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NANTAHALA AFFIRMS NARRAGANSETT—WHITHER PIKE COUNTY?

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In its long-awaited decision in *Nantahala Power & Light Co. v. Thornburg, Attorney General of North Carolina*,¹ the United States Supreme Court on June 17, 1986, decisively affirmed the so-called *Narragansett*² doctrine, ruling that once the Federal Energy Regulatory Commission sets rates for wholesale power sales in interstate commerce, a state regulatory commission cannot conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable. Breaking new ground, the Court went beyond the "more or less common sense proposition [of *Narragansett*] that one level of regulatory scrutiny of a particular item of rate base or expense ought to be enough,"³ by holding that the "filed-rate" doctrine⁴ "is not limited to 'rates' *per se*: 'our inquiry is not at an end because the orders do not deal in terms of prices or

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1. 106 S. Ct. 2349 (1986).

2. *Narragansett Electric Co. v. Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978).

3. Address by Peter A. Bradford, Chairman, Maine Public Utilities Commission, to the 17th Annual Conference of the Institute of Public Utilities, Williamsburg, Virginia, *Brought to You by the Brewers of Narragansett: FERC, Middle South and State Electric Utility Regulation 2* (December 9, 1985).

4. *See Montana-Dakota Util. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 259-62 (1951), in which the Court held that "the right to a reasonable rate is the right to the rate which the Commission files or fixes, and that, except for review of the Commission's orders, the courts can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one."

volumes of purchases.'"⁵

While the debate continues about the significance of the *Nantahala* decision, it is already clear that the decision does not lay to rest all of the conflict that has raged for the past several years over the issue of federal versus state jurisdiction to regulate electric utilities. This paper examines *Nantahala*, its ancestors, and its likely progeny, and points out some questions it does not answer. Illustrating Justice Holmes' observation that "hard cases make bad law,"⁶ this paper suggests that the excesses of construction, cost, and creative financing in the electric industry over the past decade are bringing about a fundamental shift in the locus and purpose of electric utility regulation in the United States, particularly with respect to large, multi-state integrated utility holding company systems and utilities with massive, "catastrophically uneconomical"⁷ nuclear construction projects. The result of this shift is an increasing transfer of regulatory jurisdiction to the FERC and away from the states, with a corresponding impetus toward permitting utilities full-costs recovery of failed construction ventures and away from ratepayer protection at the retail level.

What *Nantahala* leaves undecided for the present, it appears, are the following questions:

1. In what situations can the states, in setting retail rates, determine that a *purchaser* was imprudent in agreeing to buy wholesale power at a FERC-approved rate?

2. Can the FERC compel anyone to purchase power at rates it has found to be just and reasonable?

3. To what extent does affiliation with a public utility holding company or membership in a multi-state power pool affect the answers to questions 1 and 2?

I. NANTAHALA: OMENS AND OPPORTUNITIES FOR STATE REGULATORS

While the Supreme Court's decision in *Nantahala* acknowledges the states' "undoubted jurisdiction over retail rates"⁸ and while the facts of the case did not present issues involving public utility holding companies or "allocations" of nuclear plant costs, the language of the Court's 7-0 opinion may pre-empt difficulty for state regulators dealing with those issues. At the same time, it may permit states to continue applying the prudence-of-purchase standard in setting retail rates that was first clearly articulated in *Pike County Light & Power Co. v. Pennsylvania Public Utility Comm'n.*⁹ In that case, the Common-

5. *Nantahala*, 106 S. Ct. at 2357 (citation omitted).

6. *Northern Sec. Co. v. United States*, 193 U.S. 197, 400 (1904) (Holmes, J., Dissenting).

7. *Mississippi Indus. v. FERC*, No. 85-1611, slip op. at 7 (C.A.D.C. Jan. 6, 1987).

8. *Nantahala*, 106 S. Ct. at 2359.

9. 77 Pa. Commw. 268, 273-74, 465 A.2d 735, 737-38 (1983). For an excellent review of federal and state decisions on *Pike County* and *Narragansett* issues, see Pfeffer & Lindsey, *The Narragansett Doctrine: An Emerging Issue in Federal State Electricity Regulation*, NAT'L REGULATORY RESEARCH INST. Occasional Paper No. 8 (Dec. 1984). This report was updated recently by the same authors in Pfeffer & Lindsey, *The Narragansett Doctrine: A 1986 Update*, NAT'L REGULATORY RESEARCH INST. (Aug. 1986). See also Hobelman, *The Narragansett Decision and Its Aftermath*, 6 ENERGY L.J. 33 (1985); Note, *The Role of the States in Energy Regulation*, 4 ENERGY L.J. 255 (1983); Note, *Has the Supreme Court Pulled the Plug*

wealth Court of Pennsylvania capitalized upon the opportunity to distinguish between the *sale* of power at wholesale, which it recognized was under the FERC's exclusive jurisdiction pursuant to Section 205 of the Federal Power Act,¹⁰ and the *purchase* of power at a FERC-fixed rate. The court held:

[W]hile the FERC determines whether it is against the public interest for Orange & Rockland to charge a particular rate in light of its costs, the PUC determines whether it is against the public interest for Pike to pay a particular price in light of its alternatives. The regulatory functions of the FERC and the PUC thus do not overlap¹¹

While ruling that on the facts of *Nantahala*, the North Carolina Supreme Court could not rely on the *Pike County* principle to avoid federal preemption, the U.S. Supreme Court indicated some sympathy for use of the prudence-of-purchase test by retail regulators. Citing *Pike County*, Justice O'Connor wrote for the Court:

Without deciding this issue, we may assume that a particular *quantity* of power procured by a utility from a particular source could be deemed unreasonably excessive if lower-cost power is available elsewhere, even though the higher-cost power actually purchased is obtained at a FERC-approved, and therefore reasonable, *price*.¹²

A brief description of the facts in *Nantahala* illustrates why the foregoing passage from the Court's opinion is dicta, notwithstanding its favorable portents for state regulation.

Nantahala Power & Light Co. and its affiliate Tapoco, Inc. own hydroelectric power plants from which they supply a variable quantity of power to the Tennessee Valley Authority's grid in exchange for low-cost entitlement power. High-cost purchased power is also obtained from TVA by Nantahala. While Tapoco serves only the Aluminum Company of America, which is the parent company to both, Nantahala has retail customers in North Carolina and is subject to the jurisdiction of the North Carolina Utilities Commission.

In the early 1970's, Nantahala and Tapoco filed a proposed wholesale power sales agreement with the FERC in which the parties agreed to a 20%/80% split of TVA "entitlement power," respectively. Entitlement power is cheaper hydroelectric power than other power purchased from TVA. Despite this agreement among the Alcoa affiliates, in May 1982, the FERC found that the voluntary inter-company allocation did not produce just and reasonable rates and ordered Nantahala to file revised rates in accordance with its finding that "the most equitable division of entitlements would give Nantahala that portion of . . . entitlements which is proportionate to the utility's actual contribution of power turned over to TVA."¹³ This portion was 22.5% rather than 20%. Subsequently, the North Carolina Utilities Commission, in a Nantahala retail rate proceeding, imputed a larger, 24.5%, share of the lower-costs power

from *Under the FERC's Electric and Natural Gas Regulation?* 4 ENERGY L.J. 251 (1983).

10. 16 U.S.C. § 824d (1982).

11. *Pike County*, 77 Pa. Commw. at 274, 465 A.2d at 738. See also *Kentucky-West Va. Gas Co. v. Pennsylvania Pub. Util. Comm'n*, No. 85-1514, slip op. (M.D. Pa. Dec. 23, 1986); *Kansas-Neb. Natural Gas Co. v. State Corp. Comm'n*, 4 Kan. App. 2d 674, 679-80, 610 P.2d 121, 127 (1980); *Commonwealth Elec. Co. v. Department of Pub. Util.*, 397 Mass. 361, 491 N.E.2d 1035 (1986), *petition for cert. filed*, Docket No. 86-61 (July 18, 1986); *Appeal of Sinclair Machine Prods., Inc.*, 498 A.2d 696 (N.H. 1985).

12. *Nantahala*, 106 S.Ct. at 2360 (emphasis in original).

13. *Nantahala Power & Light Co.*, 19 F.E.R.C. ¶ 61, 278 (1982).

to Nantahala. In so doing, the North Carolina commission put Nantahala in a "squeeze" between the federal and state jurisdictions and thereby stepped over the *Narragansett* line. The Supreme Court reversed the North Carolina Supreme Court's affirmance of the state commission's order imputing an allocation of entitlement power to Nantahala larger and more favorable to the utility's North Carolina retail ratepayers than the FERC's allocation. The Supreme Court held:

The filed-rate doctrine ensures that sellers of wholesale power governed by FERC can recover the costs incurred by their payment of just and reasonable FERC-set rates. When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail rates to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate Such a 'trapping' of costs is prohibited. Here, Nantahala cannot fully recover its costs of purchasing at the FERC-approved rate if NCUC's order is allowed to stand.¹⁴

In short, therefore, the Court found that North Carolina was precluded from pretending that Nantahala was "paying less for the power it receives from TVA, under agreements not subject to NCUC's jurisdiction, than is in fact the case."¹⁵

Finally, despite the fact that the issue of the FERC's jurisdiction to allocate entitlement power between Nantahala and Tapoco was not an issue in the case, the Supreme Court found that the FERC order to Nantahala to adjust its wholesale rates so that its costs of power reflected an allocation of 22.5% rather than 20% of TVA entitlements power, while not actually reformation of the Nantahala/Tapoco apportionment agreement, was "essentially the same as reformation of the agreement itself."¹⁶ This language in the opinion undoubtedly will be cited by some observers as dispositive of the issue of FERC's jurisdiction to "allocate" and "re-allocate" power among public utility holding company affiliates, as the FERC has done in the *Middle South* cases,¹⁷ which were recently affirmed by a panel of the Court of Appeals for the District of Columbia Circuit.¹⁸ This argument will be pressed despite the fact that *Nantahala* in no way concerned the placing into rates of the costs of new generating facilities or the issue of the FERC's jurisdiction over such facilities under section 201(b) of the Federal Power Act,¹⁹ both of which are presented by *Middle South*. Last, *Nantahala* did not address the issue of forced purchases, which appellants in *Middle South* have raised in the context of the FERC's order that Middle South Utilities, Inc., affiliate Arkansas Power & Light Co. (AP&L), must take and pay for an "allocation" of 36% of the cost of the Grand Gulf Nuclear Plant, notwithstanding that the unit power sales agreement voluntarily entered into by AP&L's three sister companies and Middle South Energy, Inc. (MSE), Grand Gulf's owner, provided for the sale by MSE of all of the Grand Gulf power to those three companies and none of it to AP&L. (AP&L was a

14. *Nantahala*, 106 S. Ct. at 2360.

15. *Id.* at 2359.

16. *Id.*

17. Middle Energy, Inc. and Middle Serv. Inc., Opinion Nos. 234 and 234-A, 31 F.E.R.C. ¶ 61,305 and 32 F.E.R.C. ¶ 61,425 (1985) [hereinafter *Middle South*].

18. *Mississippi Indus. v. FERC*, No. 85-1611 slip op. at 37-39, 50-51 (C.A.D.C. Jan. 6, 1987).

19. 16 U.S.C. § 824(b) (1982).

signatory to but not a party to that agreement.) In short, neither the wholesaler-as-seller, MSE, nor AP&L entered into an agreement with the other for the sale of power for which FERC-approval was sought, and yet the FERC has "allocated" the single largest share of power and costs to that nonpurchaser, AP&L. As indicated, the remainder of this paper will examine the nexus between *Nantahala, Pike County*, and the prudence-of-purchase and forced-purchase cases now working their way toward the Supreme Court.²⁰ Before doing so, however, it is necessary to survey the evolution of the prudence-of-purchase doctrine, as seen through the eyes of the FERC and the states, in order to better understand the current state of the law in this fecund area.

