

ENERGY LAW JOURNAL

Volume 22, No. 1

2001

LESSONS FROM THE CALIFORNIA “APOCALYPSE:” JURISDICTION OVER ELECTRIC UTILITIES

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The extraordinary developments since May 2000 in California’s energy markets have given rise to a no-less-extraordinary series of legislative proposals, court decisions, and administrative orders at the state and federal levels. Our purpose here is not to diagnose, much less prescribe a solution for, the problems that led to what Commissioner William Massey of the Federal Energy Regulatory Commission (FERC or Commission) has aptly called an “apocalypse” in California’s electric power industry.¹ Rather, the focus of this article is on the issues of state versus federal jurisdiction that have been laid bare in the course of these events.

In their broad contours, the events themselves, as of early spring 2001, are familiar to even casual newspaper readers. California elected in 1996 to “deregulate” its electric utility industry, in order to introduce competition in the generation and sale of electricity. In particular, California encouraged investor-owned utilities to sell off their generation plants and compelled them to buy all of the power needed to supply their customers in a newly created spot market. That at the same time it capped, below the then-current levels, the retail rates the utilities could charge for that power. The plan seemed to work well enough from its inception in April 1998 to late May 2000. At that point, wholesale prices soared. Forced by state law to buy high and sell low, the state’s two largest utilities watched over the next six months as their financial position crumbled and suppliers became increasingly chary about selling to them. By mid-December 2000, the utilities could meet retail demand only with the help of a series of orders by the federal Department of Energy that required suppliers to make sales. By mid-January, the utilities were unable to pay their debts, a state agency

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1. *San Diego Gas and Elec. Co. v. Sellers of Energy and Ancillary Servs. Into Mkts Operated by the Cal. Indep. Sys. Operator and the Cal. Power Exch.*, 93 F.E.R.C. ¶ 61,249, at 62,030 (2000) (Massey, W., Concurring).

was purchasing power on their behalf, and retail customers were being involuntarily curtailed.

These events brought state and federal authorities into sharp conflict, each, predictably perhaps, blaming the other for what had gone wrong. Most notably, state officials adopted a strongly parochial tone, not only in their rhetoric, but also in the remedies that they proposed. Those remedies, as we describe below, have, in important respects, exceeded the state's jurisdiction, occupying areas reserved to the federal government under the Constitution.

I. BACKGROUND

A. *The Dual Scheme of Regulation*

Regulatory jurisdiction over both the electricity and natural gas industries is divided between federal and state authorities. Each authority operates, at least in theory, in its own exclusive sphere. As the courts are fond of saying, in both industries, Congress expressly intended that there be a "bright line easily ascertained" between two, mutually-exclusive spheres of authority.²

The settled scheme of jurisdiction is that the individual states are empowered to regulate essentially all retail and local distribution services involving electric power and natural gas, while the federal government, through the authority delegated to the FERC, has exclusive jurisdiction to regulate interstate transmission and sales-for-resale of electricity and natural gas in interstate commerce.³ This dual scheme of regulation has its roots in a series of early Twentieth Century Supreme Court decisions limiting, under the Commerce Clause of the federal Constitution, the states' power to regulate interstate transactions.⁴ The dual scheme is also codified in two principal, New Deal-era statutes imposing federal regulation on the interstate and wholesale aspects of the two industries: Part II of the Federal Power Act (FPA), enacted in 1935,⁵ and the Natural Gas Act (NGA),⁶ enacted in 1938.⁷

The provisions of the FPA and the NGA regarding *jurisdiction*, as well as the provisions of the two statutes setting forth the *substantive* powers granted to the FERC (and its predecessor agency, the Federal Power Commission) are so closely parallel that the courts over the years have de-

2. FPC v. Southern Cal. Edison Co., 376 U.S. 205, 216 (1964).

3. The most notable exception to this scheme is that the FERC lacks jurisdiction over wellhead and other "first sales" of natural gas. See generally Natural Gas Wellhead Decontrol Act of 1989, 15 U.S.C. § 3431(b)(1)(A) (1997).

4. See generally Public Utils. Comm'n v. Attleboro Steam & Elec. Co., 273 U.S. 83 (1927), and cases cited therein.

5. 16 U.S.C. §§ 824-824(m) (2000).

6. 15 U.S.C. §§ 717-771(z) (1997).

7. See generally Frank R. Lindh, *Federal Preemption of State Regulation in the Field of Electricity and Natural Gas: A Supreme Court Chronicle*, 10 ENERGY L.J. 277, 278-86 (1989).

veloped a practice of relying upon the precedents established under these statutes “interchangeably.”⁸ Both statutes purport to place under federal regulation only those aspects of the subject industries that were held to be outside the reach of state regulation under the earlier Commerce Clause cases.⁹ Thus, both the FPA and the NGA give the FERC the authority to regulate the rates, terms, and conditions of interstate transmission and transportation, and sales-for-resale, or wholesale sales, in interstate commerce by non-governmental entities.¹⁰ Both statutes contain language expressly disclaiming federal jurisdiction over production-related aspects (“generation” in the case of electric power and “production and gathering” in the case of natural gas) and over local distribution, deeming such activities to be properly within the jurisdiction of the individual states, consistent with the older Commerce Clause cases.

In extending federal regulation of sales only to wholesale transactions, Congress in both the FPA and the NGA left to the states regulation of all retail sales, even if the electric power or the natural gas being sold can be traced to an out-of-state source. Under the federal “filed-rate doctrine,” however, a state commission engaged in setting the retail rates of a local distribution utility, electric or gas, is not at liberty to disregard a decision by the federal regulatory authority that authorizes the wholesale vendor to charge a given price for a given quantity of electricity or natural gas in a federally-regulated wholesale transaction.¹¹ The Supreme Court, applying established principles of federal preemption under the Supremacy Clause of the Constitution, has held that such action by a state commission would amount to a second-guessing of the federal regulatory agency’s decision and would impose unlawful “trapped costs” on the retail utility.¹²

Despite their overall similarity, the NGA and the FPA diverge significantly with respect to jurisdiction over the construction and operation of interstate transmission facilities. Under section 7 of the NGA, a non-governmental entity may not construct, operate, or abandon interstate natural gas pipeline facilities without the FERC’s prior approval.¹³ Such approval carries with it the right of eminent domain and, as construed by

8. *Id.* at 286 and n.64 (citing *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348, 353 (1956), *cited with approval* in *Arkansas La. Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981); *Permian Basin Area Rates Cases*, 390 U.S. 747, 820-21 (1968)).

9. *FPC v. Southern Cal. Edison Co.*, 376 U.S. 205, 212-16 (1964); *United States v. Pub. Utils. Comm’n*, 345 U.S. 295, 311 (1953); *FPC v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 502-03 (1949); *Public Utils. Comm’n v. United Fuel Gas Co.*, 317 U.S. 456, 467 (1943).

10. *See generally* 16 U.S.C. §§ 824, 824d, 824e (1994), and 15 U.S.C. §§ 717, 717c, 717d (1994). Government-owned utilities are largely exempt from this entire regulatory scheme. *See also* 15 U.S.C. § 717a, defining a “natural gas company,” and 16 U.S.C. § 824(e) defining a “public utility.”

11. *See generally* *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988); *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986). *See also* *Arkansas La. Gas Co. v. Hall*, 453 U.S. 571 (1981); *Montana-Dakota Utils. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246 (1951); *see generally* Lindh, *supra* note 7, at 309-13.

12. *See, e.g., Nantahala Power and Light Co.*, *supra* note 11, at 970.

