REGULATING PUBLIC UTILITY PERFORMANCE: THE LAW OF MARKET STRUCTURE, PRICING AND JURISDICTION

By Scott Hempling

Reviewed by Jonathan Schneider*

Very unlike such fundamental areas of legal study as the law of torts or contracts, public utility law cannot be well understood if studied as an inventory of fixed principles and cases. The core statutory provisions can be counted on one hand; they are broadly phrased and not much more than vessels into which evolving meaning has been poured as the industries they govern change. Perhaps more like antitrust law, public utility law calls for an appreciation of the dynamic nature of the industries to which it is addressed, and the unique economic history of the industrial sectors they comprise. Complicating matters further, public utility law is both reactive, in the sense that it responds to the issues and crises of the day, and normative, insofar as it is capable of altering the behavior of regulated entities, their customers, and associated stakeholders, and changing the very structure of the industries and individual companies subject to regulation.

For something more than the past thirty years, a great deal of the ferment in public utility law has sprung from the introduction of competition into specific segments of the vertically integrated utility structure, and a reexamination of the regulation applicable to the industry segments that remain fully monopolistic, with the aim of facilitating fair competition. The impetus for this structural change came initially from the courts, applying antitrust theory to networked industries. This, of course, was the case with the Modification of Final Judgment issued in *United States v. American Telephone & Telegraph Co. (AT&T)*, directing AT&T to divest itself of the Bell Operating Companies in order to ensure a competitive market for long distance service and customer equipment.[1] And it was so in *Otter Tail Power Co. v. United States*, requiring transmission wheeling as a remedy for anticompetitive behavior and thereby paving the way for an open access transmission grid.[2] Legislation has played a role, as with the creation of the independent power producer sector through section 210 of the Public Utilities Regulatory Policies Act of 1978[3] and deregulation of natural gas production through the Natural Gas Policy Act.[4] And regulatory agencies stepped into the mix in setting the ground rules for competition, from the Federal Communication Commission's Computer II

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1. United States v. American Telephone & Telegraph Co. (AT&T), 552 F. Supp. 131 (D.C.D. 1982).
2. Otter Tail Power Co. v. United States, 40 U.S. 366 (1973).
3. 16 U.S.C. § 824a-3 (2012).
4. 15 U.S.C. §§ 3301-432 (2012).

inquiry to orders directing open access for competitive suppliers in the gas and electric sectors.[5]

Scott Hempling's *Regulating Public Utility Performance: The Law of Market Structure, Pricing and Jurisdiction*, shows an acute appreciation for the history of economic regulation and the role that the courts and evolving regulatory theory have had in driving changes in these industries.[6] The book was not written in a literary vacuum, of course, and it builds on a robust body of work upon which Hempling liberally relies.[7] But Hempling's unique contribution to the literature, coming now over three decades into the competitive revolution, is to turn a discussion that once included competition and market structure as an afterthought, into the main event. The table of contents alerts the reader. Part One is entitled "Market Structure: From Monopolies to Competition—Who Can Sell What to Whom" while Part Two addresses "Pricing" and traditional regulatory concepts. The organization of the book quite literally turns the venerable *Principles of Public Utility Rates*[8] on its head.

Read once over, as a description of the current state of play, and as a story of the legal and regulatory milestones along the way, *Regulating Public Utility Performance* is well worthwhile. Hempling's approach is philosophical, the book is well-written, and the discussion proceeds from a thoughtful reflection on basic principles (the purpose and subject of regulatory law), to the characteristics of a retail monopoly, and on to the case for competition and its application to discrete segments of the telecommunications, gas, and electric sectors. Along the way, Hempling provides a good account of core regulatory concepts, and he retells the history of telecommunications, gas, and electric industries, discussing seminal decisions and orders shaping the current state of play.

Regulating Public Utility Performance will surely be a good teaching tool, read cover to cover. Hempling was the Executive Director of the National Regulatory Research Institute for some years, and serves as an adjunct professor of public utility law at Georgetown University Law Center. No doubt, the book incorporates much of the material employed in those settings and will surely add

5. *See, e.g.*, FERC Order Nos. 436, 636, 888. Order No. 888, *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, F.E.R.C. STATS. & REGS. ¶ 31,036, 61 Fed. Reg. 21,540 (1996) (to be codified at 18 C.F.R. pts. 35, 385); Order No. 636, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Wellhead Decontrol*, F.E.R.C. STATS. & REGS. ¶ 30,939, 57 Fed. Reg. 13,267 (1992) (to be codified at 18 C.F.R. pt. 284); Order No. 436, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, F.E.R.C. STATS. & REGS. ¶ 30,665, 50 Fed. Reg. 45,907 (1985) (to be codified at 18 C.F.R. pts. 2, 157, 250, 284, 375, 381).

6. SCOTT HEMPLING, REGULATING PUBLIC UTILITY PERFORMANCE: THE LAW OF MARKET STRUCTURE, PRICING AND JURISDICTION (2013).

7. Hempling's sources run from the groundbreaking ALFRED KAHN, THE ECONOMICS OF REGULATION (Mass. Inst. of Tech. 1988) (1970), to RICHARD J.PIERCE, JR. & ERNEST GELLHORN, REGULATED INDUSTRIES IN A NUT SHELL 21 (West Grp. 4th ed. 1999), to FREDRICK M. SCHERER & DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 21-23 (Houghton Mifflin 3d ed. 1990); RICHARD PIERCE & ERNEST GELLHORN, REGULATED INDUSTRIES 38-62 (1990); and JOSEPH P. TOMAIN & RICHARD D. CUDAHY, ENERGY LAW IN A NUT SHELL 26-32 (West 2004).