II. ORIGINS OF PIKE COUNTY—THE "OLD FERC" ON PRUDENCE OF PURCHASE

In 1981, the FERC planted a seed that eventually grew into the "Old FERC"/*Pike* prudence-of-purchase corollary to the *Narragansett* doctrine. In *Philadelphia Electric*,²¹ the Commission accepted an agreement for the interstate sale of capacity and energy over the objections of the Pennsylvania Consumer Advocate, who had alleged that Philadelphia Electric (PE) had agreed to sell power to Jersey Central Power & Light at a rate that was not compensatory to PE or its customers in Pennsylvania. The Commission stated:

Further, our decision to accept the contract rate and service arrangement is not predicated on a determination that, over the initial terms of the contract, PE could have done no better selling to someone else, or that Jersey Central could have done no better buying from someone else, or that the transaction over this period will redound to the benefit of the retail and wholesale requirements customers of the two respective parties to the contract. It does appear that PE's other customers will realize a net benefit from this transaction over the initial term of the contract; but *we did not mean by this order to prejudge, for our own purposes or those of the respective state commissions, a determination of the prudence of either party in entering into this transaction.*²²

Two years later, in *Pennsylvania Power & Light Co.*,²³ FERC repeated its disclaimer of preemption over prudence-of-purchase issues, although it warned the New Jersey Board of Public Utilities not to engage in "Monday-morning quarterbacking" of decisions by PP&L to construct plant, declaring:

We therefore suggest that evaluation of the prudence of a 1979 power contract on the basis of 1982 demand forecasts is neither fair nor appropriate. Thus, while we commend the New Jersey Board for its concern in protecting the ratepayers within its jurisdiction, we do not believe that this protection can be at the expense of Pennsylvania ratepayers and utilities. The latter are entitled to rely on the fact that New Jersey utilities will honor their *contractual commitments* to purchase capacity built at least partly to fulfill their contractual demand.²⁴

The next year, in *Southern Company Services*,²⁵ the FERC restated its

20. See *infra* notes 79, 80, and 99.

21. 15 F.E.R.C. ¶ 61,264 (1981).

22. *Id.* at 61,601 (emphasis added).

23. 23 F.E.R.C. ¶ 61,006 (1983).

24. *Id.* at 61,019 (emphasis added).

25. 26 F.E.R.C. ¶ 61,360 (1984).

conservative view of its ability to review the prudence of purchases, finding that "the Commission is not empowered to disapprove or modify a power sales agreement on the grounds that the buyer may not be making the best possible deal."²⁶ The Commission then said: "As we held in another case involving Southern Companies, the question of the prudence of a utility's power purchases is properly an issue in the buying utility's rate case where it seeks to pass the costs of its purchased power on to its ratepayers."²⁷ It should be noted that the Commission then declared that, in that case, if and when the wholesaler-as-buyer (Gulf States) made a rate filing with the FERC reflecting its costs under the contracts with the wholesaler-as-seller (Southern Company Services), "any interested party may intervene and challenge those costs."²⁸ The significance of this statement is that the FERC implicitly acknowledged its ability to review the prudence of purchase by Gulf States in the limited context of a Gulf States wholesale rate case in which Gulf States sought to charge its wholesale customers (such as municipalities) the FERC-approved costs paid to Southern—an entirely logical and yet separate issue from prudence-of-purchase reviews by the states at the retail level. As will be seen, however, the FERC becomes mired down on this point when it comes to the issue of unit power sales among subsidiaries of holding companies, as in *Middle South* and *AEP Service Corp.*, *infra*. In those cases the FERC fails to recognize the significance of the fact that a holding company subsidiary may—at one and the same time be (1) a wholesaler-as-purchaser for resale at wholesale (to a municipality, for example, at a rate fixed by the FERC) and (2) a wholesaler-as-purchaser for sale at retail (to retail customers at a rate fixed by state regulators). Under the "old-FERC" view of the prudence-of-purchase principle, the FERC would review the prudence of the purchase only in the first situation—and then, only if the municipal purchaser, FERC staff, or some intervenor raised the issue in a wholesale rate case. In the second second situation, only the state or local regulator would examine the prudence of the retailer in making the purchase. These results would be consistent with *Pike County* and the early FERC interpretations of its powers and responsibilities vis-a-vis the states in *Philadelphia Electric*, *Pennsylvania Power*, and *Southern Company Services*, all discussed *supra*. And, more significantly, the prudence-of-purchase principle could be intelligibly, consistently, and fairly applied to purchase by both affiliates and non-affiliates—thus eliminating the nonsensical double-standard that results from the "new-FERC's" current interpretation that the states cannot review the prudence of a purchase when he purchaser and seller are affiliated and part of an integrated system.

As discussed earlier, after *Pike County* was decided by the Commonwealth Court of Pennsylvania in 1983, other state courts began to enunciate the prudence-of-purchase doctrine in response to utility arguments and even state commission findings of preemption. The New Hampshire Supreme Court, in *Appeal of Sinclair Machine Products, Inc.*,²⁹ reversed and remanded a state PUC

26. *Id.* at 61,795.

27. *Id.*

28. *Id.*

29. 498 A.2d 696 (N.H. 1985).

decision which had assumed that *Narragansett* required the PUC to pass through FERC-approved wholesale rates without change. The New Hampshire court found that the utility had not met its burden of showing that the purchase at the FERC-approved rate was the product of reasonable efforts to secure the lowest cost in light of appropriate alternatives available to the company and that the PUC could not abdicate its responsibility to ensure that the rates are just and reasonable by simply assuming (in the absence of dispute) that the purchase was prudent. The court referred to *Philadelphia Electric* and *Pennsylvania Power & Light, supra*, as the "modern trend, which we here adopt and approve," and sent the case back to the PUC to make determinations on the prudence of the purchase.³⁰

III. THE AEP CASES: THE "NEW FERC" CREATES AN EXCEPTION TO *Pike County* FOR POWER POOLS AND AFFILIATED COMPANIES

In 1985, the FERC began to retreat from its *Philadelphia Electric* posture: that prudence-of-purchase issues were a fit subject for review by the states (and also by the FERC when sitting in judgment of the wholesaler-as-buyer for resale at wholesale). In the first of two AEP cases, *AEP Generating Company*,³¹ the Commission at first followed the *Philadelphia Electric* line of cases and held that the prudence of a bulk power purchase by an AEP pool member would *not* be an issue in the wholesale bulk power rate case. However, on rehearing in September 1985, the Commission departed somewhat from its earlier position and declared that a determination of what options the buying pool member had available to it under the pool agreement *was* a question for the Commission to answer under its primary jurisdiction over questions of interpretations of a jurisdictional pool agreement, and invited AEP to file a separate petition for a declaratory order as to the interpretation of the AEP System

30. *Id.* at 704. *But see* Washington Gas Light Co. v. Pub. Serv. Comm'n, 508 A.2d 930 (D.C. Cir. 1986), wherein the District of Columbia Court of Appeals held that a FERC order approving expenses incurred by Washington Gas Light Co. for surcharges paid to the Gas Research Institute preempted local regulators from prohibiting the company from passing those expenses through to ratepayers. It should be noted, however, that the D.C. Court of Appeals found that "since it does not appear that WGL has any alternative source which would not require it to pay the GRI surcharges, *Pike County* has no bearing on this case." 508 A.2d at 941. As with *Narragansett*, it is possible to make more of *Pike County* than the case deserves. A review of state commission decisions over an extended period would probably turn up additional instances of states finding imprudence in the purchase of power at FERC-approved rates. In 1976, for example, the Arkansas Public Service Commission enunciated a policy of not allowing AP&L to pass through its fuel adjustment clause any charge for purchased power which was more expensive than its own generation, thus regulating the prudence of AP&L's purchases including those from its affiliates in the Middle South system. The utility has never challenged the right of the Commission to do, but in 1984 it did not seek to flow FERC-allocated charges for Grand Gulf through its fuel adjustment charge, choosing instead to file a separate rider. *See Re Arkansas Power & Light Co.*, 15 PUR 4th 153, 175 (1976). In the retail rate case which considered this Grand Gulf rider (APSC Docket No. 84-249) and in related federal litigation filed by AP&L against the Arkansas Commission in August 1985, AP&L argued that the FERC order in Middle South preempted state commission review of the prudence of AP&L's "purchase" of Grand Gulf power, citing *Narragansett*. It is thus possible that the magnitude of the costs involved in more recent cases such as *Middle South*, which included over \$6 billion in construction costs associated with the Grand Gulf and Waterford 3 nuclear plants, has provided utilities with the incentive to strenuously litigate preemption questions that were previously not considered worth pursuing.

31. 29 F.E.R.C. ¶ 61,246 (1984).

Interconnection Agreement.³² This decision apparently marks the first time the Commission signalled an inclination to predicate preemption of prudence-of-purchase issues on membership in a power pool or holding company system.³³

Evidently hoping this "new dog would hunt," the FERC made another attempt to eviscerate the *Philadelphia Electric* line of cases in a second AEP case, *AEP Service Corp.*,³⁴ where it held that a state commission could not separately question the prudence of a utility's membership in an interstate pool transmission agreement which was a part of the entire affiliated pool relationship. Further, it found that state inquiries into such questions would appear necessarily to impinge on the Commission's exclusive jurisdiction to determine the justness and reasonableness of the pool transmission agreement.³⁵ Pointing out that the AEP pool agreement does not provide for direct compensation among the AEP companies for the use of transmission facilities owned and operated by the individual companies, the FERC observed that no party had suggested that a company could rely on non-AEP transmission facilities to receive its requirements of power and energy as a party to the AEP pool agreement.³⁶ In other words, there were no alternatives available to any of the AEP companies for transmitting power, as apparently required by *Pike County*. Not content to base its decision on this distinction from unit power sales agreements, alternatives to which are often available, the Commission engaged in some rhetorical speculation about the manner in which a state commission might conduct a prudence review of an AEP operating company's entering into the transmission agreement:

For example, would granting the motions [to declare prudence not to be an issue] mean that a State commission would be free to find that it was imprudent for an AEP operating company to enter into an EHV transmission agreement because costs allocated by that agreement include all of the EHV transmission facilities in the AEP system (rather than only those facilities directly connecting the participating utility to the system)? Or would it mean that a State commission could find that it was imprudent for an AEP operating company to enter into an EHV transmission agreement that contains a five year phase-in provision? These are the sort of issues as to the EHV transmission agreement that are being tried in the proceeding before this Commission. For a State commission to decide such questions for itself would be an invasion of our exclusive jurisdiction over the EHV transmission agreement.³⁷

Then, without elaborating, the Commission concluded:

Commission precedent leaving to the State commissions the question of the prudence of an operating company in making a particular purchase is not applicable under the facts of this case.

. . . As discussed above, we believe that the prudence issue raised here involves consideration of the entire AEP pool relationship and therefore is not properly raised in

32. AEP affiliate Kentucky Power Company filed such a petition for a declaratory order on November 18, 1985. See *Kentucky Power Company*, FERC No. EL86-10-000. On August 20, 1986, FERC granted the petition (36 F.E.R.C. ¶ 61,227 (1986)) and an administrative law judge decision issued on November 7, 1986. See 37 F.E.R.C. ¶ 63,015 (1986).

33. See *AEP Generating Co.*, 32 F.E.R.C. ¶ 61,364 (1985).

34. 32 F.E.R.C. ¶ 61,363 (1985).

35. *Id.* at 61,817-18.

36. *Id.* at 61,818.

37. *Id.*

a proceeding concerned only with the transmission portion of that pool relationship.³⁸

The asserted inextricability of membership in a transmission pool from membership in a pool generally was sufficient in *AEP Service Corporation* for the FERC to rationalize preemption of state commissions from reviewing or regulating transmission agreements on a prudence-of-purchase basis. The Commission stated:

Transmission and the allocation of the costs of the established AEP transmission network are integral parts of the operation of the AEP pool. Therefore, *the prudence of being a party to the EHV transmission agreement cannot be considered separately from the prudence of being a party to the entire AEP pool relationship. A challenge to the membership in a public utility holding company power pool of a member of the holding company is a federal matter.*³⁹

It is noteworthy that the FERC declared power pool membership to be an exclusively "federal" matter and did not hold that the FERC had exclusive jurisdiction over the question. In a footnote to the just-quoted passage, the FERC elaborated:

We note that the formation and dissolution of holding companies is regulated by the SEC. 15 U.S.C. §79a(c), 79e (1982 ed.). Under the Public Utility Holding Company Act (PUCHA), a holding company must operate on an integrated basis. 15 U.S.C. §79k(b) (1982 ed.) Therefore, the question of continued membership in a holding company power pool raises in the first instance the question of the composition of the holding company which is within the jurisdiction of the SEC.

The broad scope and purpose of SEC review of holding companies is set forth in PUCHA, Section 1, 15 U.S.C. 79a, under the heading "Necessity for Control of Holding Companies." Section 1 of PUCHA sets forth the ultimate or fundamental objectives of the Act; namely, the protection of consumers of gas and electricity and the protection of investors in utilities. The abuses PUCHA seeks to correct, as well as the purposes it proposes to accomplish, would require the consideration of certain factors set forth in Section 1 of the Act. Those factors include: (1) the cost of gas and electricity for consumers; (2) economy of management of utilities; (4) protection of utility investments; (5) effectiveness of utility regulation; and (6) adequacy and efficiency of utility service.