13. *See generally* 15 U.S.C § 717f (1994).

the FERC, broadly preempts state requirements.¹⁴ The FERC has no such siting authority under the FPA with respect to interstate electric transmission lines, even though the FPA affords the FERC broad authority to regulate the rates, terms, and conditions for electric transmission services.¹⁵ Rather, regulation of the siting of most electric facilities has been left mainly to the states, with the exceptions of hydroelectric and nuclear generating plants, which are licensed by the FERC and the Nuclear Regulatory Commission, respectively.¹⁶

B. *The Emergence of an Independent Generating /Marketing Sector and FERC Order No. 888*

The “dual regulatory scheme” described above was developed at a time when most investor-owned electric utilities operated as state-sanctioned, franchised monopolies that generated their own power, transmitted it by high-voltage transmission lines to local substations, and then distributed it by low-voltage lines for sale to their retail customers. The industry changed significantly in the 1980s and 1990s with the rapid growth—spurred on by federal legislation¹⁷—of an independent generation sector. By the mid-1980s, non-utility generators accounted for the bulk of new generation capacity under construction in the United States.¹⁸ Over the same period, there emerged a large and sophisticated segment of marketers, many unaffiliated with traditional utilities, who buy and sell bulk power on a spot or long-term basis.¹⁹ The proliferation of independent

14. See generally 15 U.S.C. § 717f(h). In issuing certificates, the FERC routinely warns that state or local permitting requirements may not “prohibit or unreasonably delay” the certified project. See, e.g., *Vector Pipeline L.P.*, 87 F.E.R.C. ¶ 61,225, at n.31 (1999).

15. Under a somewhat similar division of jurisdiction, the FERC regulates the rates, terms and conditions for interstate shipments by oil pipelines, but siting authority over otherwise interstate facilities, as well as jurisdiction over intrastate shipments, resides with the states. See generally DAVID J. MUCHOW AND WILLIAM A. MOGEL, *ENERGY LAW AND TRANSACTIONS*, Vol. 4, Chap. 85, and STEPHEN H. BROSE, *OIL PIPELINES* (LEXIS 2000); see also Leonard L. Coburn, *The Case for Petroleum Pipeline Deregulation*, 3 *ENERGY L.J.* 225 at 230-36 (1982).

16. See generally Part I of the Federal Power Act, 16 U.S.C. §§791-823a (1997), and the Atomic Energy Act of 1954, 42 U.S.C. §§ 2011-2296 (1997).

17. Specifically, in the Public Utility Regulatory Policies Act of 1978 (PURPA), 16 U.S.C. §§ 2601-2645. Congress, among other things, compelled utilities to purchase power from “qualifying facilities” (plants not owned by utilities and applying certain technologies) at state-set rates not exceeding the costs avoided by the utility as a result of the purchase. Additionally, in the Energy Policy Act of 1992, Congress significantly strengthened the FERC’s powers to compel utilities to transmit power to other utilities, and provided new exemptions for non-utility generators from the strictures of the Public Utility Holding Company Act. Except for “qualifying facilities” under PURPA, independent generators are “public utilities” whose sales at wholesale are subject to the FERC’s jurisdiction. See, e.g., *Ocean State Power*, 44 F.E.R.C. ¶ 61,261 (1998).

18. See generally Order No. 888, *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Service by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, [Regs. Preambles 1991-1996] F.E.R.C. STATS. & REGS. ¶ 31,036, 61 Fed. Reg. 21,540 (May 10, 1996); *order on reh’g.*, F.E.R.C. STATS. & REGS. ¶ 31,048, 62 Fed. Reg. 12,274 (Mar. 14, 1997), citing Black and Pierce, *The Choice Between Markets and Central Planning in Regulating the U.S. Electricity Industry*, 93 *COLUM. L. REV.* 1339, 1346 (1993).

19. For the most part, these marketers focus on wholesale transactions. When they sell electric

generators and marketers dramatically increased the extent to which utilities could look to sources of supply other than their own power plants in meeting the demand of their retail customers.

In Order No. 888, issued in April 1996, the FERC sought to foster wholesale competition by requiring those utilities subject to its jurisdiction to adopt a *pro forma* tariff offering transmission service (other than to retail customers) on a non-discriminatory basis.²⁰ The FERC also asserted preemptive authority to prescribe such requirements and to displace any state rules to the contrary.²¹ At the same time, the Commission declined to assert authority over the transmission component embedded in traditional retail sales service.²² The FERC also held that the definition of “distribution” would encompass at least some portion of the service of delivering electricity to end users, regardless of the nature of the facilities used for such delivery, so that states would have jurisdiction over rates for the final leg of unbundled retail wheeling for purposes of imposing stranded cost charges. This is so even where the end user is connected directly to transmission facilities.²³

Even as Order No. 888 was undergoing judicial review, the Commission made further changes to its rules governing interstate transmission of electric power. In Order No. 2000, issued in December 1999,²⁴ the FERC

power for resale in interstate commerce, marketers are engaged in an activity that the Federal Power Act authorizes the FERC to regulate and they are treated as “public utilities” within the meaning of section 201 of the FPA. See generally *Citizens Power & Light Corp.*, 48 F.E.R.C. ¶ 61,210 (1989). As such, they require the FERC authorization to make sales at wholesale at market-based rates and the Commission has developed standards that marketers must meet to demonstrate that they lack market power. See generally *Heartland Energy Servs., Inc.*, 68 F.E.R.C. ¶ 61,223 (1994). Some marketers also sell at retail, where state rules provide for direct access to end-users.

20. Order No. 888, *supra* note 18.

21. *Id.*

22. Order No. 888, *supra* note 18.

23. In contrast, when the FERC-regulated interstate natural gas pipelines began to offer “unbundled” transportation services, as distinct from sales of gas at the delivery point, the FERC held that no state jurisdiction would attach to the delivery of third party gas by an interstate pipeline to an end-use consumer whose plant straddled the pipeline, because there was no “local distribution” involved in such pipeline deliveries, even though sales of gas by an interstate pipeline to an end-user had long been held to be subject to state regulation. See generally *Michigan Consol. Gas Co. v. Panhandle E. Pipe Line Co.*, 887 F.2d 1295 (6th Cir. 1989), citing *Michigan Consol. Gas Co. v. FERC*, 883 F.2d 117 (D.C. Cir. 1989), and distinguishing *Panhandle E. Pipe Line Co. v. Pub. Serv. Comm’n of Indiana*, 332 U.S. 507 (1947). It may seem anomalous that the delivery of third-party electricity by a FERC-regulated, high-voltage transmission line operator to an end-use consumer directly connected to the transmission line is subject to the imposition of distribution or other charges by state regulatory authorities, while the delivery of third-party natural gas by a FERC-regulated, high-pressure gas pipeline operator to an end-use consumer directly-connected to the pipeline is completely immune from state regulation. But that in essence is how the FERC has decided the issue and the courts to date have not second-guessed the FERC’s rulings. *But see* *Midwestern Gas Transmission Co. v. McCarty*, 120 F. Supp. 2d 1155, 1169-79 (S.D. Ind. 2000) (evaluating case law on whether states retain any jurisdiction over pipeline deliveries of third-party gas to end-users, and concluding that the law is unclear on the subject), *appeal pending sub nom.* *Midwestern Gas Transmission Co. v. McCarty*, No. 00-4340 (7th Cir. filed Dec. 29, 2000).

24. Order No. 2000, *Regional Transmission Organizations*, [Regs. Preambles] F.E.R.C. STATS. & REGS. ¶ 31,089, 65 Fed. Reg. 809 (Jan. 6, 2000), *reh’g denied*, Order No. 2000-A, 90 F.E.R.C. ¶ 61,201, 65 Fed. Reg. 12,088 (Mar. 8, 2000).

found that the continued management of the transmission grid by vertically integrated utilities gave rise to engineering and economic inefficiencies, and that, notwithstanding the implementation of Order No. 888, utilities might still discriminate in the operation of their transmission systems. The Commission accordingly directed all utilities subject to its jurisdiction either to take steps to join a "Regional Transmission Organization" (RTO) or to explain, by a date certain, why they had not done so. The new order specified certain minimum characteristics of an RTO, notably independence from any individual market participant or group of such participants, authority to control the operation of transmission facilities extending over a broad geographic area, and responsibility for maintaining the short-term reliability of the transmission grid. The Commission also held that RTOs should perform certain functions, including: the exclusive design and administration of transmission tariffs, management of transmission congestion, market-power monitoring, planning and expansion of the transmission grid, and coordination with other regions.

