>See *Electricity Competition and Reliability Act of 1999: Hearing on H.R. 2944 Before the Subcommittee on Energy and Power of the House Comm. on Commerce*, 106th Cong. 51 (1999) (statement of Hon. James J. Hoecker, Chairman, Federal Energy Regulatory Commission), available at <http://comnotes.house.gov/ccheat/hearings106.nsf/20c324c6a1a1950a8525680f0067184a/5aa27673532e03ae85256992007b1644?OpenDocument> (last visited Oct. 25, 2001).

<sup>95</sup>See *Electricity Competition and Reliability Act of 1999: Hearing on H.R. 2944 Before the Subcommittee on Energy and Power of the House Comm. on Commerce*, 106th Cong. 16 (1999) (statement of Hon. T.J. Glauthier, Deputy Secretary of Energy, U.S. Department of Energy), available at <http://comnotes.house.gov/ccheat/hearings106.nsf/20c324c6a1a1950a8525680f0067184a/5aa27673532e03ae85256992007b1644?OpenDocument> (last visited Oct. 25, 2001).

<sup>96</sup>Bliley, *Barton Have Dueling Proposals On Transmission As Bill Goes To Markup*, POWER MARKETS WK., June 12, 2000, available at LEXIS, News Library, ALLNEWS file.

<sup>97</sup>This bill is S. 389 by Sen. Murkowski; see *GOP Energy Bill Launches Washington Electricity Debate Anew*, ELECTRIC UTIL. WK., March 5, 2001, available at LEXIS, News Library, ALLNEWS file.

<sup>98</sup>*Murkowski Drops Energy Bill Seeking Tax Breaks To Boost Domestic Supply*, POWER MARKETS WK., March 5, 2001, available at LEXIS, News Library, ALLNEWS file.

be to implement a system-wide solution to the transmission problems. To this end, a number of proposals have been put forward, each of which would extend FERC's reach, and each of which attempts to pave the way for lower prices through increased competition.

1. Permitting FERC to maintain jurisdiction over unbundled retail transmission

As noted, the goal of Order 888 was to encourage wholesale competition by preventing transmission-owning entrenched utilities from charging higher prices for new generators to wheel power over their lines.<sup>99</sup> The basic idea was that competitive generation could lead to lower prices for electricity; but in order to take advantage of competitive generation, electricity generators needed to be able to "wheel" their power. FERC recognized that in order to have efficient wholesale competition, utilities would need to be able to wheel their power at a reasonable price. Hence, including unbundled retail transmission within the scope of Order 888 became a central part of FERC's plan to open the transmission; the more that transmission transactions could be subject to FERC's open access rules, the lower transmission prices would be.

Many observers have agreed that federal jurisdiction is needed to ensure that power can be moved reliably and efficiently. Recently, a representative from the Electric Power Supply Association testified before Congress, arguing that state jurisdiction over "bundled" uses of the transmission grid would result in the grid moving from "an eight lane super highway to a dirt road."<sup>100</sup> He cited a "poorly managed effort to curtail 400Mw of power flowing between Ontario and Michigan" in the summer of 1999 that led to "a dramatic price spike in Illinois, Indiana, and Ohio" to support his position that all transmission of electricity is essentially interstate commerce; and that federal regulation is needed to keep the grid functioning properly.<sup>101</sup>

In addition to being less cost efficient, regulation at the state level seems likely to cause a "Tragedy of the Commons"<sup>102</sup>-style market failure. All utilities with both generating and transmission facilities would benefit from being able to wheel their power at reasonable rates on others' lines. But the marginal utility of charging a higher rate to others may well exceed the marginal utility gained from unilaterally lowering transmission rates. Since states are likely to have only a small number of utilities inside their borders—and a much larger number of utilities outside their borders, wishing to stay within state lines—there is always an incentive to charge more than the efficient market would bear.

Even some state regulators support Order 888; some agree that it could well lead to greater efficiency which would ultimately benefit their citizens. John Hanger, a state regulator from Pennsylvania, expressed his support for Order 888 and the effect

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<sup>99</sup>Lanka, *supra* note 26.

<sup>100</sup>*Hearing on Pending Electricity Legislation*, 106th Cong. (1999) (statement Joseph Ronan, Vice President, Calpine Corporation and on behalf of Electricity Power Supply Association), available at [http://energy.senate.gov/hearings/full\\_committee/Electricity\\_Legislation2/Ronan.htm](http://energy.senate.gov/hearings/full_committee/Electricity_Legislation2/Ronan.htm) (last visited Oct. 25, 2001).

<sup>101</sup>*Id.*

<sup>102</sup>Garrett Hardin, *The Tragedy of the Commons*, 162 *Sci.* 1243 (1968).

it would have on opening the nation to competition. He wrote that “[t]he supply, movement, and price of electricity remains vital to the economies of Pennsylvania and the nation. . . . In my opinion, the price of electricity affects our nation’s economic well-being more than the price of oil.”<sup>103</sup> Hanger wrote that Order 888 was an example of “cooperative federalism” that could aid the supply, movement, and price of electricity, and he cautioned that states should not “act like protectionists intent on impeding interstate commerce.”<sup>104</sup>

Many state regulators disagree with Hanger and oppose Order 888. Interestingly, most arguments by the states focus very little on the efficiency of federal regulation over unbundled retail transmission; rather, such arguments focus instead on the historical tradition of state power over retail sales.<sup>105</sup> Nevertheless, there is some concern that federal jurisdiction over bundled retail transmission could make states more “hesitant” to enact retail competition, due to concern that “their commissions will be precluded from regulating much (or any) of the retail delivery service provided by the utility.”<sup>106</sup> If this were to happen, then the promise of lower rates and greater competition could not be fulfilled. However, there is no evidence to show that states are less likely to enact retail restructuring simply because of federal power over unbundled retail transmission; FERC noted that many states have ordered retail unbundling even after Order No. 888.<sup>107</sup> In fact, states may be just as likely to forego restructuring for fear of a lack of access to reasonably priced transmission. As FERC Commissioner William L. Massey stated, “[i]f the states cannot depend on the wholesale market regulator to ensure reasonable prices for consumers, then states will surely think twice before heading down the restructuring path.”<sup>108</sup>

## 2. Extending FERC’s authority to cover bundled retail transmission

The arguments for extending FERC’s authority to cover bundled transmission sales are very similar to those for permitting FERC to regulate unbundled retail transmission—in a nutshell, such regulation is seen as a further step toward ending open-access discrimination. Among those people who agree that FERC *should*

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<sup>103</sup>John R. Hanger, *Four Olive Branches; What the FERC Bestowed on PUCs in Order 888*, PUB. UTIL. FORT., Oct. 1, 1996, at 38, available at LEXIS, News Library, ALLNEWS file.