The review of these factors by the SEC in the course of its regulation preempts state review and determination of the prudence of the overall membership and operation of the holding company system. For example, such review would inevitably involve findings which overlap with those made by the SEC in the course of its regulation.⁴⁰

It is inescapable from the FERC's gratuitous, expansive, and self-serving description of the preemptive power of the Securities and Exchange Commission under the Public Utility Holding Company Act (PUHCA), that FERC was combing the federal statutes to find language which limited the role of the states in dealing with operating subsidiaries of public utility holding companies. It should be noted, however, that the FERC failed to acknowledge or discuss provisions of PUCHA which clearly indicate that the Act was intended by

38. *Id. AEP Serv. Corp.* is doubly significant in that the FERC's decision was released almost simultaneously with that in *Middle South, infra*, in which the "forced purchase" issue was raised by certain parties. It is clear that if the FERC has the power to compel a purchase, the state regulator is almost certain to be presented by the "purchasing" utility with a defense to any prudence of purchase issue: i.e., "FERC made me to it."

39. *Id.* (emphasis added).

40. *Id.* (emphasis added).

Congress to be legislation in aid of, not in place of, state regulation.⁴¹ As the *Middle South* cases discussed in the next section illustrate, the question whether anyone—FERC, the states, or the SEC—can (or will) review the prudence-of-purchase issue for holding company subsidiaries or members of power pools is now clouded by the FERC decisions on appeal to the federal courts.

On August 20, 1986, the FERC drew unto itself further power to review prudence-of-purchase issues in a holding company context by issuing orders in two of the *AEP* cases cited above.⁴² While the procedural history of these cases is tangled and confusing, and will not be described here, there is new, revealing language from the Commission indicating that its "preemptive muscles" are growing stronger through increased use. For example, in its Order on Rehearing in *AEP Generating Company*, the Commission recanted its earlier decision not to grant AEP a rehearing and, making painstakingly arcane distinctions between wholesale rate filings and pooling agreements, backedpedaled:

We recognize that the November 23, 1984 order in this proceeding stated that the prudence of [Kentucky Power Company's] decision to enter into the Rockport agreement, in light of the availability of alternative power supplies, was not an issue. The Commission stated that it did not view its responsibilities under the Federal Power Act as including a determination that a purchaser had acted wisely, but that the question was a legitimate concern when the purchaser sought to as through costs associated with the transaction in its rates for sales to others. 29 F.E.R.C. at 61,501. *Under narrow, non-pool circumstances, that view would remain sufficient and dispositive.* That opinion was expressed in this case because a discrete rate filing was before the Commission, not a request to modify the broad, underlying pooling agreement. In that context, *the salient inquiry was considered to be the validity of the cost support for the Rockport unit charges, not the availability of other power alternatives.* Indeed, this is the typical basis for evaluating the reasonableness of a filed unit rate, since potential alternatives may exist with respect to any filed rate.⁴³

The Commission then enunciated what must now be considered to be its litmus test for federal preemption of wholesale power transactions vis-a-vis the prudence of purchase when holding companies are involved:

The continuing controversy that has ensued, however, makes it clear that *where*, as here, *the transaction involves affiliated, jurisdictional utilities, which are members of an integrated, interstate holding company arrangement, performing diverse functions on a coordinated basis, and particularly where rights and obligations under the basis system agreements [sic], the relevant issues may not be so readily segregated. Under these circumstances, more complex, interrelated questions arise and, whether one characterizes the questions as related to prudence, interpretation, or cost allocation, they are clearly matters most appropriately resolved by this Commission as part of its overriding authority to evaluate and implement all applicable wholesale rate schedules.* Given that the implications of the parties' obligations under the System Agreement have been raised in the context of determining the justness and reasonableness of the unit power sales arrangement (as well as the rates), the Commission will undertake to interpret the System Agreement in that context. Insofar as such an interpretation determines or affects the appropriateness and reasonableness of the unit power sales agreements, we consider our interpretations to be conclusive. *See Nantahala Power &*

41. See, e.g., 15 U.S.C. §§79a, 79g(g), 79i(b), 79j(f) (1982).

42. *AEP Generating Co.* 36 F.E.R.C. ¶ 61,226 (1986), Order on Rehearing; *Kentucky Power Co.*, 36 F.E.R.C. ¶ 61,227 (1986), Order Setting Issues for Hearing and Consolidating Dockets. See *supra* note 32.

43. 36 F.E.R.C. at 61,550 (emphasis added).

*Light Co., supra.*⁴⁴

In a companion order issued in *Kentucky Power Company*⁴⁵ the same day, the Commission brushed aside the objections of the Kentucky Public Service Commission and elaborated on the FERC's powers, declaring that:

[cn]. . . in an integrated, affiliated power pool system, such as the AEP System, it may, in effect, be necessary for this Commission to provide its interpretation of power pool obligations and salient rate schedule provisions, where such issues are raised in the context of a jurisdictional system rate filing. An evaluation of the operations of the pool, including the members' capacity obligations and costs sharing arrangements, carries broad interstate implications which are properly considered by this agency. Our decisions regarding wholesale rate schedules, in turn, are conclusive and can compel certain subsidiary effects at the retail ratemaking level.⁴⁶

The Commission went on to set for expedited hearing and decision by an administrative law judge the question whether the AEP system interconnection agreement, as implemented by the AEP companies, establishes, as KEPCO asserts, an obligation on the part of member companies to supply sufficient capacity to meet their native load requirements over time, or whether such obligation is inherent in the nature of the AEP system here, or, on the other hand, whether the System Agreement permits a member company to become capacity-deficient, purchasing its capacity shortfall from other members under the System Agreement, on a permanent basis.⁴⁷

Following hearings in October 1986, the FERC administrative law judge Isaac D. Benkin issued an initial decision finding that the answer to the question posed above was "None of the above."⁴⁸ Judge Benkin's order held:

The Interconnection Agreement, as implemented, does not establish an obligation on the part of the AEP System members to supply sufficient capacity over time to meet their native loads, nor is such an obligation inherent in the nature of the AEP System. "Native load" (with or without a reserve margin) is a concept that is not used in administering the Interconnection Agreement. There is no evidence that it has ever been so used. The theoretical obligation of a member under the agreement is established by the utility's member load ratio. Even so, a member that is deficient in meeting its capacity obligation under the agreement is not, as a matter of practice, required to acquire sufficient capacity to erase that deficiency. Members have in the past been allowed to remain capacity-deficient for the indefinite future. *What has mattered, and continues to matter, is whether the collective generating capacity of all the members is sufficient to meet the needs of the pool.* If it is, the capacity-deficient members have been allowed, and will continue to be allowed, to satisfy their needs by purchasing power from the pool upon payment of a capacity equalization charge to the capacity-surplus member or members. Under the Interconnection Agreement, as it has been administered, there is no reason why this arrangement cannot go on indefinitely as long as the pool as a whole does not need to add new capacity.⁴⁹

In finding the AEP Interconnection Agreement to be an "ambiguous" contract, Judge Benkin held that from its "intrinsic character . . ., it is a power

44. *Id.* (emphasis added).

45. 36 F.E.R.C. ¶ 61,227 (1986).

46. 36 F.E.R.C. at 61,555 (emphasis added).

47. *Id.* ¶ 61,227 (1986).

48. 37 F.E.R.C. ¶ 63,015 at 65,176 (1986).

49. *Id.* at 65,176 (emphasis added).

pooling agreement, not a contract for the purchase and sale of electricity."⁵⁰ It remains to be seen what, if anything, the FERC will make of this distinction as it moves on to resolve "the broader, more complex jurisdictional issues" in the *Kentucky Power* case, which issues the Commission instructed its law judge not to address.⁵¹ One final point in Judge Benkin's order deserves emphasis, however. The judge held that it was virtually impossible for holding company subsidiaries to contract with each other at arms-length, stating:

Although several parties have tried to argue that traditional rules of contract construction, such as *contra proferentem* [against the party who proffers a thing], should be employed to resolve ambiguities, there is no profit in attempting to parse the AEP Interconnection Agreement by the rules devised to construe arms-length contracts among independent parties. *The AEP member companies are all owned by the same entity and operate as part of the same business. They do not deal with each other, or with AEP, as independent business. Hence, their contractual agreement, which exists in the first place only because the Federal Power Act requires a tariff defining the terms and conditions of inter-member sales to be on file, has not been drafted with the attention to detail and concern for clarity that commonly marks contracts between independent businessmen.*⁵²

It is difficult to reconcile such a finding with the FERC's rejection in *Middle South*,⁵³ of the Arkansas parties' argument that FERC had premised its equalization order on a finding that Middle South Utilities, Inc. is a "monolith," whose operating companies could almost by definition not engage in interstate "sales" of power. The Arkansas parties argued that this inability of Middle South to engage in a sale with itself deprived the FERC of jurisdiction.⁵⁴ In affirming the *Middle South* decision of the FERC dismissing this argument, the District of Columbia Circuit Court of Appeals approvingly found that the Commission had suggested that, "whatever the merits of such an argument where a 'monolithic' system is concerned, there was no question but that *the transfer of power among the MSU operating companies constitutes a 'sale for resale'*"⁵⁵ The court then said:

The Commission rejected any attempt to mischaracterize its decision as based on a view that MSU is a "monolith." *Id.* at 61,952. FERC simply insisted that, whatever the powers of the individual operating companies, the MSU Operating Committee makes the "major critical decisions on the System, primarily for the System as a whole." *Id.* at 61,953 (emphasis in original).⁵⁶

As will be seen in the next section, the FERC's contention, as affirmed by the D.C. Circuit, is that its decision to reallocate nuclear generating facility capacity costs in *Middle South* was premised on the deeply "integrated" nature of the System rather than its "monolithic" nature. The authors must confess to frustration in attempting to grasp the distinction, particularly in light of Judge Benkin's observations concerning contracts among members of the AEP system, which is similar in structure and operation to MSU.

50. *Id.* at 65,171 (emphasis added).

51. *Id.* at 65,170.

52. *Id.* at 65,177 n.4.

53. See discussion *infra* notes and accompanying text.

54. 32 F.E.R.C. at 61,957 (1985).

55. *Mississippi Indus.*, slip op. at 29 (emphasis added).

56. *Id.* at 30.

IV. "PERVERTED" PRUDENCE—FERC DECISIONS IN THE MIDDLE SOUTH CASES:

As mentioned previously, the *Middle South* cases⁵⁷ involve, directly or indirectly, a number of issues that have been the subject of the FERC opinions and court decisions in *Narragansett*, *Pike County*, *Nantahala*, and the *AEP* cases. These include prudence-of-purchase issues and more particularly, the forced purchase issue, allocations of power, and power pool/holding company/SEC issues of preemption. The *Middle South* cases apparently present the first instance of the FERC employing the concept of "cost equalization" in an electric case. This cost allocation technique was adopted by the FERC as a tool for spreading the enormous cost of all of the nuclear plant investments on the Middle South Utilities, Inc. (MSU) system among the four operating companies, Arkansas Power & Light (AP&L), Louisiana Power & Light (LP&L), Mississippi Power & Light (MP&L), and New Orleans Public Service Inc. (NOPSI). Before discussing the equalization concept further, however, a brief history of the *Middle South* cases is necessary.

Throughout the four states served by MSU,⁵⁸ the *Middle South* cases are referred to, often derisively, as "Grand Gulf." This is because their genesis was the construction of the Grand Gulf Nuclear Plant near Port Gibson, Mississippi. In 1974 MSU created a wholly-owned generation subsidiary called Middle South Energy, Inc. (MSE), for the purpose of owning and constructing Grand Gulf. A certificate of convenience and necessity was obtained from the Mississippi Public Service Commission and construction commenced in that same year. The operating companies of MSU simultaneously entered into financial agreements, later filed with and approved by the SEC, by which they agreed to indemnify MSE for all costs of the plant and to take and pay for all the power it produced. The power from Grand Gulf was to be purchased, upon completion of the plant, under a year-to-year "floating" arrangement pursuant to the MSU pooling agreement, called the 1973 System Agreement. The amount each company would take under that agreement would have varied from time to time depending upon its own ownership of generating facilities and its own loads.