Thereafter, in *Transmission Access Policy Study Group v. FERC (TAPS)*, decided in June 2000, the United States Court of Appeals for the District of Columbia Circuit sweepingly affirmed both the substantive open-access requirements and the jurisdictional rulings set forth in Order No. 888.²⁵ First, *TAPS* affirmed the essential "open access" provisions of Order No. 888, which require electric utilities to provide transmission services to third parties on a par with the transmission of their own power. Thus, even though the transmission component of a fully-integrated retail utility's operations remains subject to state jurisdiction, the retail utility is prohibited by the federal rule from either granting any preference to transmission of its own power or discriminating against competitors who seek third-party transmission service on the utility's system.²⁶

Second, the *TAPS* court affirmed the FERC's ruling that any transmission of third-party electric energy, including transmission on behalf of a retail customer, falls exclusively within the FERC's jurisdiction, rather than the states.²⁷ Under the FERC's view, every third-party transmission service provided at any point along the privately-owned, interstate-connected transmission grid is subject exclusively to federal regulation, even if the source of the energy (the generating plant) and the consumer of the energy are located in the same state.²⁸

Third, the *TAPS* court held that while the FERC's jurisdiction over retail transmission might be construed to require all jurisdictional utilities to fully "unbundle" the transmission component of their service arrange-

25. *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000) [hereinafter *TAPS*].

26. Note that this is arguably inconsistent with the Eighth Circuit's holding in *Northern States Power Co. v. FERC*, 176 F.3d 1090 (8th Cir. 1999), *cert. denied*, 528 U.S. 1182 (2000).

27. *TAPS*, 225 F.3d 667.

28. In their petition for certiorari, the state commissions challenging Order No. 888 characterized this as "intrastate" transmission. *New York v. FERC*, No. 00-568, Petition for Certiorari at 9 (filed Oct. 11, 2000).

ments from their retail sales services, as some parties urged, the FERC's more restrictive reading of the statute, which deferred to state jurisdiction over "bundled" service, was also permissible. Additionally, under the *Chevron* doctrine, the Commission itself was entitled deference from the court.²⁹

Fourth, the *TAPS* court upheld the FERC's conclusion that any delivery of electricity to a reseller (as distinct from an end user) constitutes FERC-jurisdictional "transmission" service, even to the extent that the facilities used to render this service include local distribution facilities. Noting that section 201(b) of the FPA exempts local distribution facilities from FERC jurisdiction, "except as specifically provided in this subchapter and subchapter III," the court concluded that the "FERC's assertion of jurisdiction over all wholesale transmissions, regardless of the nature of the facility, is clearly within the scope of its statutory authority."³⁰

On February 26, 2001, the Supreme Court granted two writs of certiorari (one by a group of state regulatory commissions and the other by a wholesale power marketer) to review the *TAPS* court's jurisdictional rulings.³¹ The order granting certiorari indicated that the Court's review would be limited to the second and the third of the above-listed rulings.³² The Court will decide the case during its October 2001 term.

29. *TAPS*, 225 F.3d 667.

30. *Id.* at 696.

31. The individual state commissions that petitioned for the writ of certiorari were New York, Florida, Idaho, New Jersey, North Carolina, Vermont, Washington, and Wyoming. The state petitioners also were joined by the National Association of Regulatory Utility Commissioners, an association of state regulatory commissions from all the states. The California Public Utilities Commission is not among the individual state commissions in the Supreme Court case. Also petitioning the Supreme Court, and in opposition to the state commissions, is Enron Power Marketing, Inc. The Court denied a separate petition filed by the Board of Water Light and Sinking Fund Commissioners of the City of Dalton, Georgia (No. 00-800).

32. *TAPS*, 225 F.3d 667 (D.C. Cir. 2000), *cert. granted*, *New York v. FERC*, 69 U.S.L.W. 3574 (U.S. Feb. 26, 2001) (No. 00-568 and No. 00-809). The issues as to which certiorari was granted are listed below. The first issue was raised by the State of New York and the other three by Enron Power Marketing, Inc.:

- (1) Given that Congress in 1935 stated that federal regulation extends "only to those matters which are not subject to regulation by the states" . . . and transmission of energy from generators to retail customers in same state was then "subject to regulation by states" . . . may FERC preempt state jurisdiction over such intrastate retail transmissions of electric energy?
- (2) Does FERC have jurisdiction under the Federal Power Act to regulate all transmission of electric energy in interstate commerce, including interstate transmission of electric energy that is sold to retail customers at "bundled" prices?
- (3) Did FERC have jurisdiction under the FPA to eliminate pervasive "undue discrimination" in provision of interstate electric energy transmission services by requiring transmission-owning utilities to provide interstate transmission services on the same terms to all users, for all interstate transmissions, including transmissions bundled with retail sales?
- (4) Did the appeals court err in ruling that FERC had discretion to interpret [the FPA] as denying FERC the necessary jurisdiction to remedy undue discrimination it had found in provision of interstate transmission?

TAPS, 225 F.3d 667.

This appears to be one of those relatively rare cases the Court has taken, not in order to resolve any conflict among the lower courts, but rather to address an issue of overriding national importance.³³

II. WHAT HAPPENED IN CALIFORNIA

A. California's Effort to Restructure Its Electricity Industry: 1995-1998

In a decision issued in December 1995, and modified in January 1996, the California Public Utilities Commission (CPUC) prescribed a broad scheme for restructuring California's investor-owned electric power industry.³⁴ The main elements of that scheme were:

a) Retail competition: Customers were to be able to choose among suppliers, with certain consumer-protection requirements applicable to those suppliers serving residential or small commercial end-users.

b) Independent System Operator (ISO): The three large California utilities, Pacific Gas and Electric Company (PG&E), Southern California Edison Co. (Edison), and San Diego Gas & Electric Co. (SDG&E), were to transfer operational control over their respective transmission systems to a state-chartered ISO, which would be responsible for assuring non-discriminatory access and system reliability.

c) California Power Exchange: The three utilities were to sell all of their generation or purchased power into, and purchase all of their retail requirements through, a transparent spot market conducted by a state-chartered Power Exchange, which would be independent of the ISO. Independent generators and other market participants would be entitled to buy and sell through the Power Exchange on a non-discriminatory basis.

d) Transition cost recovery: Retail customers would be subject to a non-bypassable surcharge (the "competition transition charge" or CTC) designed to allow the utilities to recover the book costs of generation and other assets in excess of market value.

e) Generation divestiture: PG&E and Edison were ordered "to voluntarily divest themselves . . . of at least fifty percent of their fossil generating assets."³⁵

33. In its petition for certiorari, Enron Power Marketing began its argument with the indisputable observation that "[e]lectricity is in many ways the nation's most important product. The availability and price of electricity directly affect the cost and conditions of production of almost every other product." *Enron Power Mktg. v. FERC*, 69 U.S.L.W. 3382 (Nov. 20, 2000) (No.00-809), petition at 10. As a leading treatise on Supreme Court practice has commented:

Many of the cases coming to the Supreme Court on certiorari involve the construction and application of acts of Congress and federal administrative regulations. In some of them it can be shown that there is a conflict of decisions among lower courts or that there is a probable conflict with applicable decisions of the Supreme Court. In others, however, the importance of the issue is the major basis for securing review.

STERN, ET AL, *SUPREME COURT PRACTICE* 187 (7th Ed. 1993).

34. *In re Proposed Policies Governing Restructuring California Electric Services Industry and Reforming Regulation*, 166 P.U.R. 4th 1 (1995), as modified by Decision 96-01-009.