8. JAMES C. BONBRIGHT, ALBERT L. DANIELSEN & DAVID R. KAMERSCHEN, PRINCIPLES OF PUBLIC UTILITY RATES (Pub. Utils. Reports, Inc. 1988).

value for students and practitioners looking for a broad-based context in which to understand the sea of material available in this area. For a generation of attorneys, a broad-based background in various aspects of energy regulation and an appreciation for its evolution has been somewhat difficult to come by without extensive exposure over the course of many years. The sources of what one thinks of as the body of public utility law are numerous and found in a long list of statutes and decisions at the federal and state level. As well, while authority from one networked industry has clear implications for the others, these authorities are not often drawn together, even by regulators who have purview over multiple industries. Hempling does a good job of organizing these varied authorities thematically. Students of law, industry professionals, and regulators will no doubt benefit from the work.

Whether the book will serve as a useful research tool is not quite as clear. In part because the material is presented thematically (Chapter 2 is entitled "The Traditional Utility Monopoly;" Chapter 3, "Authorizing Competition;" and Chapter 4, "Making Competition Effective"), certain legal concepts are discussed with different emphasis in different places in the book (eminent domain,[9] constitutional constraints,[10] and just and reasonable rates,[11] for example). Moreover, the index (at least as of the time of this early review) appears not to be as extensive as it might be. In fairness, it seems probable that organizing the material otherwise would have limited its narrative strength.

If there is a substantive shortcoming, it is in providing only modest attention to concerns regarding the operation and structure of evolving markets, particularly in the electric sector. Concern over the operation of independent system operator (ISO) markets came dramatically to the public's attention initially during the California Energy Crisis of 2001,[12] though the event warrants little more than a footnote in *Regulating Public Utility Performance*.[13] Suggesting strongly that the markets remain susceptible to manipulation, the past two years have been witness to FERC settlements with sophisticated players in the hundreds of millions of dollars each,[14] while Hempling devotes just two pages to the subject.[15]

On a more structural level, there is at least a reasonable question whether a narrative that draws a straight line from the day the first independently-owned telephone was plugged into the Bell System to the operation of a regional transmission organization's (RTO) bid-based security constrained economic

9. HEMPLING, *supra* note 6, at 55-61, 93-96.

10. *Id.* at 96-115, 221-27.

11. *Id.* at 213-85.325-37, 408-09.

12. *See generally Addressing the 2000-2001 Western Energy Crisis*, FERC, http://www.ferc.gov/industries/electric/indus-act/wec.asp (last updated Oct. 21, 2010) (providing the chronology of events and actions taken in response).

13. HEMPLING, *supra* note 6, at 340, 343 & n.12.

14. *See, e.g.*, *Make-Whole Payments and Related Bidding Strategies*, 144 F.E.R.C. ¶ 61,068 (2013) (approving stipulation and consent agreement with JP Morgan Ventures Energy Corp. and assessing a civil penalty of $285M and disgorgement of $125M); *Constellation Energy Commodities Grp., Inc.*, 138 F.E.R.C. ¶ 61,168 (2012) (ordering approving stipulation and consent agreement, assessing a $135M civil penalty and $110M disgorgement).

15. HEMPLING, *supra* note 6, at 204-05, 349-50.

dispatch with locational marginal cost transmission pricing framework[16] does not call for some pause to consider the cost of the system, its enormous complexity, its susceptibility to manipulation (owing to its complexity), and its efficacy in achieving identified goals. Some good work raising these questions has been done by the American Public Power Association and others,[17] and FERC has itself recently asked whether RTO generation capacity markets have worked as intended in bringing forth needed generating capacity at an appropriate price.[18] It has been roughly twelve years since FERC abandoned its Standard Market Design initiative, designed to create RTOs in parts of the nation where none exist, and the nation remains divided over the merit of these organizations.[19] Hempling's book need not answer these questions, but it seems something of a disservice not to air them fully.

Having said that, *Regulating Public Utility Performance* is a work meriting serious attention as a meaningful contribution to the literature on public utility regulation.

16. *Id.* at 70-84.

17. *See, e.g.*, *Electric Market Reform Initiative (EMRI)*, AMER. PUB. POWER ASS'N, www.publicpower.org/Programs/interiordetail2col.cfm?ItemNumber=38695&navItemNumber=38586 (last visited Nov. 19. 2013).

18. Notice, *Centralized Capacity Markets in Regional Transmission Organizations and Independent System Operators*, FERC Docket No. AD13-7-000 (Oct. 25, 2013).

19. Order No. 2000, *Regional Transmission Orgs.*, F.E.R.C. STATS. & REGS. 31,089, 65 Fed. Reg. 809 (1999), *order on reh'g*, Order No. 2000-A, F.E.R.C. STATS. & REGS. 31,092, 65 Fed. Reg. 12,088 (2000).