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

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Everyone involved with utility regulation during the last ten years has been bedeviled by the difficulty in applying traditional (and indeed statutory) regulatory principles to the explosion of climate change, electric utility industry structure, digital divide, federal-state jurisdictional overlap and ideological issues affecting the electric and natural gas business and to a lesser extent telecommunications. Indeed, the Federal Energy Regulatory Commission's ("FERC's) recent spate of technical conferences about a multitude of electric utility issues, its pipeline certificate policy statement review and parallel actions by state commissions in those areas and telecommunications reflect the urgency of climate, environmental, social equity and privacy issues. The urgency felt by regulators and the regulated to address the effects of these and other trends in the electric, natural gas and telecommunications industries led Scott Hempling and the American Bar Association to issue a second and revised edition of his not-so-old 2013 book "Regulating Public Utility Performance."

Unlike most public utility texts that provide a deep dive into individual subjects, "Regulating Public Utility Performance" is written "to present the fundamentals of public utility law: the legal principles that practitioners need to make public-spirited proposals and that policymakers need to make public-spirited decisions."[1] Indeed, Mr. Hempling's ambition in this book is to promote the "effectiveness of regulation" in a "public spirited" direction. This goal of "increasing" effectiveness rather than just teaching the basics distinguishes this text from other legal case books or economic texts on principles of public utility regulation. Instead of elucidating principles of regulation to educate lawyers, economists and engineers how to use regulation to represent clients or the public interest on specific matters, this book is organized to: "Enable readers to act effectively in all regulated industries; help non-lawyers become conversant with law; prepare policymakers to adjust the law to accommodate technological change and preserve the credibility of regulation."[2] This vision of "effective regulation" is further explained as follows:

> What regulation must balance is not competing private interests but competing components of the public interest—e.g., long-term societal needs, short-term eco-

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1. SCOTT HEMPLING, REGULATING PUBLIC UTILITY PERFORMANCE: THE LAW OF MARKET STRUCTURE, PRICING, AND JURISDICTION xix (2d ed. 2021).

2. *Id.* at xxi-xxii.

> nomic needs, investor satisfaction, affordability, efficient price signals, environmental values, and global competitiveness . . . Effective regulation therefore aims to align private behavior with the public interest. Regulation defines standards for performance, then assigns consequences, positive and negative, for that performance. The common purpose of all regulation is performance . . . . *This view is neither universally shared nor permanently held*.[3]

That goal governs the book's organization into three main sections comprised of twelve chapters. The pithy titles of these sections reflect the utilitarian perspective with which the book is to be read and understood. They are:

> **Part One** - Market Structure: From Monopolies to Competition—Who Can Sell to Whom?;
> **Part Two** - How Much Can Sellers Charge—And Who Decides?; and
> **Part Three** - Jurisdiction: State, Federal and Future

The individual topics under these headings are organized and displayed in an unusually fulsome and easy to follow table of contents.

This ordering may seem counterintuitive and initially may bother someone like me who has designed syllabi for law school regulatory courses. We often instruct our students (and law firm associates) to start with "who has jurisdiction, i.e., the power to decide an issue," and then move on to how prices are regulated and how competition either is or is not permitted within the legally, although not operationally discrete, federal and state jurisdictions. While the author states early on that "the legal lodestar" of regulation is the regulatory statute"[4], the bulk of the book does not deal substantively with statutes until Part Three, the discussion of jurisdiction. When one realizes that it might seem to be obliviously pedantic to tell the prime target audience for this book, the regulators, to approach "effective regulation" by relearning their own authority, the ordering of these subjects makes eminent sense.

Indeed, the decision to focus on market structure first makes sense. When the Federal Power and Natural Gas Acts were adopted in the 1930s, the statutory structure and division of jurisdiction between federal and state authorities reflected the market structure of the time. The immense technological changes that have accompanied the infusion of competition into utility regulation policy has changed market structure and thereby drawn state and federal jurisdiction into more frequent conflict. In terms of market structure, regulators and the regulated are facing questions such as:

- "Which customers require regulation and for what services?"
- "How should end users be permitted to 'shop the market' for energy supplies across what are now wholesale and retail markets while still being tethered to a single delivery distribution/transmission wire or pipeline?"
- "Under what terms should sellers of those commodities and delivery services be allowed access to those customers?"

Those are the types of challenges that Mr. Hempling has identified and tackles in this book.

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3. *Id.* at 3, n.4 (emphasis provided).
4. Hempling, *supra* note 1, at 3.

Mr. Hempling approaches market structure at the book's outset from the perspective of "prove to me that utilities still should be regulated as natural monopolies" rather than that natural monopolies are and still should be the norm. He moves from a description and evaluation of the means by which natural monopolies are embedded in law and regulation, running from service territory franchises to statutory "obligations to serve," and the entrenched incumbent utility advantages of service contracts and rights of eminent domain, to the mechanics of how competition should be introduced. The market structures for each of natural gas, electricity and telecommunications are discussed along with representative cases and, in the case of telecommunications, aspects of the Telecommunications Act of 1996, Pub.L. No.104-104, 110 Stat. 56, that altered the relationship between federal and state regulation in that area. Examples of representative state commission actions related to each type of change are provided. Some case citations are recent; others may date to the 1920s. The case citations for each topic discussed are intended to be illustrative but not exhaustive of any regulatory action anywhere.

The book views changes in market control or structure of these industries as key to injecting needed competition. It does focus on the need or desirability to eliminate as many "bottleneck controls of essential facilities" as possible.[5] This antitrust theorem, applied primarily to the electric utility and telecommunications industry, e.g., local telephone exchanges, has often been raised in regulatory proceedings, certainly at the FERC, but not always officially recognized in agency decisions. Many state regulators that evaluate whether or how to inject competition into the markets they regulate will not address the essential facilities doctrine. Indeed, the extended focus on essential facilities raised my eyebrows a bit, but perhaps that was the author's underlying intention as a way of encouraging greater evaluation of the material.