35. *Id.*

The CPUC's order envisioned that restructuring would take effect on January 1, 1998. The state commission acknowledged that important elements of its plan were subject to approval by the FERC, notably the design and operation of the ISO and Power Exchange, demarcation between ISO-controlled "transmission" assets and utility-controlled "distribution" assets, and the determination that all retail customers were subject to the CTC surcharge.³⁶

Subsequent California legislation, Assembly Bill 1890 (A.B. 1890), signed by Governor Wilson in September 1996,³⁷ affirmed the state commission's restructuring plan in almost all respects.³⁸ Additionally, it created a five-member "Electricity Oversight Board" to appoint the governing boards of the ISO and the Power Exchange, and to hear appeals of decisions rendered by the two boards.³⁹ The new state legislation also capped the retail rate for each customer class of each utility at ninety percent of its June 10, 1996 level, for a period ending on the earlier of: (a) March 31, 2002, or (b) the utility's full recovery of its generation-related transition costs.⁴⁰

Beginning in late 1996, the FERC issued a series of orders approving, in their general contours, the proposals by the three utilities, and later by trustees for the ISO and the Power Exchange, to implement the state's plan. These included proposals to: (1) transfer control of the utilities' transmission systems to the ISO; (2) delineate which facilities constituted transmission as distinct from distribution; (3) determine the operating rules and governance for the ISO and the Power Exchange, both of which would be deemed "public utilities" subject to the FERC's jurisdiction; and (4) restrain any exercise of market power by utility-owned generation.⁴¹ In approving the state's plan, the FERC repeatedly deferred to policy decisions embodied in the state legislation and other pronouncements by state officials.⁴² During the same period, the FERC granted a series of requests

36. 166 P.U.R. 4th at 25. The CPUC noted that, because the utilities had agreed to provide direct access there was no need to determine whether it or the FERC had jurisdiction to do so. *Id.*

37. Act of September 24, 1996, 1996 Cal. Stats. 854, codified, in relevant part, at CAL. PUB. UTIL. CODE §§ 330-398.5 (Deering 2001).

38. The statute did shorten the period during which the utilities would have an opportunity to recover transition costs other than the costs of certain power-purchase contracts. A.B. 1890 § 368, 1996 Cal. Stat. 854.

39. A.B. 1890 § 364, 1996 Cal. Stat. 854.

40. A.B. 1890 § 368, 1996 Cal. Stat. 854.

41. See, e.g., *Pacific Gas and Elec. Co.*, 81 F.E.R.C. ¶ 61,122 (1997); *Pacific Gas and Elec. Co.*, 80 F.E.R.C. ¶ 61,128 (1997); *Pacific Gas and Elec. Co.*, 77 F.E.R.C. ¶ 61,265 (1996); *Pacific Gas and Elec. Co.*, 77 F.E.R.C. ¶ 61,204 (1996); and *Pacific Gas and Elec. Co.*, 77 F.E.R.C. ¶ 61,196 (1996).

42. As the FERC remarked in its December 15, 2000 Order, *Directing Remedies for California Wholesale Electric Markets*, in Docket Nos. EL00-95-000: "Beginning in 1996, this Commission issued a series of orders which, at the urging of California State regulators, deferred to the State on all significant aspects of State restructuring of California electric power markets and market rules—including those aspects which directly implicated this Commission's exclusive jurisdiction." *San Diego Gas & Elec. Co.*, 93 F.E.R.C. ¶ 61,294, at 61,982 (2000).

by the buyers of the plants formerly owned by the utilities⁴³ for authorization to sell electricity in wholesale markets at market-based rates.⁴⁴ The wholesale generators' requests for market-based rate authority were supported by California officials (notably the state public utilities commission) and none were tested on judicial review. In granting these applications, the FERC applied its standard analysis, looking at the share of generation capacity controlled by the generator and its affiliates in a geographic market usually comprised of northern California, southern California, or both. This form of analysis did not entail any inquiry into overall supply and demand projections, or how the market as a whole would function under anticipated conditions.⁴⁵

Meanwhile, on July 31, 1996, in a case that attracted widespread attention, the FERC denied a request by the City of Palm Springs, California, for a "municipalization-lite" scheme to avoid the imposition of CPUC-approved stranded cost transition charges for the City's 40,000 residents.⁴⁶ The FERC found that the City's scheme, which called for the installation of duplicate, City-owned meters on the premises of each of Edison's existing distribution customers within the City boundaries, which the City claimed would constitute FERC-jurisdictional "wholesale" points of interconnection, constituted a "sham wholesale" transaction that the FERC was barred from ordering under section 212(h) of the FPA.⁴⁷ The Commission also found that Palm Springs' scheme would be contrary to the public interest because it would undermine the orderly implementation of California's restructuring program.

B. Initial Operations: April 1998 – May 2000

The first sign of serious market dysfunction in California occurred in the ISO's ancillary service markets⁴⁸ in July 1998, just three months after the ISO and the Power Exchange had begun operation. Alleging that it had "witnessed dramatic spikes in the price for Replacement Reserve capacity"⁴⁹ and that similar spikes would occur in the prices for all ancillary services, the ISO filed an emergency motion for a stay of the wholesale

43. Although the CPUC ostensibly did no more than direct Edison and PG&E to divest themselves "voluntarily" of one half of their fossil-fueled generating capacity, by mid-1998, all three utilities had sold all of their non-hydroelectric, non-nuclear capacity in California to third parties.

44. See, e.g., *Duke Energy Morro Bay L.L.C.*, 83 F.E.R.C. ¶ 61,317 (1998). Certain plants were recognized to have "locational market power," meaning that, because of transmission constraints, their operation would at times be necessary to assure local reliability. To prevent the exercise of market power the utilities placed these plants under "reliability must-run" contracts allowing the ISO to call upon them to run at cost-based prices if necessary for reliability. See, e.g., *Pacific Gas & Elec. Co.*, 81 F.E.R.C. ¶ 61,122, at 61,554-55 (1997). These contracts are concededly subject to regulation by the FERC.

45. See, e.g., *Duke Energy Moss Landing L.L.C.*, *supra* note 44.

46. *City of Palm Springs*, 76 F.E.R.C. ¶ 61,127 (1996), *reh'g denied*, 84 F.E.R.C. ¶ 61,225 (1998).

47. 16 U.S.C. § 824k(h)(1994).

48. Ancillary services are, in essence, uses of generation capacity other than simply to provide energy, notably as reserve callable upon specified periods of notice.

49. *AES Redondo Beach, L.L.C.*, 85 F.E.R.C. ¶61,123 (1998).

generators' market-based pricing authorization.⁵⁰ The California state commission, notwithstanding its prior acquiescence in such authorization, supported the ISO's motion for a stay. By an order issued July 17, 1998, the FERC denied the ISO's motion for a stay, but authorized the ISO, as an "interim measure," to "[reject] . . . bids in excess of whatever price levels it believes are appropriate" for ancillary services and to file additional market-monitoring reports.⁵¹

During the same period, contention also arose over the governance of the ISO. Among other things, the FERC overruled provisions of California's restructuring legislation that would have granted the California Electricity Oversight Board the authority to appoint members of the ISO and the Power Exchange boards of directors, and to entertain appeals from the decisions of these boards. The FERC also rejected a California residency requirement for members of the two boards.⁵²

In retrospect, however, the period from April 1998 through May 2000 appears relatively serene. Wholesale prices in the Power Exchange remained low enough to allow the state's three utilities to recover their costs of operation through their capped retail rates and to recoup a portion of their transition costs as well. In fact, in June 1999, one of the utilities, SDG&E, completed recovery of its generation-related transition costs and thereupon ceased to be subject to the state-imposed rate cap.

C. Onset of the Crisis

In the latter part of May 2000, wholesale energy prices in the California markets soared dramatically. Real time prices in the ISO's imbalance energy market rose to the ISO-capped level of \$750 per megawatt-hour for several hours,⁵³ while the average price of energy, as calculated by the ISO, reached \$58; by way of comparison, monthly energy prices in 1999 had fluctuated between \$20 and \$37, rising to \$50 for one month (October).⁵⁴ In June 2000, faced with heightened demand due to hot weather and a large amount of generation capacity out of service, the ISO was forced to declare a "Stage 2" emergency, leading to the curtailment of supplies to non-firm retail customers.⁵⁵ The high price levels not only persisted but ac-

50. *AES Redondo Beach, L.L.C.*, 84 F.E.R.C. ¶ 61,046 (1998).