Since some MSU companies were building their own power plants while Grand Gulf was under construction.⁵⁹ It was suggested within Middle South in 1979 that companies which were "long" (i.e., which had built more capacity than they needed for their own loads, plus reserves) would not need and thus should not purchase any of the Grand Gulf power and energy, at least until such time as their load growth outstripped their capacity and they become

57. See *supra* note 17. In using the term "Middle South cases," it is intended to refer to two FERC proceedings that were unconsolidated but decided together by the Commission: Middle S. Serv., Inc., No. ER82-616-000, which concerned a unit power sales agreement governing the sale of power from the Grand Gulf Nuclear Plant. Both cases were decided by the full Commission after separate initial decisions by two administrative law judges. Those decisions were reported, respectively, at 30 F.E.R.C. ¶ 63,030 (1985), and 26 F.E.R.C. ¶ 63,044 (1984).

58. AP&L serves approximately 35,000 retail customers in the State of Missouri.

59. Between 1970 and 1985, AP&L built two nuclear units and four large coal units; LP&L built the Waterford 3 nuclear plant and additional gas/oil facilities; MP&L built gas/oil plants; and NOPSI built gas/oil units.

"short." By 1980, as its own extensive nuclear and coal construction program neared completion, AP&L was indisputably in a "long" position and had no need for Grand Gulf capacity or energy. Recognizing this and the preference of the lending institutions for fixed responsibilities for Grand Gulf costs, the operating companies in 1980 entered into various agreements which had the effect of changing from a floating to a fixed "allocation" of Grand Gulf for each company. AP&L's share was fixed at 0%, and other agreements were signed by the operating companies purporting to indemnify or "hold harmless" AP&L if it should ever be required by the banks financing Grand Gulf to pay for any of the costs of financing the plant.

During the period of Grand Gulf construction, from 1974 until the present, a multitude of financial guarantees and indemnification agreements was signed by AP&L and the other operating companies; these agreements with banks and other lenders were necessary to enable MSE to obtain the billions of dollars that eventually were spent to construct the plant. Each of these financial guaranty agreements was filed with, and received the approval of, the Securities and Exchange Commission. None of them was filed with the FERC, and none was filed with the state commissions for review or approval, although by 1984 the Arkansas Public Service Commission contended certain agreements should have been so filed and approved.⁶⁰ It was not until 1982, when construction was nearly complete on Grand Gulf Unit One, that the first document relating to the plant (the Unit Power Sales Agreement or UPSA) was filed with the FERC.⁶¹ As previously agreed to by the operating companies in 1980, and approved by the SEC in 1981,⁶² AP&L was to have a zero allocation of Grand Gulf under the terms of the UPSA.

To make a long story somewhat shorter, notwithstanding the voluntary agreements among all of the MSU operating companies that AP&L should be responsible for purchasing none of Grand Gulf's power or energy, the FERC in its June 13, 1985, order deciding the pooling agreement and Grand Gulf unit sales agreement cases together, reallocated Grand Gulf among the operating companies. The shares agreed to by LP&L and NPSI were reduced considerably, MP&L's share was increased slightly, and AP&L's share was in-

60. See *Middle S. Energy, Inc. v. Arkansas Pub. Serv. Comm'n*, 772 F.2d 404 (8th Cir. 1985), cert. denied sub nom., *Ratepayers Fight Back v. Middle Energy, Inc.*, 88 L.Ed.2d 919, 106 S. Ct. 884 (1986). In this case the 8th Circuit ruled that the Arkansas commission could not review or regulate the propriety of AP&L placing its credit behind Grand Gulf by signing various financial agreements. The court held that such regulation by the state commission would have resulted in the shifting of Grand Gulf costs to ratepayers in the other Middle South states. The court determined that "economic protectionism," which cannot be exercised by states pursuant to the Commerce Clause of the United States Constitution, U.S. Const. Art. 1, §8, cl. 3, entails both preference to one state and expense to another state or states.

61. A fact distinguishing the FERC from most state commissions is that under the Federal Power Act, 16 U.S.C. § 824 (1982), the FERC has no authority to grant construction certificates or make preconstruction determinations of need for generating facilities, whereas most states do have such authority. This difference in the powers of the federal and state agencies regulating electric utilities explains why, although Middle South Energy sought and obtained a construction certificate for Grand Gulf from the Mississippi Public Service Commission in 1974, the company never filed any Grand Gulf-related documents with the FERC until the Unit Power Sales Agreement was executed by the operating companies in 1982, by which time the plant was virtually completed.

62. See 23 SEC Docket at 1596 (Nov. 18, 1981).

creased from 0% to 36%.⁶³

The FERC's rationale for reallocating Grand Gulf power was its acceptance of arguments made by Louisiana parties that all of the nuclear production capacity, including Grand Gulf, had been constructed for the benefit of the MSU system as a whole and none of it for the individual operating companies. This conclusion was reached despite the anomalous fact that Grand Gulf was the only such facility not constructed and owned by an operating company. MSE is a totally wholesale generation subsidiary, have no retail ratepayers whatsoever; its only asset is Grand Gulf. All of the other nuclear units were constructed and financed by and are owned and operated by individual operating companies: AP&L owns Arkansas Nuclear One (Units 1 and 2) and LP&L owns Waterford 3. Each of those units is placed into the ratebase of the owner by the state commission regulating that operating company. MSE is regulated only by the FERC, and Grand Gulf is totally ratebased by the FERC. Pursuant to the UPSA, therefore, the costs of Grand Gulf are transmogrified from a rate base item for MSE at the FERC into an operating expense item at the state level for each operating company purchasing capacity and energy from MSE.

Although denying that it had found Middle South Utilities, Inc. to be a "monolithic" superutility which dictated all construction decisions from above (and thus might be said to be incapable of making a jurisdictional "sale" under the Federal Power Act),⁶⁴ the FERC order, as affirmed on rehearing,⁶⁵ and by the District of Columbia Circuit Court of Appeals,⁶⁶ ordered that all nuclear plant costs on the MSU system be combined and apportioned among the four operating companies in such a way as to "equalize" the nuclear investment costs of the companies. In essence, therefore, the FERC used Grand Gulf as the currency to equalize these system-wide nuclear construction costs. The result was that, since AP&L had built its nuclear units earlier and at much lower costs, the Arkansas company's "contribution" to the FERC-mandated pool of nuclear costs was relatively low in dollars, and thus, AP&L was forced to take the single largest share of Grand Gulf costs. Louisiana Power & Light, which alone built and owns (i.e., ratebases) the Waterford 3 unit, almost equal in expense to Grand Gulf, consequently was allocated the smallest share of Grand Gulf. The other companies were allocated intermediate-sized shares of the plant's costs.

Probably the most significant finding by the FERC in its orders in the *Middle South* cases was that the Commission had not "forced" AP&L to purchase any power, but rather had simply "allocated costs" among members of an "integrated" multi-state holding company power pool. Although the Commission did not find any reason to pierce the corporate veils of the four operating companies which had signed agreements de-obligating AP&L for any portion of Grand Gulf, the FERC nonetheless "reformed" the contract embodied in the 1982 Unit Power Sales Agreement, thus requiring the only nonparty

63. 31 F.E.R.C. ¶ 61,305 (1985).

64. See discussion *supra* note 55 and accompanying text.

65. 32 F.E.R.C. ¶ 61,425 (1985).

66. See *Mississippi Indus. v. FERC*, *supra* note 7.

to that contract—AP&L—to pick up its “fair” share of the higher cost Grand Gulf and Waterford 3 plants and to surrender the benefits of the lower-cost Arkansas Nuclear One units, which AP&L alone financed and built. The FERC’s actions on these matters are without precedent and indicate that the Commission is entering a new era of expansive interpretations of its own jurisdiction.⁶⁷

On January 6, 1987, the Court of Appeals for the District of Columbia Circuit affirmed the decision of the FERC in the *Middle South* cases.⁶⁸ In a 93-page *per curiam* decision, the court uncritically accepted all of the rationales advanced by the FERC in dismissing the arguments of the Arkansas parties that a forced purchase by AP&L had been ordered; that FERC had sought to exercise jurisdiction over generating facilities, contrary to section 201(b) of the Federal Power Act; that the traditional FERC jurisdictional prerequisite of voluntary wholesale transactions should be held applicable to holding company affiliates, and that joint planning of generating facilities should not result in joint liability among holding company affiliates for *each other’s* power plants. The D.C. Circuit’s opinion predictably employed the *Nantahala* decision in support of its decision and repeatedly underscored its assent to FERC’s claim of plenary jurisdiction to regulate all contracts which “affect” the rates of holding company affiliates, citing sections 205 and 206 of the Federal Power Act.⁶⁹ The court held:

The combined force of these provisions [sections 205 and 206] leads inexorably to the conclusion that, under the circumstances presented in the instant case, FERC had jurisdiction to modify the Grand Gulf allocation set forth in the UPSA [Unit Power Sales Agreement].

The distribution of Grand Gulf costs and capacity in the UPSA inevitably affects each operating company’s generating costs and, by extension, their wholesale rates. When, as here, generation capacity has been built and planned on a profoundly integrated basis, the Commission properly may examine its allocation as a cost component

67. This is illustrated in a brief filed by the FERC as *amicus curiae* in *New Orleans Pub. Serv., Inc.*, No. 85-3654 (5th Cir. Nov. 22, 1985). In its brief FERC underscored its earlier findings in the case of *AEP Serv. Corp.*, *supra*, that power pools are a different species when it comes to prudence-of-purchase issues, stating:

The City Council purports to be exercising a legitimate local regulatory power to determine whether NOPSI’s participation in the Grand Gulf development was prudent. *But NOPSI is a member of the Middle South holding company group—which is a matter for federal [SEC] determination under the Public Utility Holding Company Act—and, as such, NOPSI had no choice in the matter of allocation of Grand Gulf costs.* These circumstances, where wholesale cost allocations among members of an integrated interstate system are at issue, are distinct from cases where the Commission has simply approved a wholesale rate as just and reasonable, but not in the context of an interstate bulk power arrangement among many members. *Compare American Electric Power Service Corp.*, . . . (involving an interstate transmission agreement among members of a public utility holding company pool) with *Pennsylvania Power & Light Co.*, . . . (distinguishing between approval of a wholesale contract subject to the Commission’s exclusive jurisdiction and the question whether the purchaser was prudent in entering that contract).

Brief for Federal Energy Regulatory Commission at p. 6 n.7. (emphasis added, citations omitted).

68. *Mississippi Indus. v. FERC*, No. 85-1611 (C.A.D.C. Jan. 6, 1987) [hereinafter *Mississippi Indus. slip op.*].

69. 16 U.S.C. §§ 824d(a), 824e(a) (1982). Under this rationale, FERC jurisdiction might logically be extended to include contracts relating to such matters as fuel purchases, labor contracts, choice of management, or return on equity—so long as the contracts can be said to “affect” rates.

affecting wholesale rates. For this purpose, the UPSA cannot be examined in isolation. As the Commission stated, the UPSA is "an agreement which 'supplements or supercedes' the coordination arrangements among the MSU utilities, and . . . is a contract 'affecting' rates under the 1982 System Agreement [the Middle South system pooling agreement]."⁷⁰

While further appeals of the District of Columbia Circuit's decision are certain—through the filing of a petition for rehearing *en banc* by the Court of Appeals and/or the filing of a petition for a writ of certiorari from the Supreme Court of the United States—one cannot read the three-judge panel's opinion as anything but a ringing endorsement of the "New FERC's" determination to create what might be termed a new Federal Power Act (FPA) for holding company affiliates. While it is unquestionable that Part II of the original FPA created a system of federal regulation for specific wholesale transaction—*i.e.*, those beyond the regulatory reach of state agencies in the aftermath of the *Attleboro*⁷¹ decision—the new "for affiliates only" FPA inaugurates a scheme of plenary regulation for entire "systems" of affiliated utilities, apparently premised upon FERC's judgment that the "old FPA" did not give FERC enough muscle to deal with the problems of holding companies—including the problems presented by state commission attempts to regulate holding company retail affiliates.

Rather than awaiting the occasion of the individual, heretofore voluntary, jurisdictional transactions described in section 201 of the FPA,⁷² this new and more potent FPA deems all the generating costs of individual operating companies in a holding company system to be "wholesale" or at least potentially so, and therefore all subject to regulation and, indeed, transformation through the mechanism of reforming or modifying contracts among affiliates. Thus, the D.C. Circuit affirmed FERC's finding of "unreasonable disparities"⁷³ in the costs of Grand Gulf borne by affiliates. The court approved the FERC's order finding discrimination and ordering an "equitable distribution"⁷⁴ of costs, holding: "This equitable distribution is mandated by the FPA because of the historical integration of the MSU system."⁷⁵ The breadth of the FERC's new power to modify contracts at will, so long as sufficient "integration" of a system is found, is suggested by the following declaration of the D.C. Circuit:

FERC's allocation of Grand Gulf's costs and capacity, like the setting of entitlement percentages in *Nantahala Power & Light*, does not set a sales price, but does directly affect costs and, consequently, wholesale rates. We cannot disregard the Supreme Court's clear and timely message that FERC's jurisdiction under such circumstances is unquestionable.⁷⁶

What is striking about the preceding passage is the court's holding that it is the actions of the FERC (FERC's allocation), rather than those of the holding company affiliates, which have the prerequisite jurisdictional "effect" on

70. *Mississippi Indus.* slip op. at 33-34.