The market structure section also addresses the multiple avenues that might be used to reduce barriers to entry into previously regulated markets where public utilities had been given exclusive service franchises, etc. The book starts from the proposition that if a market is deemed ripe for competition, the incumbents do not warrant **any** preference, including service territories. Notwithstanding many customers' preference to stay with the incumbent utility, regulatory commissions should view such preference as "[A]dvantages [that] flow from government conduct rather than performance merit, they are unearned advantages. They do not arise from 'skill, foresight and industry.'"[6] Similarly, "[W]hat makes immature markets vulnerable to misbehavior, justifying regulatory involvement, is the presence of incumbents that seek to provide the newly competitive services while also providing the monopoly services."[7] There are similar observations throughout Part One. These observations both may pique the reader's interest but also run the risk of distracting the reader's focus from the analysis to the author's opinion.

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5. *See id.* at Part 1, Section 4.B.
6. *Id.* at 201.
7. *Id.* at 244.

Part Two is titled: "Pricing, How Much Can Sellers Charge And Who Decides." The discussion is divided into two major foci of analysis: accepted pricing methodologies in "noncompetitive", i.e., cost-regulated, markets; and what constitutes just and reasonable pricing from a regulatory perspective in competitive markets. The first section provides a familiar overview of the principles of the elements of cost-based ratemaking. The discussion is broken down between retail and wholesale jurisdictions.

This section has several strengths not present in other books on public utility economics, ratemaking, etc. First, many of the chapters in this section include drawings, such as Figure 6 that presents a flow/decision chart portraying the decision-making process under basic cost of service principles either faced by a utility or used by a regulator in deciding how to recover costs. Other charts/graphs, etc. take similar forms that graphically illustrate how the principles of the chapter within a section of the book fit together.

Chapter 9, regarding the filed rate doctrine, and Chapter 11, discussing the Mobile-Sierra doctrine, present the most lucid descriptions that I have ever encountered of what those doctrines mean and how they are applied. Chapter 11 starts with the attention-grabbing statement, "In 1956, Dwight Eisenhower was reelected President, Don Larsen pitched baseball's only World Series perfect game,[note omitted] and the U.S. Supreme Court established the *Mobile-Sierra* doctrine."[8] Shortly thereafter, the quandry presented by the Mobile-Sierra doctrine is framed by two examples from California: PG&E's attempt to alter a long-term power sale contract entered into in 1947 (the *Sierra* case portion of Mobile-Sierra) and the 2000 California energy crisis situation that gave rise to the Supreme Court decision in *Morgan Stanley Capital Group, Inc. v. Public Utility District No. 1*, 554 U.S. 527 (2008). The latter case reinterpreted how the Mobile-Sierra concept should be applied to long-term power sales contracts operating under materially changed market conditions after their execution.

For all of its strengths, the discussion in Part Two also epitomizes one of the curiosities about this book's approach. It is not until page 389 that the "public interest" standard of utility statutes is discussed at length. That is the point where I start one of my courses but that's an organizational concept best applied to students and other newbies to the regulatory biz. A book for regulators about better regulation shouldn't have to explain to a regulator how the "public interest" standard is to be applied.

Part Three, "Jurisdiction: State, Federal and Future," is the shortest section of the book. It starts on page 405 and ends on page 481. It consists of just two chapters: one on various aspects of the "federal-state relationship" and the other on "jurisdiction's future." The former focuses on the U.S. Constitutional sources of federal jurisdiction that otherwise supersede state jurisdiction. These include the Commerce Clause, the Tenth Amendment Supremacy Clause, statutory limits on agency authority (federal and state) and the dormant Commerce Clause issues (with no apologies to Justice Thomas or all those doubters of the doctrine's validity). This section also makes one or two sweeping generalizations that might set the experienced practitioner's (as well as Constitutional historians') teeth on

8. Hempling, *supra* note 1, at 386.

edge, such as "Our regulated industries live with two historical legacies: the Framers' 1787 decision to have both federal and state governments, and Congress's 1930s decisions to allocate regulatory powers between those two levels."[9] Upon reflection (or, in other words, "now that I've grabbed your attention"), the statement does make one reflect on the challenge that technological change and the pressure of political concerns such as climate change pose to regulators operating under somewhat antiquated structures.

The chapter on the future of jurisdiction returns to the central theme of analyzing central aspects of utility regulation, such as the obligation to serve, exclusive franchises, market structure and pricing against new market structures. A closing note says it all:

The questions in all four of these areas—market structure, pricing, jurisdiction and cor- porate structure—are far from complete. I leave it to readers to raise more questions, and provide answers, as they pursue careers in the regulation of public utility performance.[10]

Current events in the electric utility regulation area present the perfect opportunity to read "Regulating Public Utility Performance." The FERC's newly established task force on electric transmission (FERC Docket No. AD-21-15-000) as well as the currently outstanding Advanced *Notice of Proposed Rulemaking on Building for the Future Through Electric Regional Transmission Planning and Cost Allocation and Generator Interconnections* (FERC Docket No. RM21-17-000) address the disconnections in market structure, inconvenient differences between state and federal jurisdiction and the possible disruption of utility business models that are causing both anguish and optimism to those engaged in the process. Mr. Hempling's book provides a uniquely utilitarian and very timely perspective through which to think through these increasingly pressing issues.

9. *Id.* at 408.

10. *Id.*