51. 84 F.E.R.C. ¶ 61,046 (1998); *reh'g denied*, 85 F.E.R.C. ¶ 61,123 (1998); *further reh'g denied*, 87 F.E.R.C. ¶ 61,208 (1999); *and* 88 F.E.R.C. ¶ 61,096 (1999).

52. *California Power Exch. Corp. v. California Indep. Sys. Operator and California Elec. Oversight Bd.*, 85 F.E.R.C. ¶ 61,263 (1998).

53. FEDERAL ENERGY REGULATORY COMMISSION, Staff Report to the Federal Energy Regulatory Commission on Western Markets and the Causes of the Summer 2000 Price Abnormalities at 3-2 (Nov. 1, 2000) [hereinafter Staff Report], available at <http://www.ferc.fed.us> (FERC RIMS Doc 210511).

54. See generally Attachment A, Motion for Issuance of Refund Notice to Sellers, Request for Hearing, and Request for Expedited Action of the California Independent System Operator and the California Electricity Oversight Board, FERC Docket No. EL00-95-000 (Mar. 1, 2001) [hereinafter ISO Mar. 1 Appendix].

55. Staff Report, *supra* note 53 at 3-8.

tually increased as the year progressed, rising sharply with the onset of winter. The monthly average prices of energy were \$147 (June), \$112 (July), \$168 (August), \$119 (September), \$100 (October), \$155 (November), \$294 (December), and \$265 (January 2001).⁵⁶

Caught between spiraling wholesale prices and the state-imposed cap on their retail rates, PG&E and Edison were forced to borrow enormous amounts simply to sustain operations and continue to meet demand.⁵⁷ As the utilities' debts mounted and their financial condition deteriorated, suppliers began to insist on various forms of security to assure payment. The ISO consequently began having difficulty in finding willing sellers of power in the "real time" market it operated to obtain power for reliability purposes. Because reliability of the grid was now threatened, in mid-December 2000, the ISO requested and obtained an extraordinary emergency order from the Secretary of Energy under section 202(c) of the FPA. The order directed certain generators and marketers to make sales to the ISO.⁵⁸ Notwithstanding that and subsequent emergency orders, and the ISO's invocation of certain contract provisions requiring generators to sell it energy, the ISO was forced to call "Stage 3" alerts (meaning that reserves had fallen to less than 1.5%) throughout January and much of February on almost a daily basis. Those alerts were accompanied by the curtailment of interruptible retail load. On January 16, supplies dropped to the point that PG&E was compelled to impose rolling blackouts across its service territory. On January 18, Edison defaulted on a payment obligation of more than \$250 million. Similarly, on February 2, PG&E defaulted on obligations of even larger amounts to the ISO and the Power Exchange.⁵⁹ By the beginning of February, the unrecovered purchased power costs of the two utilities had risen to more than \$12 billion. Under the pressure of utilities' ability to pay for power and the FERC orders described below, the Power Exchange discontinued the bulk of its operations on February 1, 2001, and on March 9, declared bankruptcy.⁶⁰ Blackouts recurred in mid-March.

56. See generally ISO Mar. 1 Appendix, *supra* note 54. The figure for January 2001 reflects only the first 29 days of that month. When ancillary services are taken into account, the average cost per MWh increases slightly. *Id.*

57. In September 2000, the State Legislature enacted Assembly Bill No. 265, reimposing retail rate caps on SDG&E, retroactive to June 1, 2001. The bill directed the CPUC to provide for the subsequent recovery of any wholesale costs prudently incurred by SDG&E and not recovered because of the cap.

58. Notice of Issuance of Emergency Orders Under Section 202(c) of the Federal Power Act, 65 Fed. Reg. 82,989 (Dec. 29, 2000).

59. *So. California Edison Hasn't paid \$395M of Commercial Paper*, DOW JONES NEWS SERV. (Feb 5, 2001).

60. Press Release, California Power Exchange, Cal PX Files for Chapter 11 Protection (Mar. 9, 2001), available at www.calpx.com.

D. Federal Response

For almost three months, the federal government in general and the FERC in particular, responded to this sequence of events by doing nothing. Finally, on August 23, in response to a complaint filed by SDG&E, the FERC opened an investigation into California wholesale prices, establishing a date sixty days thereafter, after which such sales, to the extent that they were under the FERC's jurisdiction, would be subject to potential refund.⁶¹ On November 1, having received a report from its staff, the Commission issued an order finding that the:

electric market structure and market rules for wholesale sales of electric energy in California are seriously flawed and that these structures and rules, in conjunction with an imbalance of supply and demand in California, have caused, and continue to have the potential to cause, unjust and unreasonable rates for short-term energy . . . under certain conditions.⁶²

Asserting that California's requirement that utilities buy and sell all of their energy through the Power Exchange had exposed them unduly to spot-market price fluctuations and lay at the root of the crisis, the FERC proposed, among other things, to abolish this buy-sell requirement. The FERC also proposed to restructure the ISO and the Power Exchange boards, to place certain conditions on bids above \$150 per megawatt hour, and to penalize purchases in the real-time market exceeding five percent of the buyer's load.⁶³ The FERC declined, however, to impose cost-of-service or other forms of price caps on wholesale prices.

On December 15, 2000, after receiving comments on its November 1 proposals, the FERC adopted those proposals with certain modifications. Most notably, it "eliminated" the state's "buy-sell" requirement by: (a) forbidding SDG&E, PG&E, and Edison to sell power into the Power Exchange after December 31, 2000, and (b) terminating the Power Exchange's rate schedules as of April 30, 2001.⁶⁴ The FERC declined again, however, to impose cost-of-service pricing on wholesale vendors or to require those vendors to file accounting data from which their cost-of-service might be ascertained.⁶⁵

61. *San Diego Gas & Elec. Co.*, 92 F.E.R.C. ¶ 61,172 (2000).

62. *San Diego Gas & Elec. Co.*, 93 F.E.R.C. ¶ 61,121, at 61,349-50 (2000).

63. *Id.* The conditions proposed for bids exceeding \$150 were: (a) that such bids, if accepted, would not set the market-clearing price in what were otherwise single-price auctions conducted by the ISO and the Power Exchange, and (b) the bidder, if successful, would have to submit certain information related to its actual costs and opportunity costs.

64. 93 F.E.R.C. ¶ 61,121. The December 15th order did approve the previously proposed conditions on bids exceeding \$150 as a temporary measure, pending the adoption of longer-term market-monitoring measures, and adopted a "benchmark" (roughly, the utilities' generation costs in June 1996), by which it would measure future long-term contracts and as a recommended standard for the CPUC in judging the prudence of such contracts.

65. *San Diego Gas & Elec. Co.*, 93 F.E.R.C. ¶ 61,294 (2000). In a further order, issued March 9, 2000, the FERC directed generators that had sold energy to the ISO during "Stage 3" emergencies at prices exceeding the variable cost of operating a hypothetical combustion turbine to refund those charges or justify them. The Commission stated that it would issue a similar proxy price for each

One other federal decision in response to events in California—this one judicial—merits mention here. On January 22, 2001, a federal court in Los Angeles denied a motion by the CPUC to dismiss a complaint, filed by Edison, challenging California's retail rate caps as violative of the federal filed rate doctrine. The district court held that the filed rate doctrine, insofar as it precludes the states from forcing retail utilities to absorb FERC-approved wholesale power costs, could apply to market-based rates no less than to traditional, cost-of-service rates specified in a tariff.⁶⁶

E. State Response

California state officials responded to the crisis, in part, by blaming outsiders for the run-up in wholesale prices and the FERC for failing to restrain those prices. Thus, in his "State of the State" address on January 8, 2000, Governor Davis asserted that "[t]he out of state generators who bought most of our utilities' power plants are now charging California several hundred percent more for wholesale electricity than we paid just one year ago." "Never again," he said, "can we allow out-of-state profiteers to hold Californians hostage. Never again can we allow out-of-state generators to threaten to turn off our lights with the flick of a switch." The FERC, he added, had "shirked its responsibilities to protect ratepayers from this legalized highway robbery."⁶⁷ For its own part, the state took a series of actions of significance.