71. *Public Util. Comm'n v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927).

72. 16 U.S.C. § 824 (1982).

73. *Mississippi Indus.* slip op. at 35.

74. *Id.* at 34.

75. *Id.* at 35.

76. *Id.* at 38.

wholesale rates. If action by the FERC "affecting rates" is sufficient under the FPA for the FERC to rewrite contracts among holding company affiliates, then there is little or nothing that the FERC cannot do to upset the expectations of individual operating companies that have historically dealt with each other through such instruments.

It should be noted that, without pointing to any finding of fraud, collusion, bad faith dealing, or other improper or illegal conduct among the *Middle South* affiliates, and without piercing the corporate veils which legally exist for such affiliates under the Public Utility Holding Company Act of 1935 (pursuant to which Middle South Utilities' continued existence is tolerated), the Court of Appeals for the District of Columbia rejected the argument of of the Arkansas-Missouri parties, who asserted that the FERC was inconsistent in denying that it had compelled a "purchase" by a nonparty to the unit power sales agreement (AP&L), while the court premised its finding of jurisdiction over AP&L on the "sale of electricity at wholesale in interstate commerce in the context of *exchanges* within a multi-state power pool, an area subject exclusively to the FERC control."⁷⁷ Agreeing with the FERC's finding that "the issue here is not whether a company should be forced to purchase or sell power, but rather is the appropriate allocation of costs among integrated companies owned by the same parent," the Court of Appeals held that "[t]he depth of the operating companies' historical involvement in both the [Middle South] system and the [Grand Gulf] project allows the Commission to step in and reallocate costs under section 206(a) of the FPA so that each of the operating companies is treated fairly."⁷⁸

In the wake of the D. C. Circuit's affirmance of the FERC's precedent-shattering *Middle South* holdings, it now appears that the new—"for affiliates only"—jurisdictional test has been judicially embraced. This new standard is a powerful tool that would seem to permit the FERC to bootstrap its own jurisdictional determinations. This is evident from the Court of Appeals' qualified endorsement of FERC's assertion in its *Middle South* order on reconsideration⁷⁹ that, while it had *not* ordered AP&L to purchase power (but had merely allocated costs to AP&L), the Commission did have authority to compel such a purchase. The Court stated:

The Commission suggests upon reconsideration that its authority is unchanged whether "the central issue is viewed as one of cost allocation or as 'forced' purchases. 32 FERC ¶ 61,425 at 61,949. We do not interpret this comment as an assertion by FERC that it may, *under any circumstances*, force a purchase among *nonaffiliates*.⁸⁰

Citing the case of *Pennsylvania Water & Power Co. v. FPC*⁸¹ as support for its findings that the FERC had jurisdiction over AP&L under section 206 of the Federal Power Act, the Court of Appeals then declared: This case [*Pennsylvania Water*] provides a solid foundation for the Commission's authority to order a *purchase or sale* of power when, as here, such an order is

77. 16 U.S.C. § 824-824k (1982).

78. *Mississippi Indus.* slip op. at 43-48 (emphasis added).

79. 32 F.E.R.C. ¶ 61,425. (1985).

80. *Mississippi Indus.* slip op. at 44 n.75 (emphasis added).

81. 343 U.S. 414 (1952).

consistent with the historical integration of a power pool or network.”⁸² It is inescapable that, in these passages, the Court of Appeals has placed its imprimatur upon the FERC’s “for affiliates only” rule for determining its jurisdiction: If a company is part of an integrated “power pool or network,” the FERC may order a purchase or sale in the interests of fairness and equitable distribution of the costs of generating capacity and, having done so, may then find that it has jurisdiction under section 206 of the FPA because, in the language of that section, the “rate . . . charged” for any “sale” or any “contract affecting such rate . . . is unjust, unreasonable, unduly discriminatory or preferential.”⁸³

The *Middle South* cases involve approximately \$4 billion in rates to be collected over ten years. If the Supreme Court grants certiorari in the cases, the Court will be presented with the opportunity to examine FERC’s costs equalization remedy, its jurisdiction over generating facilities, its disavowal of forced purchases, and its rationale for treating wholesale transactions among integrated power pool and holding company system members differently from wholesale power arrangements among nonaffiliates with respect to prudence of the purchase.

Common sense suggests that the FERC cannot have its cake and eat it too. If the FERC has jurisdiction over *sales* of power at wholesale in interstate commerce, as the Federal Power Act provides, then there must also be *purchases*, which connote arms-length transactions among the parties—even if *those parties are part of multi-state, integrated power pools or holding companies*. After all, those separate corporate entities are permitted to exist as parts of a holding company by explicit provision of the Public Utility Holding Company Act. If, as the FERC would apparently have it today, there are only “allocations of costs” among such entities, how can there be a “wholesale” sale justifying the FERC’s exercise of exclusive jurisdiction?

When parties to both the *Middle South* and AEP litigation have raised these very points in briefs to the FERC and the D.C. Circuit, both the Commission and that court have shrugged them off and maintained that the Commission has the power both to reallocate costs in order to fix just and reasonable rates for holding company members and to preempt all state review of the prudence of the purchase when holding companies are involved. The FERC’s perverse and proprietary view of the prudence-of-purchase standard is equivalent to its saying to the states: “What’s mine is mine; what’s yours is now mine too—especially if a holding company is involved.” This is a new, and, to many state regulators, profoundly disturbing, double standard for applying the once-remedial language of the Federal Power Act.⁸⁴

V. ABSTENTION V. PREEMPTION—THE *Kentucky* AND *New Orleans* CASES

Most of the federal courts which have considered the issue have declined to abstain from exercising federal jurisdiction when state or local regulators have taken actions that raise *Narragansett* and *Pike County* issues.⁸⁵ Yet at least

82. *Mississippi Indus.* slip op. at 45 (emphasis added).

83. *Id.*

84. See 16 U.S.C. § 824-825 (1982).

85. See, e.g., *Kentucky W. Va. Gas Co. v. Pennsylvania Pub. Util. Comm’n*, 791 F.2d 1111 (3d Cir.

two circuits—the Fifth and the Sixth—have abstained from enjoining state regulation even in the face of claims of federal preemption. In both of these cases, *American Electric Power Co. v. Kentucky Public Service Commission*⁸⁶ and *New Orleans Public Service, Inc. v. City of New Orleans*,⁸⁷ the utilities seeking to enjoin state regulation have filed petitions for writs of certiorari with the Supreme Court of the United States. Not surprisingly, the AEP and Middle South holding companies are involved. At this writing, neither petition has been granted, although the Supreme Court has invited both the Solicitor General and the FERC to submit their views in both cases, and the Edison Electric Institute has filed briefs *amicus curiae* in support of the petitioner utilities in both cases. The National Association of Regulatory Utility Commissioners (NARUC) has also filed a brief *amicus curiae* supporting the City of New Orleans and opposing the granting of the petition. NARUC argues for the preservation of the federal courts' discretionary right to abstain when strong state or local interests are involved and where the exercise of federal jurisdiction would interfere with a complex state regulatory scheme or with ongoing state proceedings.⁸⁸

The facts in *American Electric Power Co. v. Kentucky Public Service Commission*, (*AEP v. Kentucky PSC*) constitute perhaps the clearest example of forum-shopping by a utility that has been observed in recent years. In 1981, Kentucky Power Co., a wholly-owned subsidiary of American Electric Power Company (AEP), filed an application with the Kentucky PSC seeking authority to own 15 percent of the 1,300 megawatt coal-burning Rockport generating plant then under construction by AEP near Rockport, Indiana. As with most integrated multi-state holding companies, all AEP subsidiaries are parties to a pooling agreement which governs the generation and transmission facilities each subsidiary provides to the power pool and specifies how the subsidiaries are to share in these facilities. Kentucky Power's application to purchase 15 percent of the Rockport plant was based on two contentions: the company's alleged need for additional generating capacity and the company's alleged inability to meet that need by purchasing capacity under the pooling agreement.⁸⁹

Witnesses for Kentucky Power testified before the Kentucky PSC that, because of an *implied* obligation under the pooling agreement, the company was prohibited from continuing to purchase power from the pool. Conse-

1986); compare *Appalachian Power Co. v. Public Serv. Comm'n of W. Va.*, 614 F. Supp. 64 (S.D.W. Va. 1985) (preliminary injunction), *aff'd*, 770 F.2d 159 (4th Cir. 1985), 630 F. Supp. 656 (S.D.W. Va. 1986) (declaratory judgment) with *Aluminum Co. of America v. Utilities Comm'n of N.C.*, 713 F.2d 1024 (4th Cir. 1983), cert. denied, 465 U.S. 1052 (1984); *Middle Energy, Inc. v. Arkansas Pub. Serv. Comm'n*, 772 F.2d 404 (8th Cir. 1985), cert. denied sub nom., *Ratepayers Fight Back v. Middle Energy, Inc.*, 106 S. Ct. 884 (1986); *IBEW v. Pub. Serv. Comm'n of Nev.*, 614 F.2d 206 (9th Cir. 1980).

86. No. 85-5129 slip op. (6th Cir. Mar. 24, 1986), *petition for cert. filed*, 55 U.S.L.W. 3032 (July 17, 1986).

87. 782 F.2d 1236 (5th Cir. 1986), modifying Part IV, 798 F.2d 858 (5th Cir. 1986), *petition for cert. filed* No. 86-546 (October 3, 1986).

88. See Brief *Amicus Curiae* of the National Association of Regulatory Utility Commissioners in *New Orleans Pub. Serv., Inc. v. City of New Orleans* (No. 86-546).

89. Testimony of Kentucky Public Service Commission Vice Chairman Rush W. Dozier, Jr., at a Hearing on the Ratepayers Protection Act, S. 1149, before the Committee on Energy and Natural Resources, Subcommittee on Water and Power (July 23, 1986) [hereinafter Testimony of Rush W. Dozier].

quently, the company argued that the purchase of a portion of the Rockport plant was its only available source of supply for additional power.⁹⁰

The Kentucky PSC, after several years of litigation, eventually denied Kentucky Power's bid to purchase 15 percent of the Rockport plant. The Commission found that the AEP interconnection agreement did not require Kentucky Power to provide power to the pool equal to its load plus a reserve margin and, thus, that there was no reason for Kentucky Power to stop buying power from the pool. In support of its conclusion, the PSC found that the AEP system had a combined reserve margin of nearly 50 percent and that power purchased from the pool was much cheaper than the power available from the Rockport plant.⁹¹

On August 2, 1984, the same day that the Kentucky PSC issued its opinion disapproving Kentucky Power's application to buy a share of Rockport, AEP filed a unit power sales agreement with the FERC. This agreement called for AEP Generating Co. (a subsidiary formed to own Rockport) to sell 15 percent of the capacity and energy from Rockport to Kentucky Power. The financial effect of this agreement was almost identical to the originally-proposed purchase by Kentucky Power of 15 percent of the plant. Invoking the prudence-of-purchase standard of *Pike County*, the Kentucky PSC denied Kentucky Power the right to recover the unit power sales costs from retail ratepayers. According to Kentucky PSC Vice Chairman Rush W. Dozier, Jr., testifying before a Senate Subcommittee in July 1986,

In essence, we felt that the unit power agreement was simply a tactic by AEP to use the FERC to require Kentucky Power to do something the Kentucky PSC had ordered it not to do. We refused to allow Kentucky Power to pass through to its customers the extra \$23.3 million a year in costs from the imprudent unit power agreement and our litigation with AEP began. To use, the AEP's tactics seemed a dangerous example of arbitrarily jumping to a federal forum in order to overturn the legitimate decision of a state public service commission. That this maneuver was even possible highlights the grave uncertainties that exist in the interpretation of the Federal Power Act.⁹²

To date, in both state and federal forums, the Kentucky PSC has managed to avoid a finding of federal preemption of its actions. The Court of Appeals for the Sixth Circuit upheld the decision of the U.S. District Court to abstain from involving itself in the case.⁹³ It is this decision that is now the subject of AEP's petition for a writ of certiorari to the U.S. Supreme Court. The Franklin Circuit Court in Kentucky also found that the PSC's disallowance of the unit power agreement was fully justified.⁹⁴ AEP has appealed this decision to the Kentucky Court of Appeals.