<sup>104</sup>*Id.*

<sup>105</sup>*Requests For Rehearing Of Order Nos. 888 And 889 Reveal General Support For Rules But Complaints Over Details*, FOSTER ELECTRIC REP., June 12, 1996, at 1, available at LEXIS, News Library, ALLNEWS file.

<sup>106</sup>*Id.*

<sup>107</sup>Brief for the Federal Energy Regulation Commission in Opposition to a Writ of Certiorari at 17, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-568).

<sup>108</sup>*Electricity Competition and Reliability Act of 1999: Hearing on H.R. 2944 Before the Subcomm. on Energy and Power of the House Comm. on Commerce*, 106th Cong. 76 (1999) (statement William L. Massey), available at <http://com-notes.house.gov/cchear/hearings/106.nsf/20c324c6a1a1950a8525680f0067184a/5aa27673532e03ae85256992007b1644?OpenDocument> (last visited Oct. 25, 2001).

regulate unbundled retail transmission, the main point of contention is whether it is truly necessary for the FERC to regulate bundled retail transmission. Enron Power Marketing and many investor-owned utilities believe that it is indeed necessary; they point to FERC's findings "that vertically integrated utilities regularly discriminate by providing themselves and their affiliates transmission superior to the transmission they provide to competing power suppliers."<sup>109</sup> As noted, such discrimination can lead to higher price charging and less competition in the marketplace.

Interestingly, even though FERC made the finding of undue discrimination, the agency has been relatively silent on the question of whether federal regulation of bundled transmission would add to improved access and more competition. In its brief in opposition to the petition for certiorari, FERC simply stated that the agency had "permissibly determined that an exercise of its jurisdiction was not necessary to achieve nondiscriminatory open access to transmission service"<sup>110</sup> even while acknowledging the "possibility that the quality of transmission service for retail purposes will be superior to the quality of transmission service offered for wholesale purposes."<sup>111</sup>

This position appears on one level to be contradictory: if retail-wholesale discrimination will exist without federal regulation, then isn't federal jurisdiction necessary to encourage competition? However, FERC may be correct in saying that such power may have little actual effect on open access: after all, under the current scheme, FERC has jurisdiction over the transmission portions of those utilities who have unbundled their transmission assets and desire (or are located in states that desire) to enter into the competitive arena.<sup>112</sup> If these utilities or these states believe that there is little economic benefit to be gained from competition, they may choose not to unbundle; in that case, it would not be FERC's lack of jurisdiction that is the primary impediment to competition, but rather a policy choice on the part of the state to not engage in such competition.

### 3. Increasing the number of utilities subject to FERC's jurisdiction

Proponents of increasing open access also want to expand the number of utilities under FERC's jurisdiction. Currently, only 20% of the nation's transmission "offers some dimension of open access transmission service."<sup>113</sup> Much of the exclusion comes from "municipal systems, rural cooperative utilities, the Tennessee Valley Authority, the Bonneville Power Administration, and power marketing administra-

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<sup>109</sup>Brief of Enron Power Marketing Power Marketing, Inc. at 36, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-809).

<sup>110</sup>Brief for the Federal Energy Regulation Commission in Opposition to a Writ of Certiorari at 21, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-568).

<sup>111</sup>*Id.* at 22.

<sup>112</sup>*Id.* ("[J]urisdiction attaches only *if* retail transmission has been unbundled from the retail sale, either voluntarily by the utility or as a result of a state-ordered retail program.") (emphasis in original).

<sup>113</sup>Michael J. Zimmer, *Transmission Policy: Ending the Masquerade*, GLOBAL ENERGY BUS., Nov. 1, 2000, at 41, available at LEXIS, News Library, ALLNEWS file.

tions,” which do not fall under FERC’s jurisdiction.<sup>114</sup> Recently, a bill was proposed in Congress that would end these exclusions and place “all transmission-owning utilities” under FERC authority.<sup>115</sup>

Many people believe that such jurisdiction is crucial to promoting open access, since such utilities control a large part of the grid. One author wrote that “[t]he FERC’s ability to promote competitive electric power through non-discriminatory open access is compromised if such entities are not subject to the same laws and regulations governing transmission access and ratemaking.”<sup>116</sup> Few people disagree that such jurisdiction would help open access, though the American Public Power Association did note that no finding has yet been made that such utilities have “engaged in undue discrimination in the provision of transmission service.”<sup>117</sup> If a finding of undue discrimination were to result from an examination of such utilities, however, it seems that adding them to FERC’s jurisdiction would be important to maintain open access.

#### 4. Regional Transmission Organizations

Most people agree that Regional Transmission Organizations (RTOs) can provide increased access to power.<sup>118</sup> In states such as California that are subject to power shortages, RTOs are viewed as beneficial because they can “spread[] any blackouts across a wider region.”<sup>119</sup> RTOs can also make transmission pricing more efficient by eliminating “horizontal transmission rate pancaking.”<sup>120</sup> RTOs are perceived as being better able to manage transmission than Independent Systems Operators (ISOs) for two reasons. First, RTOs tend to cover a larger geographical area; second, and related to the fact that they do cover a larger geographical area, RTOs are perceived as being less beholden to politics. ISOs, by contrast, have been alleged to be “political behemoths staffed by former utility personnel and executives that are

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<sup>114</sup>*Id.*

<sup>115</sup>Bliley, Barton Have Dueling Proposals On Transmission As Bill Goes To Markup, POWER MARKETS WK., June 12, 2000, at 7, available at LEXIS, News Library, ALLNEWS file.

<sup>116</sup>Donald F. Santa, *California’s Power Crisis: Catalyst for National Reform?*, PUB. UTIL. FORT., Dec. 2000, at 18, available at LEXIS, News Library, ALLNEWS file.