First, beginning in August 2000, the CPUC granted certain limited authorizations for the utilities to make purchases outside the Power Exchange.⁶⁸

Second, as noted above, in September 2000, the Legislature reimposed retail rate caps on SDG&E. In so doing, it directed the state commission to provide for the subsequent recovery of any undercollection of wholesale costs.⁶⁹ It also streamlined the procedures for the approval of new generation plants.⁷⁰

month, reflecting changed costs of natural gas and emissions credits *San Diego Gas & Electric Co.*, 94 F.E.R.C. ¶ 61,245 (2001). Additionally, on March 14, the Commission initiated an investigation of two generators' failure to comply with directives of the ISO to operate their "must-run units," thereby allegedly forcing the ISO to purchase power from more costly units. *AES Southland, Inc.*, 94 F.E.R.C. ¶ 61,248 (2001).

66. *Southern California Edison Co. v. Lynch*, No. CV-00-12056-RSWL (Mcx) (C.D. Cal. Jan. 22, 2000); *Pacific Gas and Electric Co. v. Lynch*, No. CV-01-1083-RSWL (SHx) (C.D. Cal. Jan. 22, 2000).

67. The Honorable Gray Davis, State of the State Address (Jan. 8, 2001), available at <http://www.video.dot.ca.gov/state/transcript.html>.

68. California Public Utilities Commission, Re Functioning of the Wholesale Electric Market and Associated Impact on Retail Rates, Interim Order 00-08-002 (Aug. 3, 2000); California Public Utilities Commission, Re Restructuring California's Electric Services Industry and Reforming Regulation, Decision 00-09-075 (Sept. 21, 2000).

69. CAL. PUB. UTIL. CODE § 332.1 (West 2000).

70. *Id.*

Third, on January 17, 2001, Governor Davis proclaimed a state emergency, directing a state agency, the Department of Water Resources (DWR), to buy and sell power “as may be necessary to assist in mitigating the effects of the emergency.”⁷¹ On February 1, the Governor signed new legislation,⁷² authorizing the DWR to enter into long-term wholesale power purchase contracts, to issue bonds for that purpose, and to sell the purchased power to retail customers, with the respective utilities delivering such power and serving as its agents for billing and collection purposes.

Fourth, on February 8, 2001, the Governor signed a series of executive orders further providing for the expedited processing of siting applications for new or expanded generation capacity.⁷³ At about the same time, he “commandeered” by executive order, certain power purchase contracts held by Edison and PG&E in the Power Exchange’s block forward market for the sale or purchase of electricity, thus preventing the Power Exchange from liquidating those contract positions to satisfy the utilities’ unpaid debts to Power Exchange suppliers and securing the power for the state.⁷⁴

Finally, in late February 2001, California officials undertook discussions with the three utilities concerning purchase of their transmission systems by the state.⁷⁵ Bills providing for such purchase and for state funding of new generation capacity were pending in mid-March. Such legislation funding would be conditioned upon the recipient’s agreement to give priority, in its sale of electricity, to in-state uses.⁷⁶

Also significant was what California did *not* do: the state did not allow the utilities to pass through to their retail customers the wholesale prices the utilities were required to pay for wholesale power. With the exception of a temporary rate increase of less than ten percent for Edison and PG&E,⁷⁷ the CPUC insisted until late March 2001 on maintaining retail rates at levels provided in A.B. 1890. Increases approved by the CPUC on March 27, 2001, for Edison and PG&E,⁷⁸ while significant, cannot be used to reduce the enormous revenue shortfall previously accumulated by each of the utilities, and, according to the State Controller, will not even cover the

71. Proclamation, Governor of the State of California, State of Emergency (Jan. 17, 2001).

72. CAL. PUB. UTIL. CODE § 332.1 (West 2001).

73. Exec. Order No. D-26-01 (Jan. 17, 2001), available at <http://www.governor.ca.gov>.

74. Exec. Order No. D-20-01 (Jan. 17, 2001); Exec. Order No. D-21-01 (Jan. 17, 2001), available at <http://www.governor.ca.gov>.

75. On February 26, 2001, Edison and state officials announced tentative agreement on a purchase of Edison’s transmission system for \$2.76 billion, more than twice the system’s book value.

76. 2001 Cal. Legis. Serv. 1 ES 3 (West). Senate Bill X1 6, introduced by Senators Burton and Bowen, would create the California Consumer Power and Conservation Financing Authority with authority to issue bonds to finance, among other things, new or expanded generation capacity. Under proposed section 3351(a) of the Public Utilities Code, generation projects financed by the Authority would provide electricity to California consumers at cost; electricity could be sold outside of California only to the extent that it was not needed in the state or that such sale is “financially advantageous to California consumers.”

77. *Pacific Gas and Elec. Co.*, Decision 01-01-018, 199 P.U.R.4TH 177 (2000).

78. Decision 01-03-082 (Mar. 27, 2001), available at http://www.cpuc.ca.gov/published/final_decision/6009.htm.

state's own ongoing power-acquisition costs.⁷⁹

III. FEDERAL-STATE JURISDICTIONAL ISSUES

What began as an exercise of "cooperative federalism" when California first presented its electric industry restructuring to the FERC for approval in 1996 degenerated rapidly into a series of disputes between state and federal authorities in the latter half of the year 2000 and the first part of 2001.⁸⁰ We discuss below the most significant jurisdictional issues that have arisen in that context.

A. Federal Preemption of California's Retail "Rate Freeze"

Perhaps the most fundamental jurisdictional issues that have arisen to date—and the most important in their practical implications—are the pass-through issues raised in the above-described challenges by Edison and PG&E to the state-imposed cap on retail rates. Three key jurisdictional issues are presented in these two companion cases.⁸¹

The first question is whether the filed rate doctrine must be given the same preemptive effect when the wholesale rates at issue are market-based, as distinct from cost-of-service, rates. Market-based pricing, it has been alleged, does not entail a FERC-approved "rate" and a price charged under market-based authorization thus lacks pre-emptive affect. This argument strikes us as unpersuasive. In *Nantahala Power and Mississippi Power & Light Co.*, the Supreme Court held that the filed rate doctrine applied not only to rates *per se*, but also to FERC-approved allocations of wholesale power among the sister companies in a multi-state utility holding company system.⁸² There is no suggestion in any of the Supreme Court's decisions that the *nature* of the particular federally-authorized rate (i.e., whether it be a fixed, cost-of-service-based rate, an indexed rate, or a free-floating market-based rate) should affect in any way the preemptive

79. See generally Associated Press, *California Utility Must Reveal Blackouts*, N.Y. TIMES, Mar. 29, 2001, at A-12.

80. Order Instituting Investigation on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation, Decision 95-12-063, 64 Cal. Pub. Util. Comm'n 1, at 16 (1996), 1995 WL 792086.

81. In addition to the jurisdictional issues discussed herein, the California state commission also has raised a host of defenses, including abstention and estoppel, that are beyond the scope of this article.