In a bizarre and convoluted tangle of litigation growing out of the *Middle South* cases at the FERC, the City of New Orleans was sued in 1985 by New Orleans Public Service, Inc. (NOPSI), which sought an order from the federal

90. *Id.* See the discussion of the FERC proceedings involving *Kentucky Power supra* text accompanying notes 43-56.

91. Testimony of Rush W. Dozier.

92. *Id.*

93. No. 85-5129, slip op. (6th Cir. Mar. 24, 1986).

94. *Kentucky Power Co. v. Kentucky Pub. Serv. Comm'n*, No. 84-CI-1760 (Franklin Cir. Ct., Ky., Mar. 24, 1986).

district court that the City—through its City Council, which regulates NOPSI's rates—"recognize" in retail rates, as a legitimate operating cost of NOPSI, the FERC-allocated costs associated with Grand Gulf Unit 1. In *New Orleans Public Service, Inc. v. City of New Orleans*,⁹⁵ the federal district court dismissed NOPSI's claims for lack of subject matter jurisdiction under Fed. R. Civ. P. 12(b)(1), holding that the Johnson Act,⁹⁶ which places statutory limitations on the circumstances in which a federal court can issue injunctions against state orders affecting rates of public utilities, warranted dismissal and that, in any event, *Burford* abstention⁹⁷ precluded the district court's exercise of jurisdiction.

The Fifth Circuit Court of Appeals granted NOPSI an expedited appeal. The FERC filed a brief *amicus curiae* and presented oral argument in support of the position taken by NOPSI.⁹⁸ On February 14, 1986, the Fifth Circuit reversed the district court, ruling that the Johnson Act⁹⁹ did not preclude jurisdiction and that abstention was inappropriate.¹⁰⁰ Partly because of that decision and comments to counsel from the district court concerning a companion case, the City Council of New Orleans entered into a partial settlement with NOPSI of the dispute between them, in which both the City and NOPSI reserved all of their rights. Among those reserved rights was the City's asserted right to reduce the level of FERC-mandated costs recognized in NOPSI's retail rates pursuant to an inquiry into the prudence of NOPSI's involvement in the Grand Gulf Project and the City's right to abrogate NOPSI's contracts concerning Grand Gulf. The partial settlement did not contemplate or require that any litigation between the parties be dismissed. As the result of this settlement, NOPSI began collecting increased retail rates to defray a portion of its Grand Gulf costs.

Subsequently, on June 10, 1986, the Fifth Circuit, which had "held" the mandate of its February decision, advised the parties that it would reconsider a part of its decision and requested letter briefs addressing *Burford* abstention. On September 2, 1986, the Fifth Circuit withdrew that part of its original opinion and issued an amended opinion, affirming the district court's decision to abstain, and ordering issuance of the mandate "forthwith."¹⁰¹ The FERC filed a motion to intervene to enable it to seek rehearing *en banc*, but the Fifth Circuit denied the motion on September 11, 1986. On October 3, 1986, NOPSI filed its petition for writ of certiorari with the Supreme Court, arguing that the Fifth Circuit decision and that of the Sixth Circuit in the *AEP v. Kentucky PSC*¹⁰² case present issues that have polarized the circuits, "producing widespread conflict among them." NOPSI's petition asserted that the abstention issue is now "flowering into what may become the major legal battleground in

95. No. 85-3398, slip op. (5th Cir. September 16, 1985).

96. 28 U.S.C. § 1342 (1982).

97. *Burford v. Sun Oil Co.* 319 U.S. 315 (1943).

98. See excerpt *supra* note 67.

99. 28 U.S.C. § 1342 (1982).

100. 782 F.2d 1236 (5th Cir. 1986).

101. 798 F.2d 858 (5th Cir. 1986).

102. No. 85-5129 (6th Cir. Mar. 24, 1986), *petition for cert. filed*, 55 U.S.L.W. 3032 (July 17, 1986) (No. 86-49).

utility regulatory matters during the latter half of the 20th century.”¹⁰³ Not unexpectedly, NOPSI cited *Nantahala, Narragansett*, and a litany of decisions from the Third, Fourth, Eighth, Ninth, Eleventh, and District of Columbia Circuits in support of its position that a federal court may not abstain from adjudicating a statutorily-based federal preemption claim “where there is no countervailing state interest and which claim is not the subject of a state judicial proceeding.”

Responding in opposition to the petition for certiorari, the City of New Orleans stressed the Supreme Court’s recognition in *Louisiana Public Service Commission v. Federal Communications Commission*,¹⁰⁴ that the Communications Act of 1934 established a “dual system” of state and federal regulation of telephone service and the Court’s conclusion that the Act did not preempt state regulation over depreciation of dual jurisdiction properly for intrastate ratemaking purposes. The City argued that Congress intended to preserve state regulation of electric utilities in enacting the Federal Power Act, quoting the Fifth Circuit opinion with respect to the congressionally-created “bright line” between federal and state jurisdiction, which denies “state power to regulate a sale ‘at wholesale to local distributing companies’ and allows state regulation of the sale at ‘local rates to ultimate consumer.’”¹⁰⁵ In two paragraphs, the Fifth Circuit put a new gloss on the federal/state conflict over the regulation of electric utilities:

The existence of this “bright line” colors the way we view a preemption claim involving the Federal Power Act. NOPSI has attempted to depict the situation before us as one in which the Council is stepping into the realm of *wholesale* ratemaking, a field under the exclusive jurisdiction of FERC. NOPSI focuses on the disruption of a *federal* scheme. Yet federal court intervention here may constitute a disruption of a *state* regulatory scheme, for *retail* rate making is clearly a field left to the jurisdiction of the states. While the recent Supreme Court case of *Nantahala Power & Light Co. v. Thornburg*, 106 S.Ct. 2349 (1986) required that the local council recognize the FERC-determined wholesale costs, local control over retail ratemaking is not preempted by federal law: *Nantahala* recognizes that retail rates need not necessarily be increased to reflect the corresponding increase in wholesale rates set by FERC. Instead, local councils are permitted the autonomy preserved to them by the Federal Power Act and can consider cost savings in other areas relevant to the setting of retail rates. 106 S.Ct. at 2357-58.

Thus, under the Federal Power Act, the wholesale rates by FERC, although a matter of national concern, are effectuated at the retail level only by local institutions. The structure of the Federal Power Act, preserving as it does state jurisdiction over retail rates, suggests that these local institutions should normally proceed unfettered by federal interference. Although we do not intimate that abstention in the face of a preemption claim under the Federal Power Act may never constitute an abuse of discretion, abstention should perhaps more often obtain in cases presenting a question of preemption under the Federal Power Act than would be so in cases presenting other types of federal preemption claims.¹⁰⁶

Finally, the City of New Orleans argued that the Supreme Court should deny certiorari on the grounds that the abstention issue was rendered moot by the

103. *Id.*

104. 106 S. Ct. 1890 (1986).

105. 798 F.2d 858, 860 (citations omitted).

106. *Id.* at 860-61 (emphasis in original).

retail rate settlement reached between the City and NOPSI. A decision to grant or deny the petition will probably be made by the Supreme Court in early 1987.

VI. *Commonwealth Electric*—CONSCIOUSNESS-RAISING AT THE SUPREME COURT

On October 6, 1986, the Supreme Court requested¹⁰⁷ that the FERC submit briefs to help it determine whether to review *AEP v. Kentucky Public Service Commission* and *Commonwealth Electric Co. v. Massachusetts Department of Public Utilities*.¹⁰⁸

As noted earlier, *AEP v. Kentucky PSC* (as well as *New Orleans Public Service, Inc. v. City of New Orleans*) presents the question whether federal courts should have the discretion to abstain from exercising jurisdiction over local regulation of prudence-of-purchase issues when questions of preemption are raised. *Commonwealth Electric* is not an abstention case; rather, it presents in a very direct fashion the question whether states retain maneuvering room to examine prudence-of-purchase issues.

In its April 1986 decision, the Massachusetts Supreme Judicial Court upheld the state Department of Public Utilities (DPU), which imputed to Commonwealth Electric the imprudence of Boston Edison in managing an outage of its Pilgrim-1 nuclear plant. Commonwealth Electric is a minority joint owner of the plant with Boston Edison. It should be noted that Boston Edison and Commonwealth Electric are not affiliated and that neither is a member of a public utility holding company, although both are members of the New England power pool. Commonwealth Electric purchases 11 percent of the capacity of Pilgrim-1 under a unit power agreement approved by the FERC. The state court also affirmed the DPU's disallowance of recovery of Commonwealth Electric of costs incurred by it under a federally-approved agreement to purchase expensive replacement power during the 1981-82 Pilgrim outage. In its appeal of the DPU's decision to the state courts, Commonwealth Electric argued that because the rates it must pay to its wholesale suppliers (in this case, those who furnished the replacement power) are fixed by FERC regulation, oversight by the DPU of the company's costs based on those rates is an obstacle to the realization of the purposes behind the Federal Power Act and thus, that the DPU had no jurisdiction over expenses incurred under a FERC-approved rate. The state court held that Commonwealth Electric was wrong in asserting that the Massachusetts DPU was, by regulating the prudence of purchase of replacement power, reviewing the reasonableness of the wholesale rate previously set by FERC. In so doing, the state court lucidly spelled out a compelling rationale for the *Pike County* exception to *Narragansett* preemption:

The DPU argues that the Federal regulation of the rates for wholesale transactions is not disturbed by its inquiry into the prudence of a retail seller in choosing the source of

107. 107 S. Ct. 56 (1986).

108. *Commonwealth Elec. Co. v. Department of Pub. Util.* 397 Mass. 361, 491 N.E.2d at 1035 (1986) [hereinafter *Commonwealth Electric*].

its supply and in incurring particular costs. We agree.

*The DPU offers a telling analogy to the rates it approves for retail sales to clarify the difference between rate-approval and inquiry into the prudence of incurring costs. "[W]hen the [DPU] sets retail rates, retail customers are faced with a rate that has been found to be just and reasonable, and they must pay that rate if they choose to buy electricity. . . . Decisions to purchase electricity, however, present different questions for each buyer. An industrial customer, for example, may decide that, given available alternatives, the purchase of electricity from the retail company is not reasonable or prudent from his business' point of view. He may choose to use his own power generation equipment or another source of energy, such as oil, natural gas, or coal. He may decide to leave the geographic area altogether. Similarly, a retail electric company may decline to execute a wholesale supply contract upon the discovery of less expensive alternatives. If it chooses to ignore those alternatives and execute the wholesale contract, however, or if it incurs wholesale costs as a result of its imprudence . . . , it may be ruled imprudent notwithstanding the fact that the rate at which it purchases wholesale-electricity was approved by FERC."*¹⁰⁹

Summing up, the Massachusetts court declared:

In short, while the DPU cannot inquire into the reasonableness of wholesale rates fixed by FERC, [citation omitted] the DPU may inquire whether a purchaser, such as the company, is warranted in agreeing to purchase at such a rate considering its alternatives. *Appeal of Sinclair Mach. Prods., Inc.*, 498 A.2d 696, 699 (N.H. 1985).

The company has failed to sustain its burden of demonstrating by hard evidence how the action of the DPU will frustrate the full purposes and objectives of Congress in enacting the FPA. We conclude that the DPU was not preempted from the action it took in this case.¹¹⁰

The Massachusetts court also held that the DPU was not attacking collaterally (and therefore impermissibly) an FERC administrative decision to approve the company's contracts with its wholesale suppliers, for the reason that the FERC does not have jurisdiction over retail rates and, therefore, the prudence-of-purchase issues "could not, and should not, have been raised in an FERC rate-approval proceeding or a review of a FERC decision."¹¹¹

The state court also held that Commonwealth had made no showing that the DPU's actions violated the Commerce Clause of the Constitution of the United States.¹¹² In so doing, the court summarily rejected Commonwealth's argument that "the benefit of 'an added level of review of prudence of power supply costs' would not outweigh the burdens of uncertainty of the finality of FERC approval . . . ," stating that the company's description of the benefit of State regulation is "inaccurate" and that

[t]he DPU review of the prudence of retail utilities is not "added"; the DPU is the agency charged with that function, and the jurisdiction of FERC is expressly limited to exclude that function. See 16 U.S.C.

§§ 824(a), (b)(1) (1982); *Batavia v. FERC*, 672 F.2d 64 (D.C. Cir. 1982); *FPC v. Southern Cal. Edison Co.*, 376 U.S. 205 (1964).¹¹³

The significance of *Commonwealth Electric* has been placed into high relief in recent weeks, owing to the request by the United States Supreme Court

109. 491 N.E.2d at 1045.