<sup>117</sup>American Public Power Association, *Issue Brief: Transmission Policies Needed to Promote Wholesale Competition in the Electricity Industry*, available at <http://www.appanet.org/general/issues/01brief11.htm> (last visited Oct. 25, 2001).

<sup>118</sup>Jim Puzanghera, *Electricity Regulators Demand a ‘Transmission’ from California*, SAN JOSE MERCURY NEWS, April 27, 2001, available at LEXIS, News Library, ALLNEWS file.

<sup>119</sup>*Id.*

<sup>120</sup>Motion of the American Public Power Association to Intervene, Protest, and Request for Investigation and Hearing, at 6, In re Commonwealth Edison Co., 92 F.E.R.C. ¶ 61, 113, 2000 FERC LEXIS 1561 (2000) (No. ER99-4470-000).

strictly engaged in the short-term management of power markets and pricing to form a protected rate-of-return regime.”<sup>121</sup>

Some states have passed restructuring plans that include a requirement for utilities to participate in an RTO.<sup>122</sup> In addition, FERC has asked utilities to voluntarily enter RTOs.<sup>123</sup> Congress is considering a federal requirement that mandates participation in RTOs. William Hogan, for example, notes mandatory RTOS may be necessary: “The incentive-based carrots may not be enough . . . Some regions will do the right thing on their own, but not all.”<sup>124</sup> He believes that it is just a matter of time before RTOs become mandated nationwide, asking “[h]ow long before FERC makes this mandatory?”<sup>125</sup>

Opposition to mandatory RTOs is present, but not terribly strong. House Resolution 2944 would have required utilities to join RTOs, and this provision garnered some response.<sup>126</sup> The American Public Power Association wrote an issue brief stating that public power entities should be compelled to put their transmission facilities under an RTO only upon a specific “finding that the local utility has engaged in undue discrimination in the provision of transmission service.”<sup>127</sup> Glen English, a representative from the National Rural Electric Cooperative Association, stated his support for RTOs in general but warned Congress that “the only thing worse than no RTO is a bad RTO . . . An RTO put together too fast, without full agreement of all industry participants and without adequate review from FERC, is a prescription for problems.”<sup>128</sup> A bad RTO, he stated “can make it easier for transmission owners to exercise market power, to favor their own generation, to restrict the flow of power across the RTO, or to raise transmission prices unreasonably.”<sup>129</sup> A good RTO, on the other hand, would have the opposite effect.

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<sup>121</sup>Michael J. Zimmer, *Transmission Policy: Ending the Masquerade*, GLOBAL ENERGY BUSINESS, Nov. 1, 2000, at 41, available at LEXIS, News Library, ALLNEWS file.

<sup>122</sup>Donald F. Santa, *California's Power Crisis: Catalyst for National Reform?*, PUB. UTIL. FORT., Dec. 2000, at 18, available at LEXIS, News Library, ALLNEWS file (noting that Virginia is among the states having this requirement).

<sup>123</sup>See *supra* text accompanying notes 31-36.

<sup>124</sup>William W. Hogan, *The RTO Millennium Order: Following Through or Falling Apart?* (Dec. 8, 2000), available at <http://ksghome.harvard.edu/~whogan.cbg.ksg/hepg1200.pdf>.

<sup>125</sup>*Id.*

<sup>126</sup>See *Electricity Competition and Reliability Act of 1999: Hearing on H.R. 2944 Before the Subcommittee on Energy and Power of the House Comm. on Commerce*, 106th Cong. 201 (1999) (statement of Glen English), available at <http://comnotes.house.gov/ccheat/hearings106.nsf/20c324c6a1a1950a8525680f0067184a/5aa27673532e03ae85256992007b1644?OpenDocument> (last visited Oct. 25, 2001).

<sup>127</sup>AMERICAN PUBLIC POWER ASSOCIATION, ISSUE BRIEF: TRANSMISSION POLICIES NEEDED TO PROMOTE WHOLESALE COMPETITION IN THE ELECTRICITY INDUSTRY, at <http://www.appanet.org/general/issues/01brief11.htm> (last visited Oct. 25, 2001).

<sup>128</sup>See *supra* note 126.

<sup>129</sup>*Id.*

Generally, however, people testifying on the bill agreed that well-planned mandatory RTOs would have a beneficial effect on the industry.

### 5. Transmission Siting

The current dearth of new transmission had led some Congressional representatives to believe that the federal government should take control over transmission siting. Last year, a bill was proposed that would give the federal government the power of eminent domain to site new transmission facilities.<sup>130</sup> Others agree that federal power over siting could expand available transmission capacity; an article in *Public Utilities Fortnightly* points out that such power has aided the expansion of transmission in the context of natural gas, and argues that “parallel authority” is needed for electricity transmission.<sup>131</sup>

State regulators, however, have the advantage of being more in touch with local needs; while the need for transmission is no longer solely of local concern, local issues still have a large role to play in siting decisions. A regulator from Ohio explained that “[r]ight now, the states adjudicate claims over transmission matters related to items such as the effect of electromagnetic fields and stray voltage on the milk production of dairy herds.”<sup>132</sup> If FERC has sole authority over transmission, he wondered, “[d]o I now send the citizens groups and irate farmers with cows in tow down to North Capitol St. because only the FERC has jurisdiction over transmission service?”<sup>133</sup> FERC is probably less equipped than the states to handle cows and irate farmers. Unless the transmission shortage reaches critical levels, siting decisions are probably best left to the states. Congress seems to agree; the bill introduced in 2001 removed the eminent domain language from the 2000 bill.<sup>134</sup> The sponsor of both years’ bills, Sen. Murkowski, stated that “if it becomes necessary, we can [regulate siting decisions],” but added he believed “[s]tates should have the right to address it. We think they will.”<sup>135</sup>

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<sup>130</sup>*Senate GOP Energy Bill Launches Washington Electricity Debate Anew*, ELECTRIC UTIL. WK., March 5, 2001, available at LEXIS, News Library, ALLNEWS file.

<sup>131</sup>Donald F. Santa, *California’s Power Crisis: Catalyst for National Reform?*, PUB. UTIL. FORT., Dec. 2000, available at LEXIS, News Library, ALLNEWS file (“The expansion of the interstate natural gas pipeline network pursuant to the FERC’s certificate authority under the NGA supported the development of competitive natural gas commodity markets and has facilitated the expanded role of natural gas in the nation’s energy mix.”).