82. In other cases, the Court has held that contract and tort remedies in state courts were preempted to the extent they required a result that conflicted with the federal filed rate. See generally *Arkansas-Louisiana Gas Co.*, 453 U.S. 571 (1981); and *Chicago & North Western Transp. Co. v. Kalo Brick & Tile Co.*, 450 U.S. 311 (1981). As the Court emphasized in its 1951 *Montana-Dakota Utils. Co.* decision, a party "can claim no rate as a legal right that is other than the filed rate, whether fixed or merely accepted by the Commission, and not even a court can authorize commerce in the commodity on other terms." *Montana-Dakota Utils. Co.*, 341 U.S. 426, 251-52 (1951). Indeed, even an "appeal to equitable principles" is insufficient. *Arkansas-Louisiana Gas Co.*, 453 U.S. at 584; see also *Montana-Dakota Utils. Co.*, 341 U.S. at 251-52. Nothing can justify a departure from the filed rate in any court or regulatory proceeding, other than in a timely challenge to the rate before the Commission itself or on direct judicial review of the FERC's orders approving or accepting the rate. *Id.* at 251-52.

effect of the rate once the particular form of rate structure has been approved or accepted by the FERC.⁸³ The generally applicable rule under *Nantahala Power* and *Mississippi Power & Light Co.* is that a state regulatory commission must allow the passthrough of FERC-mandated wholesale power payments and cannot disallow, or “trap,” these costs by denying the utility the opportunity to recover them in its retail rates. In its 1986 decision in *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi*,⁸⁴ the Supreme Court held that Congress’ decision to substitute market-based pricing of natural gas for traditional cost-of-service pricing at the interstate, wholesale level did not alter the preemptive effect of the federal regulatory program on the individual states. Especially here, where the FERC continues to have statutory authority over wholesale power prices, the filed rate doctrine still applies, even though the FERC, in its exercise of that authority, chooses to allow wholesalers to charge market-based prices.⁸⁵

The second question presented in the *Edison* and *PG&E* cases is whether the particular costs that Edison and PG&E have sought to recover fall within the *Pike County* exception to the filed rate doctrine, such that the full pass-through of the costs might be denied on the basis of a finding by the state commission that they were imprudently incurred.⁸⁶ Under this exception to the filed rate doctrine, as the Supreme Court has recognized in *dicta* on two different occasions, “a particular *quantity* of power procured by a utility from a particular source could be deemed unreasonably excessive [by a state regulatory commission] 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*.”⁸⁷ Because the California utilities were required to purchase all of their wholesale power requirements from the Power Exchange, and particularly in light of the fact that this requirement was approved by the FERC at the specific urging of California officials, it is difficult to envision that the fed-

83. As a matter of substantive law regarding the FERC’s rate-setting powers, it is settled that “[t]he Commission need not confine rates to specific, absolute numbers but may approve a tariff containing a rate ‘formula’ or a rate ‘rule.’ . . .” *Transwestern Pipeline Co. v. FERC*, 897 F.2d 570, 578 (D.C. Cir. 1990) (citation omitted).

84. *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Bd. of Mississippi*, 474 U.S. 409, 417-23 (1986).

85. As the United States Court of Appeals for the First Circuit recently observed, even though “the general direction in which FERC is moving” is towards market-based rates for wholesale power transactions, “unlike some other regulatory agencies, FERC is still responsible for ensuring ‘just and reasonable’ rates and, to that end, wholesale power rates continue to be filed and subject to agency review.” *Town of Norwood v. New England Power Co.*, 202 F.3d 408, 419 (1st Cir. 2000) (citations omitted).

86. *Pike County Light & Power Co. v. Pennsylvania Pub. Utils. Comm’n*, 77 Pa. Commonw. 268, 273-74, 465 A.2d 735, 737-38 (Pa. Commw. Ct. 1983); cited in *Nantahala Power*, 476 U.S. at 972.

87. *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 970 (1986) (emphasis in original), quoted in *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 373 (1988). The United States Court of Appeals for the First Circuit has referred to this as an “escape hatch” from the filed rate doctrine. *Public Serv. Co. of New Hampshire v. Patch*, 167 F.3d 29, 35 (1st Cir. 1998), cert. denied, 526 U.S. 1066 (1999).

eral courts ultimately would allow a trapping of the wholesale power costs that the utilities accrued under the Power Exchange arrangements.

A different analysis would apply if the utilities had been authorized to purchase a mix of long-term power pursuant to bilateral agreements with suppliers, along with spot market purchases from the Power Exchange. In those circumstances, a state commission under the *Pike County* exception might examine the particular mix of purchases and disallow recovery of costs found to have been imprudently incurred (for example, if the utility failed to take advantage of lower-cost long-term power contracts and instead chose to do all of its buying in higher-cost spot markets).⁸⁸ California's refusal to allow Edison and PG&E to recover their wholesale power costs was not premised, however, on any finding or suggestion of "imprudence" by the utilities in their purchasing decisions. Rather, the state commission, invoking the rate cap adopted in A.B. 1890, simply refused to allow the recovery of wholesale power costs that would result in any rate increase, other than a modest, conditional increase, at the retail level. There is no basis, under a *Pike County* analysis, for the California commission to force Edison and PG&E to absorb the huge costs they were obliged to pay for power purchased from the Power Exchange, as required not only by the Power Exchange's FERC tariff, but also by state law.

Finally, it might be questioned whether California was obliged to approve *immediate* increase in the utilities' retail rates to reflect the sharp increases in wholesale prices or whether, in the alternative, some period of suspension might be tolerated. In one case, the United States Court of Appeals for the Eighth Circuit held that the preemptive effect of the filed rate doctrine was not so strong as to forbid "a reasonable period of suspension" of proposed rate increases prior to their taking effect, in order to al-

88. As the Supreme Court has stated, "it might well be unreasonable for a utility to purchase unnecessary quantities of high-cost power, even at FERC-approved rates, if it had the legal right to refuse to buy that power." *Mississippi Power & Light*, 487 U.S. at 373-74. This principle is illustrated in a pair of recent decisions rendered by the United States Court of Appeals for the First Circuit. *Public Serv. Co. of New Hampshire v. Patch*, 167 F.3d 29, 35-36 (1st Cir. 1998), *cert. denied*, 526 U.S. 1066 (1999); *Public Serv. Co. of New Hampshire v. Patch*, 221 F.3d 198 (1st Cir. 2000), *cert. denied*, 69 U.S.L.W. 3399 (Feb. 20, 2001) (No. 00-852). In the first of these decisions, the First Circuit reversed a district court order enjoining the New Hampshire Public Service Commission from disallowing the costs incurred by a retail utility under a FERC-jurisdictional wholesale power contract, finding that the State Commission (with support by the FERC as an *amicus curiae*) had shown a reasonable likelihood of prevailing on the merits based on the availability of cheaper power from other sources and a failure by the retail utility to avail itself of such an option. In the latter decision, the same court reached the opposite conclusion after the State Commission reversed its earlier finding of imprudence when the option of switching to an alternative power source was rendered uneconomic due to the FERC's acceptance of an "exit fee" tariff filed by the wholesaler. In the latter case, the *Pike County* exception disappeared once the State Commission conceded the prudence of the utility's choice to stand by its wholesale supplier (which was also the utility's parent company) and the court in that circumstance found that the State Commission likely would be found to be preempted under the filed rate doctrine from disallowing any portion of the wholesale contract costs in the retailer's state-jurisdictional retail rates. *Cf. Kentucky W. Va. Gas Co. v. Pennsylvania Pub. Util. Comm'n*, 837 F.2d 600, 608-09 (3d Cir. 1988), *cert. denied*, 488 U.S. 941 (1988) (holding that a state commission had jurisdiction, under the *Pike County* exception, to review the prudence of a gas utility's exercise of discretion in choosing among several different FERC-approved wholesale purchase options).

low the state commission time to consider issues such as how to allocate the costs among various customer classes.⁸⁹ Although the California commission in this case has suggested that Edison and PG&E might be made whole at the end of the rate freeze, it did not merely “suspend” the rate increases they proposed in order to recover their retail costs. Furthermore, even in the case of a routine, procedural suspension of a rate increase, the eighth circuit acknowledged that a different result might well be obtained where the act of suspending the rate increase threatened the utility with insolvency:

We can imagine a case in which federally imposed costs are so large that the customary state-law suspension period, if invoked by state authorities, could jeopardize the utility’s very ability to serve the public. In such a case, a different and more difficult issue of preemption,⁹⁰ or of violation of the Commerce Clause itself, would be presented.