110. *Id.*

111. *Id.* at 1046 (emphasis added).

112. Art. I, § 8, cl. 3.

113. *Commonwealth Electric*, 491 N.E.2d at 1046 (emphasis added).

that the FERC express its opinion on the issues presented by the appeal. The fact of this request, in addition to similar ones in the *AEP v. Kentucky PSU* and *New Orleans* cases, raises the possibility that the Court's consciousness has been elevated as to the importance of resolving, once and for all, the *Pike County* issue, and that a decision by the Court to consider the question may be imminent. The *New Orleans* case may thus present simply an additional opportunity for the Court to decide the issue now. While it is possible that the Court will grant certiorari in all three of these cases and even consider them together for a decision, the Court may decide not to embroider on its 1986 *Nantahala* decision at this time. It is also possible that a petition for certiorari in the *Middle South* case (*Mississippi Industries*) will be filed and ruled upon during the current term of the Supreme Court. Should that occur and the petition be granted, it is likely that additional states and local regulators will find it irresistible to come to the defense of the prudence-of-purchase doctrine and align themselves together against the utilities and their allies, including the FERC, on this critical preemption issue.

VII. GULF STATES UTILITIES AND SOUTHERN COMPANY—THE NEW FRONTIER FOR PREEMPTION.

Although the *Middle South* and *AEP* cases have proven to be fertile ground for proponents of expanded the FERC power over holding company subsidiaries—at the expense of state regulation—recent developments in Texas and Louisiana may yet offer the FERC the opportunity to go “one step beyond” its current position. Gulf States Utilities (GSU) is a stand-alone utility serving customers in South Texas and Louisiana. Like Middle South, GSU has been mired down in a costly nuclear venture, the \$4.5 billion River Bend nuclear plant in Louisiana. Compounding its financial troubles have been the depressed oil and gas industry in the region, accompanying drop-offs in industrial load, and the increasing movement by remaining industry toward on-site self-generation as the specter of rate shock looms. While GSU has continued to plead for rate relief from the Texas Public Utilities Commission and the Louisiana Public Service Commission, contending that bankruptcy is imminent, the Texas Commission in 1986 opened an investigation of the prudence of GSU entering into two contracts with the Southern Company to purchase a total of 1000 megawatts over a ten-year period ending in 1992.¹¹⁴

On October 3, 1986, the Texas PUC voted 2-1 to affirm an administrative law judge's ruling that GSU was imprudent in entering into the contracts with the Southern Company. The decision disallowed inclusion of about \$50 million in capacity costs in GSU's Texas rates, but permitted inclusion of \$27 million in associated energy costs. The Louisiana Public Service Commission has also initiated an investigation and hearings to explore the prudence of the purchase of GSU. According to an attorney for the PUC, quoted in *Electric Utility Week*, the decision sets a precedent in Texas “that says we can look at the prudence of

114. GSU Stock Drops on La. PSC Move, But Deal Achieved With Texas Customers, *ELECTRIC UTIL. WEEK*, June 16, 1986, at 9.

[a utility's] decision-making process in incurring operating expenses."¹¹⁵ The same attorney observed that prudence reviews usually have focused on invested capital in nuclear or coal plants.

For its part, GSU has appealed the Texas PUC decision to state court.¹¹⁶ While contending that the company was not imprudent in entering into the Southern contracts, GSU has also asserted that the Texas commission is not the proper forum for resolving issues arising from the contracts. According to a GSU spokesman, "we feel that it's up to [the federal Energy Regulatory Commission] and up to the federal courts."¹¹⁷

If at some point GSU should file a complaint in federal court seeking to enjoin the Texas commission from enforcing its prudence-of-purchase disallowances, the case would present FERC with the opportunity to intervene and argue for the expansion of its preemption arguments beyond the bounds of the *AEP Generating Company* litmus test quoted above. The FERC's argument in that event might run something like this: Under *Nantahala* and *Narragansett*, so long as a purchased power contract has the FERC stamp of approval, no state or local regulatory agency may disallow any of the costs from pass-through at retail on the grounds that the purchasing utility made an imprudent purchase, *even though* the purchasing and selling utilities are not affiliated jurisdictional utilities, are not members of an integrated interstate holding company arrangement, and are not performing diverse functions on a coordinated basis.

In other words, it is but a short step for FERC to argue that what really matters is whether the FERC has approved the contract, *not* whether holding company affiliates are involved or whether systems are integrated. Perhaps the FERC will shrink from involving itself in the *Gulf States* case if the preemption issue raises its head. If the Commission does not resist the temptation, however, one can even foresee the next—perhaps ultimate—step. Should the City of New Orleans, for example, proceed with efforts initiated in 1985 to "municipalize" NOPSI by exercising provisions in its 1922 charter of that utility which permit the city to buy out the assets of NOPSI at book value, the FERC might, considering its recent track record, assert that such matters are also preempted by the Federal Power Act and the Commerce Clause, because they would "affect" the contracts of, and therefore, the rates of a jurisdictional integrated

115. *Precedential Texas Ruling Finds GSU Imprudent in Entering Southern Pact*, ELECTRIC UTIL. WEEK, Oct. 13, 1986, at 3.

116. As of late January 1987, GSU's woes had worsened to the extent that the company was promoting itself as a candidate for the first Chapter 11 bankruptcy-law filing by an investor-owned utility since the Great Depression. Having failed to obtain \$182 million in emergency rate relief from the Louisiana and Texas utility commissions and suffering from an 11 percent drop in its industrial-customer base in 1986 alone owing to rapid cogeneration development, GSU also faces investigations of the prudence of its decision to build the \$4.4 River Bend nuclear plant. According to the former head of the Texas Office of Public Utility Counsel, Jim Boyle, GSU's shrinking service base raises the spectre of a "death spiral," in which customers look for cheaper energy forms, such as cogeneration, thus reducing the number of customers available to cover the utility's fixed costs. According to Boyle, "If the company got what it wanted [\$164 million in permanent rate relief now pending before the two state commissions], it would sign its death warrant." See *Gulf States Trends Fine Line in Rate Bid*, Wall Street Journal, Jan. 28, 1987, at 6.

117. ELECTRIC UTIL. WEEK, Oct. 13, 1986, at 3.

multi-state utility holding company.¹¹⁸ Such an assertion would present an even more fundamental kind of federal/state conflict for resolution by the federal courts.

If the FERC and the utilities prevail in cases now pending before, or wending their way toward, the Supreme Court, the auguries are not good for state and local regulation of electric utilities that are able to create wholesale generation and transmission subsidiaries and engage in unit power sales agreements and purchased power agreements that can achieve the transfer of regulatory jurisdiction to the FERC and away from the states. In view of the FERC's less-than-impressive record of reviewing prudence and need-for-power issues, the final validation by the Supreme Court of such a transfer of regulatory

118. See discussion *supra* text accompanying notes 71-83. While some might say that speculation as to the FERC's next move to expand its jurisdiction is far-fetched, it is instructive to read the following excerpt from a legal opinion provided by private legal counsel to NOPSI on March 30, 1983, in response to an inquiry from NOPSI President James M. Cain:

The first point considered is whether the Takeover [shorthand in the opinion letter for "municipalization"] would constitute or result in an unlawful interference with or circumvention of the jurisdiction of the Federal Energy Regulatory Commission ("FERC") with respect to the rates to be charged by and for Grand Gulf, and any resultant jurisdiction the FERC may have with respect to the allocation of electricity generated by Grand Gulf. We note first in this connection that under the indeterminate permit the City has vested contract rights which were vested in the City in 1922, well before the adoption of the Federal Power Act ("Act") in 1935. We note further that the Act covers the regulation of electric utility companies engaged in interstate commerce in Part II thereof, that Section 201 of the Act is the first section in such Part II, and that subsection (f) of Section 201 states that no provision of such Part shall apply to, or be deemed to include, a municipality. It thus appears that the FERC has no jurisdiction over the City itself in this matter, and that the effecting by the City of the Takeover would simply constitute an enforcement by the City of its vested contract rights and would not, in and of itself, be an interference with or circumvention of FERC jurisdiction. . . .

Letter from Melvin I. Schwartzman, attorney with the firm of Monroe & Lemann, New Orleans, La., to James M. Cain, President of NOPSI, (Mar. 30, 1983) Letter, at 2 hereinafter.

It will be interesting indeed to observe whether the FERC and its legal counsel concur in this opinion by a Middle South affiliate's own lawyers, if the City of New Orleans should decide to proceed with municipalization of NOPSI. See *Can NOPSI Stop Municipalization*, Gambit (a New Orleans newspaper), (Aug. 9, 1986), which revealed the existence of the NOPSI legal opinion from which the above quotation is taken. Of even greater interest to the FERC in this event might be NOPSI's lawyers opinion in the same letter of the effect of municipalization on the recovery by NOPSI of rates, it was ordered by the FERC to pay MSE for Grand Gulf. The letter continues:

The decision of the FERC with regard to the rates at which NOPSI (and the other customers of Grand Gulf) shall or may buy power from Grand Gulf and any decision with regard to the amount or allocation of that power would still be in effect. Of course, at that point NOPSI would have no facilities with which to receive or distribute that power and presumably would have no revenues from which to pay for any power, but the FERC order would still be in effect unchanged. In other words, it appears to us that NOPSI's aforesaid inabilities would be consequential result of the City's enforcement of its rights, not giving rise to an actionable interference by the City with or circumvention by the City of FERC jurisdiction. *This might subsequently make it necessary for the rates and any power allocations of Grand Gulf's remaining customers to be increased* but, again, this is within the FERC's jurisdiction not a violation of it, and the resultant difficulties for such remaining customers and/or for the owner of Grand Gulf would, it appears to us, be consequential results not adversely affecting the right of the City to effect the Takeover.

Letter at 2 (emphasis added). One can only wonder how the FERC would react to such an argument: i.e., that New Orleans, by taking actions to municipalize, can avoid Grand Gulf obligations and shift costs onto the remaining Middle South companies—all without stepping on the FERC's jurisdictional toes.

power to the federal government would be tantamount to deregulation of the rates of the country's largest monopolies.

VIII. CONCLUSION

As these issues move closer to resolution, it is worth recalling that Congress imposed a comprehensive scheme of regulation on the electric utility industry to deal with major problems—"gaps"—existing in 1935. It enacted the Public Utility Act of 1935 in two parts—Part II of the Federal Power Act and the Public Utility Holding Company Act.¹¹⁹ Under the scheme of that landmark legislation, which was designed to deal with very serious abuses and scandals in the electric industry, the SEC was to regulate so as to close the "Holding Company Gap" (see below), and the Federal Power Commission, now the FERC, was to regulate the rates for transmission and sale for resale of power in interstate commerce in order to close the "Attleboro Gap"¹²⁰ to protect consumers.¹²¹ The FERC, consistent with ten-prevalent constitutional notions of interstate commerce, was not granted the power to regulate the construction and ownership of steam-electric power plants.¹²²

State regulation of retail electric utility service was to be supported, not supplanted, under the scheme of the 1935 legislation.¹²³ State regulation was to be fostered by making state approvals a prerequisite to approvals of public utility holding companies' proposals for system financings or for the acquisition of utility securities.¹²⁴

The 1935 legislation (for example, section 209 of the Federal Power Act),¹²⁵ as well as current notions of constitutional law, envisioned overlapping the FERC and state regulatory authority—a dual regulatory scheme. Absent this maintenance of state authority, there would be a split between the responsibilities of state agencies regarding the setting of retail rates and those agencies' authority to address some of the principal causes of rate increases, such as overbuilding of generating facilities. This split would thwart the protection of ratepayers which was the principal purpose of the Public Utility Act of 1935. Accordingly, states retain authority to determine matters such as the economic need for power.¹²⁶

Under the Public Utility Holding Company Act, the SEC is charged with the responsibility of fostering the development of holding company operating systems along economic lines, while preventing abusive use of affiliate relationships to create structures that cannot be regulated or to inflate rates. The creation and financings of holding company affiliates are to be regulated to accom-

119. 49 Stat. 803 (1935).

120. *Public Util. Comm'n v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927).

121. *See, e.g., Jersey Cent. Power & Light Co. v. FPC*, 48 PUR (NS) 129, 136 (1943).

122. *Id.* at 135-36 n.9; Section 201(b) of the Federal Power Act, 16 U.S.C. § 824(b) (1982); *Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375 (1983).

123. *See* legislative history recounted in dissent in *FPC v. Florida Power & Light Co.*, 404 U.S. (1972).

124. *See supra* note 41 for relevant PUHCA provisions.