<sup>132</sup>Craig A. Glazer, *Jurisdictional Gridlock: A Pathway Out of Darkness*, PUB. UTIL. FORT., Jan. 1, 1996, available at LEXIS, News Library, ALLNEWS file.

<sup>133</sup>*Id.* It is worth noting, however, that even the most expansive views of FERC’s regulatory power for reliability have some limitation; FERC does not have reliability authority over approximately one-third of the U.S. transmission grid, including the portions of the grid controlled by cooperatives, municipalities, and ERCOT utilities.

<sup>134</sup>*Senate GOP Energy Bill Launches Washington Electricity Debate Anew*, ELECTRIC UTIL. WK., March 5, 2001, available at LEXIS, News Library, ALLNEWS file.

<sup>135</sup>*Id.*

### B. Innovation

One argument often heard for letting the states retain as much power as possible to regulate the electric industry is that the states will be free to innovate and experiment with different ways of fashioning the regulatory scheme.<sup>136</sup> Justice Brandeis is occasionally quoted for his comments on “state laboratories”: “It is one of the happy incidents of the federal system that a single courageous state, may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.”<sup>137</sup>

This concern would seem to suggest that perhaps the country is better served by allowing the states free reign to develop their own regulatory policies; certainly, Texans have heard a great deal of talk about California’s “failed” attempt to deregulate the electricity industry, and how the Texas plan is different enough that Texas will not endure the problems faced in California.<sup>138</sup> A policy that encourages states to innovate can be good for the nation as a whole; certainly, Texas leaders studied the legislation passed in California and Pennsylvania and tried to develop a system that took advantage of the best parts of other states’ plans.<sup>139</sup>

The question should be raised, however, as to what degree of control over transmission is needed to gain the advantage of state innovation. More precisely, if state PSCs continue to have jurisdiction over bundled retail transmission, will this jurisdiction help them formulate better deregulation plans? Certainly, the states seem

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<sup>136</sup>See, e.g., Kelley A. Karn, Note, *State Electric Restructuring: Are Retail Wheeling and Reciprocity Provisions Constitutional?*, 33 IND. L. REV. 631, 632 (2000) (“This Note concludes that as states experiment with different policies and structures for the retail electric industry, the federal government should step to the side, monitor the experiments, and, when necessary, give states the power needed to ensure that the transition from monopoly to competition will be fair.”).

<sup>137</sup>*Id.* at 631 (quoting *New State Ice Co. v. Liebman*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting)).

<sup>138</sup>M. Ray Perryman, *Texas, California Differ In Planning For Energy Needs*, THE DALLAS MORNING NEWS, Feb. 11, 2001, available at LEXIS, News Library, ALLNEWS file (“Fortunately, California’s chaos will not be revisited as Texas consumers gain the opportunity to select their electricity provider.”); David Sibley & Steven Wolens, *Plans For Texas’ Deregulation Are Looking Bright*, SAN ANTONIO EXPRESS-NEWS, Dec. 29, 2000, available at LEXIS, News Library, ALLNEWS file (“The problems that have plagued California will not occur in Texas. While both Texas and California ‘deregulated’ or ‘restructured’ their electric industry, how it was done and the market in which it was done could not be more different.”).

<sup>139</sup>Courtney Barry, *Texas Passes a Restructuring Bill: Even Bubba Likes It; The Lone Star state grabs deregulation by the horns. Can the ISO make it work?*, PUB. UTIL. FORT., Sept. 1, 1999, available at LEXIS, News Library, ALLNEWS file (“Texas did look to other states for their input, and even went outside of the country for guidance . . . . In addition to studying other state’s bills, the interim committee . . . visited California, the United Kingdom . . . and later, Pennsylvania.”).



to think so: for the most part, they are loath to give up any of their current jurisdiction over transmission.<sup>140</sup>

However, increased federal jurisdiction over transmission might actually give the states more flexibility to develop new regulatory schemes. After all, states still have “authority to regulate the vast majority of generation costs, the siting of generation and transmission facilities, and decisions regarding retail service territories.”<sup>141</sup> Creative innovation in traditional rate regulation does exist, but most people talking about innovation in state regulation of electricity are generally talking about various plans to implement competition. It is possible that greater federal regulation of transmission—to the extent that it could create genuine open access in transmission—could give the states the cushion they need to implement successful competition programs. Such open access could conceivably take advantage of these state laboratories and encourage the states to find ways to take profitable advantage of “dispersed generation and momentary excesses of power by various utilities.”<sup>142</sup>

### C. Predictability and Consistency

A properly balanced policy also seeks predictability and consistency. Predictability is important from many angles: consumers want to be able to estimate how much their bills will be; utilities want to be able to propose a tariff that will be acceptable to regulators; everyone wants to be able to rely on transmission capacity being available when needed. Currently, there is jurisdictional uncertainty over regulatory power over transmission. This uncertainty has had a spillover effect: two market responses, refunctionalization and municipalization, can offer a way to “game” the system and take advantage of the uncertainty in the system. These responses, in turn, can increase the lack of predictability in the market as a whole.

#### 1. Refunctionalization

Refunctionalization involves reclassifying transmission assets as distribution assets. Refunctionalization is a direct response to FERC’s Order 888; in that order, utilities were invited to re-assess their transmission and distribution lines in light of the seven-factor test.<sup>143</sup> By reclassifying lines as distribution, rather than transmission, a utility is able to add to its rate base and avoid including the newly designated distribution lines in their open access tariffs.<sup>144</sup> Some utilities have re-

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<sup>140</sup>See *Petition for a Writ of Certiorari of the People of the State of New York and the Public Service Commission of the State of New York at 15*, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-568).

<sup>141</sup>Brief for the Federal Energy Regulation Commission in Opposition to a Writ of Certiorari at 7, *New York v. FERC*, 531 U.S. 1189 (2001) (No. 00-568).

<sup>142</sup>Harry Austin, *Heat waves and Flawed Deregulation*, CHATTANOOGA TIMES, July 23, 2000, available at LEXIS, News Library, ALLNEWS file.

<sup>143</sup>See *supra* notes 25-30.

<sup>144</sup>Whitfield A. Russell, *Refunctionalization of Transmission Assts Under FERC Order 888: Impact on Market Power 2* (1999) (Paper on file with the Public Utility Commission of Texas).

classified a large part of their transmission assets; in September of 1999, for example, Commonwealth Edison reclassified more than forty percent of its transmission lines in Illinois to a distribution function.<sup>145</sup> Illinois Power refunctionalized and added \$89 million to its distribution rate base;<sup>146</sup> the refunctionalization was done with the support of Illinois state officials, who found the reclassification “reasonable” and therefore approved it.<sup>147</sup>

Refunctionalization decreases the amount of certainty in the open-access system; in the words of one author, it makes the line between state and federal jurisdiction “a little less bright.”<sup>148</sup> The fear with refunctionalization is that if “transmission owners are allowed to appeal to local interests and authorities for these determinations, a consistent set of rules will be impossible and erosion of the interstate transmission system could result.”<sup>149</sup> Transmission owners have an economic incentive to refunctionalize; even though the functional unbundling requirement of Order 888 stipulates that a utility must charge itself the same transmission price it charged others. Such pricing requirements “don’t affect the owners of enterprises that ‘pay’ those dollars out of one pocket, but collect them in another, the same way they affect the owners of generation enterprises that do not collect, but instead pay, those dollars.”<sup>150</sup> As a result, the only net economic effect for the utility is that it “benefits them by repelling competition from other generators.”<sup>151</sup>

So far, FERC has approved all the refunctionalizations that have been filed.<sup>152</sup> Nevertheless, FERC officials have indicated that if they see a negative impact on open access, they will give no deference to the utility’s determination of transmission and distribution assets; one FERC Commissioner stated that “[i]f a proposed reclassification could impair the availability of open access services, the Commission would be concerned and would consider this possible adverse effect in evaluating the proposed reclassification.”<sup>153</sup> FERC has also indicated in another case that it would

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<sup>145</sup>*Put the Brakes on Refunctionalization Efforts, Industry Reps Tell FERC*, INSIDE F.E.R.C., Nov. 8, 1999, at 8.

<sup>146</sup>Illinois Power Comm’n, 1999 Ill. PUC LEXIS 648, \*34; 195 P.U.R. 4th 413.

<sup>147</sup>*Id.* at \*35.

<sup>148</sup>Russell, *supra* note 144, at 9.

<sup>149</sup>*See supra* note 100.

<sup>150</sup>*See supra* note 120, at 7.

<sup>151</sup>*Id.*

<sup>152</sup>*FERC OK’s Line Reclassifications, but Includes a Cautionary Note*, ELECTRIC UTIL. WK., Feb. 14, 2000, available at LEXIS, News Library, ALLNEWS file.

<sup>153</sup>*See Electricity Competition and Reliability Act of 1999: Hearing on H.R. 2944 Before the Subcommittee on Energy and Power of the House Comm. on Commerce*, 106th Cong. 51 (1999) (statement of Hon. James J. Hoecker, Chairman, Federal Energy Regulatory Commission), available at <http://com-notes.house.gov/cchea/hearings106.nsf/20c324c6a1a1950a8525680f0067184a/5aa27673532e03ae85256992007b1644?OpenDocument> (last visited Oct. 25, 2001).

follow “substance over form” in order to protect open access, by maintaining jurisdiction over a distribution facility that “is used to provide transmission service” by delivering electricity to wholesale purchasers.<sup>154</sup>

FERC’s policy of following substance over form has been criticized as being “unsatisfactory to those seeking greater clarity.”<sup>155</sup> The process of “drawing precise lines between transmission and local distribution facilities”<sup>156</sup> is seen as “fact specific and . . . contentious, particularly when one is dealing with radial lines or lines of intermediate voltages.”<sup>157</sup> Consequently, some commentators have called for a bright-line test based simply on voltage. Richard Pierce, for example, had stated that such a test ought to “confer[] on the FERC plenary power over the rates and conditions of service for all transactions that use a high voltage transmission lines,” as “[t]he transmission grid would not function effectively if it were subject to potentially conflicting rates and conditions of service imposed by the FERC and the PUCs.”<sup>158</sup>

Others agree that such a voltage test would provide important consistency and predictability to the transmission system. Recognizing the need to balance accuracy with consistency, a representative of the Edison Electric Institute proposed a “rebuttable presumption” that would “allow a transmitting utility to petition for the exclusion of specific facilities or classes of facilities from transmission.”<sup>159</sup> Such a rebuttable presumption could provide “greater assurance that utilities will not be able to create barriers to competition,”<sup>160</sup> while at the same time providing a mechanism for utilities to appeal in the event that distribution was truly provided through high-voltage wires.

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<sup>154</sup>John D. McMahon, *Restructuring from the State Regulatory Perspective*, in *UTILITY RESTRUCTURING: NEGOTIATING, STRUCTURING AND DOCUMENTING THE DEAL* 85, 95 (1998).

<sup>155</sup>*Id.*

<sup>156</sup>William H. Penniman & Paul B. Turner, *A Jurisdictional Clash over Electricity Transmission: Northern States Power v. FERC*, 20 *ENERGY L.J.* 205, 218 (1999).

<sup>157</sup>*Id.*

<sup>158</sup>Richard J. Pierce, *The State of the Transition to Competitive Markets in Natural Gas and Electricity*, 15 *ENERGY L. J.* 323, 331-32 (1994).

<sup>159</sup>*See Electricity Competition and Reliability Act of 1999: Hearing on H.R. 2944 Before the Subcommittee on Energy and Power of the House Comm. on Commerce*, 106th Cong. 182 (1999) (statement of David K. Owens, Executive Vice President, Edison Electric Institute), available at <http://com-notes.house.gov/ccheat/hearings106.nsf/20c324c6a1a1950a8525680f0067184a/5aa27673532e03ae85256992007b1644?OpenDocument> (last visited Oct. 25, 2001).