125. 16 U.S.C. § 824h (1982).

126. *Cf. Pacific Gas & Elec. Co. v. State Energy Res. and Conservation and Dev. Comm'n*, 461 U.S. 190 (1983).

plish the Public Utility Holding Company Act's purposes.¹²⁷ In exercising its jurisdiction, the SEC is the only agency with jurisdiction over the parent holding company and over the non-utility service company affiliates (as well as the utility operating companies). In the event an affiliate in a holding company system seeks to sell securities that are not subject to state approval, the SEC is the only agency with jurisdiction to require that the capital structure of the affiliate be related to the affiliate's reasonably manifest earning power.

To the extent that FERC's interpretation of the Holding Company Act undermines the ability of the states to effectively regulate operating companies in holding company systems, it thwarts the administration of the Holding Company Act. As the D.C. Court of Appeals has held: "The purpose of the Public Utility Holding Company Act, as shown by its legislative history, was to supplement state regulation—not to supplant it."¹²⁸

If the FERC's world view of holding company regulation should be affirmed by the courts, Congress should enact amendments to the Federal Power Act and the Public Utility Holding Company Act to restore the ability of the states to protect retail customers of holding company subsidiaries from abusive practices and "creative" corporate and financing structures which insulate major capital investment projects from state or local review and regulation and which result in the transfer of jurisdiction to less stringent regulation¹²⁹ at the federal level, where the cries of ratepayers are more distant and difficult to hear.¹³⁰

If the courts follow the FERC 'affiliated company' interpretation and there are no changes in federal law, ratepayers served by holding company subsidiaries (and perhaps in "non-holding company" pools) will have been relegated to a status as inferior, unprotected, second-class ratepayers—a status justified only by the corporate structure of the companies that produce their electricity or, more precisely, that hold title to generating facilities. One observer has characterized the FERC's view of holding company transactions as "[i]n for a penny, in for a pound," based on the apparent acquiescence of FERC in the existence of costs pass-through entities such as MSE, which escape state regulation owing to their wholly wholesale nature.¹³¹ Leaving the

127. *City of Lafayette, La v. SEC*, 91 PUR3d 266 (D.C. Cir. 1971).

128. *Alabama Elec. Coop. v. SEC*, 353 F.2d 905, 907 (D.C. Cir. 1965), *cert. denied*, 383 U.S. 968 (1966).

129. Observers such as *Barrons, Newsday* and the National Regulatory Research Institute at Ohio State University have recognized FERC as being more lenient with utilities than are State commissions. See also *infra* note 136.

130. See, e.g., S. REP. NO. 1149, 99th Cong. 1st Sess., which would amend the Federal Power Act to allow State commissions to determine whether to exclude all or part of rates set by the FERC when the FERC-established rates are based on an "allocation" of energy or costs within a holding company system and when the State commission had not approved the construction of the generating facility whose costs were allocated. If enacted, this bill would explicitly define a *Pike/Holding Company* exception to the *Narragansett/Nantahala* doctrine.

131. Commonwealth Edison of Illinois is the latest, and by far the largest, utility planning to restructure its corporate charter to bring major generating facilities under FERC regulation and to remove its three uncompleted nuclear plants from the regulatory oversight of the Illinois Commerce Commission. In later December 1986, Commonwealth Edison announced a comprehensive plan to transfer its entire nuclear construction program to a new, separate generating subsidiary that would "then act as a wholesale supplier," according to former FERC chairman Raymond O'Connor, now senior banker for the electric and natural gas

regulation of such generation and transmission companies solely to FERC oversight, as the FERC would apparently have it, presents grave risks that no one will be minding the store when it comes to planning, building and then ratebasing costly new capacity to be sold at wholesale to affiliates pursuant to unit power sales agreements or purchase power agreements. These risks flow from the uncontested fact that the Federal Power Act makes no provision for the issuance of certificates of public convenience and necessity by the FERC with regard to steam electric (*i.e.*, coal, nuclear, and oil) construction projects. This lacuna in the regulation of "need for power" does not exist with respect to natural gas, for which the FERC was granted certification authority under the Natural Gas Act.¹³²

In other words, unlike the states, the FERC lacks the instruments of control necessary to implement and enforce a true prudence standard. Without the power to pass on the need for power before construction takes place, the Commission can hardly be expected to examine rigorously the prudence of construction of a plant or the prudence of purchases of power from it after the plant has become a *fait accompli*. Grand Gulf is a perfect example of this nonsensical state of affairs. Furthermore, in contrast to state utility commissions, the FERC has *never* disallowed any fraction of electric utility investment in a new power plant on the grounds of excess capacity, and despite "hundreds of requests"¹³³ to do so, the FERC has found imprudence only two times in relatively minor cases.¹³⁴ Finally, while state regulators have generally amortized canceled plants over about 10 years, the FERC has usually used a 5-10 year period, placing more of the burden on ratepayers.¹³⁵ It is no wonder that FERC gets the highest marks from investment brokerage firms when it comes

industry for Citibank. [O'Connor served as FERC chairman at the time the Commission ruled in the Middle South cases, but resigned shortly thereafter.] See *Utility's Proposal Seen as Step Toward Deregulation*, Wall Street Journal, Dec. 22, 1986, at 6, which reported:

Edison still must get the [Illinois Commerce] [C]ommission's approval of its proposal and plans to formally present it to regulators within 30 days. Consumer groups have criticized the plan as one that would hurt the utility's ratepayers.

While the proposal means the three nuclear generating plants would be under federal regulation, *FERC has a reputation, at least in recent years, for regulating with a lighter touch than most state commissions.* "A federal agency has a huge amount of jurisdiction and can generally take a more detached view," Mr. O'Connor said. "It's one step removed from the very intense problems that state regulators have."

(Emphasis added.)

132. See testimony of Basil L. Copeland, Jr., in *New England Power Co.*, FERC Nos. ER85-646-005, ER85-647-003 (Phase II), Ex. 15 at 19, lines 11-23; Ex. 158 at 2, lines 14-17; and Transcript at 130 (1986).

133. *Doctrine of Prudence in the Regulation of Public Utilities*, speech by FERC Administrative Law Judge Ernst Liebman to a legal seminar of the American Public Power Association, Seattle, Wash., Oct. 1984, 4 FERC MONITOR, No. 24 at 11 Nov. 29, 1984. Judge Liebman declared that although imprudence claims have been raised "hundreds of times" in FERC rate cases, "the Commission has rarely made a finding of imprudence—a notable exception being the *Columbia Gas Transmission* case."

134. Invited testimony of Utility Analyst Alan J. Nogee, Environmental Action Foundation at Hearing on the Ratepayers Protection Act. S. 1149, 99th Cong., before the Committee on Energy and Natural Resources, Subcommittee on Water and Power, July 23, 1986, at 8 (citing Small, *FERC Electric Rate Primer*, 5 ENERGY L.J. 110 (1984)).

135. *Id.* at 13.

to ranking regulators' generosity with stockholders.¹³⁶

Still, some hope for local regulation remains. Despite *Nantahala's* sometimes ominous language, it also contains some language that may be deemed promising by state regulators as they watch other cases advance toward Supreme Court review. As mentioned previously, in *Louisiana Public Service Commission v. Federal Communications Commission*,¹³⁷ involving telephone company depreciation practices, the Supreme Court a few weeks before *Nantahala* pulled no punches in instructing the Federal Communications Commission that it had misinterpreted and overexpanded its jurisdiction under the Federal Communications Act. The Court found that Congress had established "a system of dual state and federal regulation over telephone rates" and had placed "express jurisdictional limitations" on the power of the FCC, thus "fencing off" the FCC from reaching or regulating intrastate matters. In that case, the Supreme Court found that "an agency literally has no power to act, let alone preempt the validly enacted legislation of a sovereign state, unless and until Congress confers power upon it."¹³⁸

While the Supreme Court's recent decision in *Nantahala* clearly declares that a state "must . . . give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority,"¹³⁹ the Court nowhere found that the FERC has the authority to compel purchases of power at wholesale or to preempt the right of the states to examine the prudence of purchases, whether or not holding companies are involved. These are issues for another day. Until those issues are resolved, our prediction is that state commissions will cautiously and more vigilantly consider *Pike County* as a vehicle for exercising state regulatory jurisdiction over electric utilities that purchase power at wholesale in interstate commerce, and that states will continue to exercise "review of the prudence of purchase" within the "dual regulatory" framework of federal law.

In calling for recognition of state sovereignty over prudence-of-purchase questions arising at the retail level, the authors disavow any intention or moti-

136. *FERC Gets Highest Marks in PSC Performance Ratings*, Elec. World, October 1985, at 26. See also the testimony of Dr. John W. Wilson in New England Power Co., FERC Nos. ER85-646-005 and ER85-647-003 (Phase II) Ex. 16 at 27 (1986), wherein Dr. Wilson enumerates a number of ratemaking policies which FERC has adopted that have the effect of insulating utilities from operating and financial risk. These policies include:

- (a) the use of the fuel adjustment cause;
- (b) the use of a future test year;
- (c) the allowance of 100% of pollution-control and environmental construction work in progress (CWIP) in rate base;
- (d) the allowance of 50% of non-pollution-control and environmental CWIP in rate base;
- (e) allowing a return on equity which reflects construction and cancellation risk during the construction period.
- (f) the recovery of prudent investment in cancelled and abandoned plant, i.e., the allowance of a return of investment on such plant;
- (g) the investment tax credit; and
- (h) the opportunity to make short-term power sales or interexchange transactions which are not, in some instances, recognized in the filed tariffs.

137. 106 S. Ct. 1890 (1986).

138. *Id.* at 1901.

139. *Nantahala*, 106 S. Ct. at 2357.

vation to engage in beggar-thy-neighbor games by attempting to “push off” on our sister states the high capacity costs of recently-constructed electric generating plants. The authors have noted that the FERC simply does not possess the statutory authority to conduct before-the-fact inquiries into the prudence of construction of thermal generating facilities, while most of the states do have and exercise such powers. Some observers have suggested that parochial efforts by states to shift costs of completed plants onto their neighbors will occur if states are at liberty to determine that those plants produce power at a price that is imprudently high, looking at the question with “perfect hindsight.” The response of these authors is that, in contrast to the states, the FERC exercises neither foresight nor hindsight in these matters; rather it appears to take, as *givens*, the need for construction, the costs incurred (no matter how great), and the entitlement of utility stockholders to complete costs recovery from retail ratepayers. It is thus no wonder that the State and their utility regulators, who bristle at the enormity of the consequences to their ratepayers posed by FERC reallocation decisions, such as *Middle South* and *Nantahala*, are seen by the FERC as the “bad guys” when they attempt to deflect these impacts from retail customers.

If the FERC were statutorily empowered and philosophically or politically inclined to regulate with a fair hand, from beginning to end, the questions of need for power, prudence of construction, and prudence of purchase for all utilities in the nation, there would probably be no need for the States, in response to FERC decisions to “equalize” costs, to undertake efforts to shift costs and responsibilities onto utility shareholders in order to protect ratepayers, but that is not the way our federal system of wholesale/retail power regulation is set up, and unless changed by Congress to give the FERC plenary jurisdiction over all these questions under a unified system of national utility regulation, the authors believe the States can, will, and should press for the absorption by utility stockholders of a larger share of the costs and burdens of the nuclear overbuilding debacle of the 1980s. These writers do not interpret the enactment of the Federal Power Act under the Commerce Clause of the Constitution as a license or directive to the FERC to suspend its obligation to regulate wholesale utilities and balance investor *and consumer* interests, while upbraiding the states and their regulators for attempting to do the same job at the retail level.

Perhaps the Supreme Court will ultimately hold that utility companies are absolutely entitled to a guarantee of total costs recovery, plus a profit, regardless of the perils of outrageous fortune that attend decisions to build enormous power plants using immature technologies such as nuclear power. Our reading of the *Hope*¹⁴⁰ decision still reveals, however, that the ratemaking process, *i.e.*, the fixing of “just and reasonable” rates, “involves a balancing of the investor and the consumer interests.”¹⁴¹ More to the point, the Court in *Hope* declared that “regulation does not *insure* that the business shall produce net revenues.” We adhere to the belief that every utility may make mistakes—be they in forecasting, construction management, anticipation of regulatory changes, or cost

140. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

141. *Id.* at 603 (quoting *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 590 (1942) (emphasis added)).

control—and that accompanying such mistakes is the responsibility of the company to share in their consequences with ratepayers. That means that if the utility shareholder, who stands to benefit through profits if things turn out right, also may suffer a reduction in profits if things turn out wrong.¹⁴²

142. *Id.*