<sup>160</sup>*Id.*

## 2. Municipalization

Municipalization efforts center on a city's ability to own and operate a utility; it has been described as "a century old phenomenon by which retail customers of a utility company are served by a newly formed municipal utility."<sup>161</sup> By owning a distribution system, cities become eligible to purchase power at wholesale for resale to city residents. The city itself becomes a wholesale customer of the utility.<sup>162</sup> Wholesale competition—and lower wholesale rates—made municipalization a popular policy in the mid-nineties,<sup>163</sup> and sparked a resurgence of interest after the perceived "failure" of California's deregulation.<sup>164</sup> Dozens of cities in a number of states have attempted to create municipal utilities to take advantage of wholesale competition since 1992.<sup>165</sup>

Municipalization, like refunctionalization, is an issue fraught with gray areas. First, there is the difficulty in determining just what constitutes a city utility. In Palm Springs, California, for example, the city simply placed meters on some homes and businesses and attempted to call that a utility.<sup>166</sup> FERC struck down the measure as a "sham transaction" but gave little guidance on what type of infrastructure a city needs to create in order to have a true municipalization.<sup>167</sup>

Municipalization creates uncertainty for utilities as well as for cities. Most utilities are highly resistant to the idea of being taken over by a government entity, and observers have noted that "[i]t appears to be routine practice for private utilities to intensely fight against any takeover efforts."<sup>168</sup> Utilities are encouraged to fight, in part, for fear of municipalization sweeping the nation and ending their ability to

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<sup>161</sup>*State Commissions Ask Supreme Court to Review FERC Order 888*, UTIL. INDUSTRY LITIGATION REPORTER, Dec. 2000, at 1, available at LEXIS, News Library, ALLNEWS file.

<sup>162</sup>*Parties Look Forward, Not Back as D.C. Circuit Affirms Order 888*, INSIDE F.E.R.C., July 10, 2000, at 1, available at LEXIS, News Library, ALLNEWS file.

<sup>163</sup>See Lori A. Burkhardt, *FERC Weighs in on Muni-Lite Proposals*, PUB. UTIL. FORT., Oct. 1, 1996, at 42, available at LEXIS, News Library, ALLNEWS file.

<sup>164</sup>Will McNamara, *A Shock to the System*, AM. CITY & COUNTY, April 2001, available at LEXIS, News Library, ALLNEWS file ("As California attempts to resolve its energy crisis—and other states watch to determine how they will with their own deregulation plans—a growing number of cities are pondering another option: municipalization of their electric systems.").

<sup>165</sup>Bruce W. Radford, *Volts Populi*, PUB. UTIL. FORT., July 15, 1995, at 5, available at LEXIS, News Library, ALLNEWS file (citing examples such as Albuquerque and Las Cruces, NM; Brook Park and Toledo, OH; Broken Bow, OK; Bennington, VT; Westbrook and Jay, ME; Romero, MI; and Culver City, CA).

<sup>166</sup>*Palm Springs, Citing New Calif. Law, Asks Muni Lite Rehearing*, THE ELECTRICITY DAILY, Sept. 4, 1996, at 1, available at LEXIS, News Library, ALLNEWS file.

<sup>167</sup>*Id.*

<sup>168</sup>Ola Kinnander, *Municipalization of Utilities May Follow on Heels of Deregulation*, THE BOND BUYER, Nov. 27, 2000, at 1, available at LEXIS, News Library, ALLNEWS file.

maintain profitability. Author Richard Pierce finds it likely that a successful municipalization will lead to such a sweep: “Eventually, a utility will lose one of the many municipalization battles in some state. Once that happens . . . the deintegration through municipalization movement will develop momentum so great that utilities will be unable to defeat it in any state or city.”<sup>169</sup>

As long as cities can hope to achieve lower rates through municipalization, these issues are likely to remain. However, FERC appears to be doing an admirable job to keep municipalization-related uncertainties to a minimum. Through its decision in the Palm Springs case and similar cases, FERC has showed that it is unwilling to permit cities to engage in sham transactions to gain access to rate competition. Further, in Order 888, FERC agreed to permit utilities to recover their stranded costs after municipalization; permitting stranded cost recovery avoids allowing the municipalization to be a “mere tool by which customers will escape their cost responsibilities,”<sup>170</sup> since cities would be paying for the utility’s investments regardless of whether they chose to municipalize the utility.

#### D. Fairness

Discussions of transmission preference for native load customers usually center around fairness. In *Northern States Power*, the utility argued that fairness dictated allowing a preference for native load customers who had “no other alternatives available to obtain electrical service.”<sup>171</sup> Those opposed to the preferential curtailment policy saw things differently; in their opinion, it was “preferential treatment of native load customers” that “violates the fairness precept.”<sup>172</sup> They point out that the contract at issue in *Northern States Power* actually dealt with “power that was moving to the next state, Wisconsin, to serve their native load.”<sup>173</sup>

Certainly, it is reasonable to protect customers who are not able to choose their electric service provider—customers for whom the utility is truly the provider of last resort. Nevertheless, there is a great deal of truth to the maxim that “[e]veryone is somebody’s native load customer.”<sup>174</sup> Many utilities purchasing power on wholesale contracts also serve captive customers—in such a situation, it is hard to say which customers are truly “deserving” of preference.

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<sup>169</sup>Richard J. Pierce, *The State of the Transition to Competitive Markets in Natural Gas and Electricity*, 15 ENERGY L. J. 323, 347 (1994).

<sup>170</sup>“Aggressive Municipalizations” May Elicit Strong Reactions, INSIDE F.E.R.C., Nov. 25, 1996, at 12, available at LEXIS, News Library, ALLNEWS file.

<sup>171</sup>*N. States Power v. Fed. Energy Regulatory Comm’n*, 176 F.3d 1090, 1093 (8th Cir. 1999).

<sup>172</sup>*Quotables*, THE ENERGY DAILY, Nov. 10, 1993, at 1, available at LEXIS, News Library, ALLNEWS file.

<sup>173</sup>See *Electricity Competition and Reliability Act of 1999: Hearing on H.R. 2944 Before the Subcommittee on Energy and Power of the House Comm. on Commerce*, 106th Cong. 192 (1999) (statement of Lynne Church), available at <http://com.notes.house.gov/ccheat/hearings106.nsf/20c324c6a1a1950a8525680f0067184a/5aa27673532e03ae85256992007b1644?OpenDocument> (last visited Oct. 25, 2001).

<sup>174</sup>Bruce W. Radford, *Transmission on Trial?*, PUB. UTIL. FORT., March 15, 2001, at 4, available at LEXIS, News Library, ALLNEWS file.

In the absence of a clearly “fairer” policy, it makes sense to look at the other effects of native load preferences. California has argued that a native-load preference is consistent with consumer protection in general, stating that “[i]n times when transmission is short . . . States commonly require electric utilities to protect first the retail customers to whom public utility obligations are owed.”<sup>175</sup> This very protection of retail customers, however, can turn into protectionism of state customers at the expense of customers in other states. A recent report on transmission policy found that this type of protectionism was in fact taking place, and was having a negative impact on open access in general.<sup>176</sup> According to this report, the only solution to such protectionism lies in “requiring that all transmission transactions use the OASIS structure—removal of the native load exclusion. This will bring far greater accuracy to the setting of [available transmission capacity] . . . .”<sup>177</sup> Hence, the goal of fairness may be better served by eliminating the native load exclusion and treating all customers equally.

#### *E. Federalism*

Finally, in addition to other policy goals, Congress may wish to ensure that states continue to play a vital role in regulating transmission. The Supreme Court has noted that “Congress is acutely aware of the existence and vitality of these state governments. It sometimes is moved to respect state rights and local institutions even when some degree of efficiency of a federal plan is thereby sacrificed.”<sup>178</sup>

States may be afraid of losing power even if they have never really used that power, however, especially in the context of jurisdiction over transmission; author Bruce W. Radford pointed out that within the last twenty years, no state has engaged in a rate case to determine the prudence of investment in transmission.<sup>179</sup> In his view, the state position is without merit: state PUCs are “suddenly filled with desire to recapture the power they never used.”<sup>180</sup> States may be taking a somewhat inconsistent position in desiring to keep power that is rarely exercised. Nonetheless, any bill that Congress passes would need the support of the states to be effective. As the Supreme Court noted, “Congress may think it expedient to avoid clashes between state and federal officials in administering an act . . . .”<sup>181</sup> Such expediency means that Congress must write legislation to strike a balance between regulatory power

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<sup>175</sup>Narashima Rao & Richard D. Tabors, *Transmission Markets: Stretching the Rules for Fun and Profit*, TCA Working Paper No. 327-0400, June 2000, available at <http://www.stoft.com/x/outside/open1.pdf> (last visited Oct. 25, 2001).

<sup>176</sup>*Id.*

<sup>177</sup>*Id.*

<sup>178</sup>*Connecticut Light & Power Co. v. Fed. Power Comm’n*, 324 U.S. 515, 530 (1945).

<sup>179</sup>Bruce W. Radford, *Transmission on Trial*, PUB. UTIL. FORT., March 15, 2001, available at LEXIS, News Library, ALLNEWS file.

<sup>180</sup>*Id.*

<sup>181</sup>*Conn. Light & Power Co. v. FPC*, 324 U.S. 515, 530 (1945).

that maximizes efficiency, while still presenting a regulatory solution that is acceptable to the states.

#### IV. RECOMMENDATIONS

Congress's challenge is to craft legislation that both facilitates the policy goals outlined above and is politically acceptable enough to secure the cooperation of FERC and the states. This proposition sounds idealistic, but in recent years a number of bills have been proposed in Congress that may be able to strike just this balance. Some of the best proposals are the following:

(1) Give permission for the states to enter into interstate compacts for siting decisions. H.R. 2944, introduced in 1999, would have permitted such compacts. The bill provided that "[t]he consent of Congress is given for compacts among two or more States to establish regional transmission siting agencies to . . . facilitate coordination among the States within a particular region with regard to the siting of future transmission facilities."<sup>182</sup>

This proposal would combine the efficiency of regional siting decisions with the desire to maintain traditional state power. It would be in the states' best interest to join such a compact, for the transmission shortage affects all states connected to the interstate grid. Furthermore, transmission shortages are more likely to affect an entire region, and not just a single state—for example, a recent transmission disruption between Ontario and Michigan caused a price spike in Illinois, Indiana, and Ohio.<sup>183</sup> There is still the question as to whether the regional siting agencies would be as equipped to handle local issues like the "irate farmer with cows in tow."<sup>184</sup> However, a regional agency is probably more in touch with local needs than a federal agency would be, and the "irate farmer" would yield less political influence at the regional level than he would at the state level. Thus, the regional agency would likely be able to deal with such complaints without necessarily letting local politics overrule regional needs.

(2) Codify FERC's jurisdiction over unbundled retail transmission and also codify the states' power over bundled retail transmission. From a pure efficiency standpoint, it would probably be preferable to allow FERC to have jurisdiction over both bundled and unbundled transmission transactions.<sup>185</sup> In the interest of getting the legislation passed, however, this is probably a case where Congress ought to be "moved to respect state rights and local institutions even when some degree of efficiency of a federal plan is thereby sacrificed."<sup>186</sup> During the 106th Congress, Representative Barton had enough votes to pass a bill out of the House Committee

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<sup>182</sup>See *Electricity Competition and Reliability Act of 1999: Hearing on H.R. 2944 Before the Subcommittee on Energy and Power of the House Comm. on Commerce*, 106th Cong. (1999), available at <http://com-notes.house.gov/cchea/hearings106.nsf/20c324c6a1a1950a8525680f0067184a/5aa27673532e03ae85256992007b1644?OpenDocument> (last visited Oct. 25, 2001).

<sup>183</sup>See *supra* note 100.

<sup>184</sup>See *supra* text accompanying note 130.

<sup>185</sup>See *supra* text accompanying notes 97-132.

<sup>186</sup>*Conn. Light & Power Co.*, 324 U.S. 530; see discussion *supra* at text accompanying notes 174-77.

on Commerce that would have codified FERC's jurisdiction over unbundled transmission.<sup>187</sup> This bill also contained a provision to protect open access that "would provide FERC policing authority to step in if transmission users could prove that a state had been lax in preventing utilities from favoring their own generation in granting transmission access."<sup>188</sup> Unfortunately, the bill failed because another representative pushed a new version of the bill that would have given FERC full jurisdiction over bundled as well as unbundled transmission, but brought objection from legislators who did "not want to take away traditional state authority."<sup>189</sup>

The original bill should be revived; it should contain the open access provision allowing FERC to step in if necessary, but should also contain language codifying that states have primary jurisdiction over bundled sales. The bill would have the advantage of ending the uncertainty that comes from the Supreme Court's review of *New York v. FERC*, for the bill would render the Supreme Court's decision immaterial. Furthermore, if (as posited in Part II of this paper) the Supreme Court finds that all retail transmission falls under state regulation, then the bill would protect FERC's open access requirements in a way that would be acceptable to most states—notably, at a meeting where the Barton bill was discussed, state regulators were said to be "fairly receptive to the idea."<sup>190</sup> Finally, the "safety" provision allowing FERC to step in if the states were shown to be too lax would also aid in promoting open access—states would be likely to enforce fairly strict open transmission programs in order to avoid having FERC take over regulation.

(3) Extend FERC's authority to cover more transmission-owning utilities. As discussed in Subpart III(A)(3), extending FERC jurisdiction to municipal utilities, rural cooperatives, federal utilities, and power marketing administrations would promote open access and competition. Politically, this may be a hard proposition to pass—after all, the American Public Power Association is a fairly powerful lobbying force. If it appears unable to pass, then perhaps a provision similar to that proposed for bundled transmission might be more acceptable; such a provision would state that FERC could assert authority over such utilities only upon a finding that the utilities had been engaging in undue discrimination. Even if FERC never asserted authority over these utilities, the threat alone might be enough to encourage the utilities to provide transmission at fair and nondiscriminatory rates.

(4) Create mandatory Regional Transmission Organizations. The idea of mandatory RTOs is actually less controversial than most of the other propositions.<sup>191</sup> The biggest issues with mandatory RTOs may well be in the planning. Certainly, the proposed RTOs should be carefully crafted and all participants should agree on their parameters. Such agreement may be secured most easily if the functions of the RTO are fairly limited. An RTO would not need to make siting decisions or demand

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<sup>187</sup>*Bliley, Barton Have Dueling Proposals On Transmission As Bill Goes To Markup*, POWER MARKETS WK., June 12, 2000, available at LEXIS, News Library, ALLNEWS file.

<sup>188</sup>*Id.*

<sup>189</sup>*Bliley Pulls Comprehensive Bill From Vote, Dimming Outlook More*, ELECTRIC UTIL. WK., July 17, 2000, available at LEXIS, News Library, ALLNEWS file.

<sup>190</sup>*Bliley, Barton Have Dueling Proposals On Transmission As Bill Goes To Markup*, POWER MARKETS WK., June 12, 2000, available at LEXIS, News Library, ALLNEWS file.

<sup>191</sup>*See supra* text accompanying notes 116-125.



facility expansion, for example, if states in the region had created an interstate compact to handle such decisions.

An RTO would be best equipped to handle regional pricing decisions—ensuring that rate pancaking was avoided, for example, and facilitating nondiscriminatory transmission. FERC would play a mostly supervisory role; ideally, as noted in an article on transmission policy, FERC would “monitor[] the performance of the self-regulatory RTO much like the relationship among the SEC and the large securities exchanges.”<sup>192</sup> The RTO could also enforce reliability standards and maintain the grid.

(5) Replace the current seven-factor test with a brightline voltage test. FERC’s current seven-factor test to distinguish transmission from distribution is perhaps highly accurate, but it encourages uncertainty by allowing utilities to “game” the system by relabeling transmission assets as distribution. FERC should not wait to see if there is an adverse impact on open access, but should proactively remove utilities’ incentive to engage in discrimination through asset relabeling. The “rebuttable presumption” based on voltage discussed in Subpart III(C)(1) would provide greater certainty while still allowing utilities to challenge a determination that was felt to be inaccurate.

(6) Remove the native load exclusion. Because of the decision in *Northern States Power*, eliminating the native load preference cannot be done by FERC. However, legislation was proposed in Congress that would remove the native load exclusion.<sup>193</sup> This legislation is likely to provide a benefit through eliminating some discriminatory treatment that is currently occurring in the wholesale market. While it is possible (though uncertain) that the bill could be detrimental to customers who are currently protected by the native load exclusion, such customers could be protected by adding general customer protections to the bill. Such protections could, for example, require utilities to consider whether a curtailment could result in any customers being unable to purchase power. Such a protection would be different from the current native load exclusion because the utility would have to analyze not just whether its own native load would be displaced, but whether any utility’s captive customers would be harmed. So, in the case of *Northern States Power*, a Minnesota utility would have to weigh the needs of its own customers against the needs of the neighboring Wisconsin customers. Such a solution is far from perfect—it seems likely that a utility would always want to weigh its own customers’ needs more heavily—but nevertheless, such a policy could offer some measure of increased consumer protection while decreasing the amount of transmission discrimination that currently exists under the native load exclusion.

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<sup>192</sup>Charles H. Koch Jr., *Control and Governance of Transmission Organizations in the Restructured Electricity Industry*, 27 FLA. ST. U.L. REV. 569, 586 (2000).

<sup>193</sup>See *Electricity Competition and Reliability Act of 1999: Hearing on H.R. 2944 Before the Subcommittee on Energy and Power of the House Comm. on Commerce*, 106th Cong. 51 (1999) (statement of Hon. James J. Hoecker, Chairman, Federal Energy Regulatory Commission), available at <http://com-notes.house.gov/cchea/hearings/106.nsf/20c324c6a1a1950a8525680f0067184a/5aa27673532e03ae85256992007b1644?OpenDocument> (last visited Oct. 25, 2001).

## V. CONCLUSION

Increased competition in the electricity industry in recent years has had the unfortunate effect of slowing transmission growth, just at the time that transmission transactions are growing rapidly.<sup>194</sup> Competition has also emphasized the lack of clear dividing lines between state and federal jurisdiction over transmission, and the Supreme Court will soon be determining where that line ought to be drawn.<sup>195</sup> Such a decision will likely focus more on statutory interpretation than on determining sound policy. Regardless of what the Court may decide, therefore, this paper argues that Congress needs to craft a new transmission policy that encompasses policy concerns and enacts a course of action that will benefit electricity consumers around the country. This paper further argues that the best policy would be one that extends federal power over transmission while still remaining sensitive to state interests. Such a policy would go a long way toward helping the industry move toward competition while maintaining reliable, low-cost electricity service.

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<sup>194</sup>*See supra* text accompanying note 7.

<sup>195</sup>*See supra* Part II.