In short, the case law points strongly to the conclusion that California acted in violation of the Supremacy Clause when it refused to allow Edison and PG&E to pass through in retail rates the costs the two utilities incurred in purchasing wholesale power from the California Power Exchange.

B. *Utility Purchases and Sales*

In initially approving California’s scheme for restructuring the state’s electricity industry, the FERC purported to adopt as its own the state requirement that the three large utilities purchase all of their power from the Power Exchange for five years. Certain parties had argued that, because of the utilities’ size as purchasers, the buy-sell requirement would unduly restrict the options available to third party wholesale sellers, in violation of the Commerce Clause.⁹¹ The FERC rejected that claim, based on its *own* approval of the buy-sell requirement and the concession by California officials that the FERC’s approval of this requirement was necessary: “Very simply, the five-year provision can only be implemented if we agree to it.”⁹² The Commission went on to conclude that, in light of its limited duration, the buy-sell requirement met the just-and-reasonable standard of the FPA.⁹³

89. *Arkansas Power & Light Co. v. Missouri Pub. Serv. Comm’n*, 829 F.2d 1444, 1452 (8th Cir. 1987). The Eighth Circuit explained the holding of the case as follows:

On the merits, we hold that the ordinary Missouri statutory process of suspension and investigation is not preempted by the Federal Power Act. The judgment of the [d]istrict [c]ourt, commanding [the Missouri Public Service Commission] to authorize an immediate pass-through without regard to this statutory process, is reversed.

Id. at 1452-53.

90. 829 F.2d at 1452-53.

91. Supplemental Comments of ELCON, and American Iron and Steel Institute, FERC Docket No. ER96-1663-000 at 5-11 (July 18, 1996).

92. *Pacific Gas and Elec. Co.*, 77 F.E.R.C. ¶ 61,265, at 62,088 (1996).

93. *Id.*

In subsequent orders, however, the Commission has appeared to distinguish, for jurisdictional purposes, between *purchases* by a utility and *sales* by a utility. Thus, for example, in July 2000, the Commission rejected a complaint relating to the ISO's decision to reduce the maximum amount it would pay to wholesale vendors for energy and ancillary services. The Commission emphasized that, so long as suppliers were free not to sell to the ISO, the ISO—a "public utility" under the FPA—was free to offer whatever price it chose.⁹⁴

Similarly, the FERC's order of December 15, 2000, distinguishes between wholesale sales, regulated by the FERC, and wholesale purchases, regulated, if at all, by the states. To attain its objective of "eliminating" the "sell" half of the CPUC's buy-sell requirement, the Commission simply prohibited the three California utilities from making *sales* through the Power Exchange.⁹⁵ In contrast, the FERC issued no such prohibition as to the utilities' *purchases* through the Power Exchange. Noting the CPUC's insistence that "its 'buy' requirement will remain in place until the California Commission removes it," the FERC took what it characterized as the "unusual" step of terminating the Power Exchange's wholesale tariffs, thus accomplishing indirectly what the FERC apparently believed it could not do directly.⁹⁶

This resolution—federal jurisdiction over wholesale *sales* and state jurisdiction over wholesale *purchases*—squares not only with the plain language of the FPA,⁹⁷ but also with recent Commission precedent. In 1995, the Commission rejected the argument that all aspects of wholesale transactions are subject to federal jurisdiction and that any attempt by the states to regulate such transactions is preempted. It concluded, instead, that states may require utilities to generate or purchase electricity from specific sources, such as renewable energy facilities.⁹⁸

94. *Morgan Stanley Capital Group, Inc. v. California Indep. Sys. Operator Corp.*, 92 F.E.R.C. ¶ 61,112, at 61,431 (2000).

95. *San Diego Gas & Electric Co.*, 93 F.E.R.C. ¶ 61,121, at 62,001 (2000).

96. *Id.* at 61,999. The FERC did note that:

removing the voluntary buy/sell requirement from the PX tariff under our jurisdiction . . . will not serve to rectify the situation . . . [a]s long as the California Commission continues to require (either directly or indirectly) the IOU's to sell or purchase the bulk of their needs from the PX.

93 F.E.R.C. ¶ 62,001, at 61,999. The FERC was presumably referring to the CPUC's ability effectively to compel sales as well as purchases through the Power Exchange by means of retail rate treatment or other indirect means.

97. Section 201(b) of the FPA provides that Part II of that Act applies to "the transmission of electric energy in interstate commerce and to the *sale* of electric energy at wholesale in interstate commerce." 16 U.S.C. § 824(b)(1994)(emphasis added). The courts have held that the FERC has jurisdiction over the purchases of natural gas under the NGA, at least to the extent that a buyer that is itself a pipeline subject to FERC's jurisdiction may not discontinue purchases that have been certificated by the FERC under section 7 of the NGA without prior approval. *See generally* *Panhandle Eastern Pipeline Co. v. FERC*, 803 F.2d 726 (D.C. Cir. 1986); *see also* *Panhandle Eastern Pipeline Co. v. FERC*, 907 F.2d 185 (D.C. Cir. 1990). Those decisions turn, however, on the FERC's authority to certificate sales and service under section 7. As seen above, the FPA has no comparable provision.

98. *Southern California Edison Co.*, 70 F.E.R.C. ¶ 61,215, at 61,176, *order on reconsideration*, 71

It appears that the FERC's initial assertion of jurisdiction over the "buy" side of California's buy-sell requirement— "the five-year provision can only be implemented if we agree to it"—was an anomaly. In light of the FERC's subsequent conclusion that the "buy" requirement lay at the root of California's problems, it is not surprising that the FERC, in undoing that requirement, neglected to mention that the FERC itself had previously asserted jurisdiction over—and approved—the very same provision.⁹⁹

C. FERC's Assertion Of Jurisdiction Over "Wholesale Distribution"

1. Service And "Wholesale Interconnection" Disputes On Utility Distribution Systems In California

The FERC's assertion of authority over all transmission service to the point where a wholesale transaction occurs, even if the wholesale point of delivery occurs on lower-voltage, distribution-level facilities, has given rise to controversy in California, as elsewhere. It is our view, as described below, that Congress intended that *all* activity on public utility distribution-level facilities be regulated by the states, not by the FERC, and that the FERC's assertion of jurisdiction over "wholesale distribution" is erroneous and likely to lead to the kind of forum-shopping Congress intended to prevent.

2. Order No. 888's Departure From *Connecticut Light & Power*

We believe the court in *TAPS* was correct in affirming the FERC's assertion of jurisdiction over all transmission, both wholesale and retail, as well as the FERC's decision to allow continued state regulation of the transmission component of fully-bundled service offered by vertically-integrated electric utilities. Although one may fairly question the D.C. circuit's holding that the courts are obligated under the *Chevron* doctrine to give the same broad level of deference to an agency's interpretation of its own *jurisdiction*, as they must with respect to an agency's *policy* choices,¹⁰⁰

F.E.R.C. ¶ 61,269, at 62,280 (1995). In Order No. 888, the Commission suggested that demand-side activity by utilities is subject to state regulation. F.E.R.C. STATS. & REGS. ¶ 31,036, at 31,782 n.544 (1996).

99. In a complaint filed on February 27, 2001, FERC Docket No. EL01-40-000, Tucson Electric Power Co. asserted that the State's seizure of the block forward contract positions of Edison and PG&E in the Power Exchange required prior FERC approval under section 203 of the FPA. That claim is apparently based on the long-standing holding that contracts to make jurisdictional sales are themselves "facilities" used to make sales of electricity at wholesale, and thus subject to the FERC's jurisdiction under section 201. See generally *Hartford Elec. Power Co. v. FPC*, 131 F.2d 953 (2d Cir. 1942), cert. denied, 319 U.S. 741 (1943). To the extent that the contract rights seized were *buyer's* rights, that claim would appear to be misplaced, since, as seen above, it is only *sales* (i.e., the *seller's* interest) that are jurisdictional.

100. There is a split of authority regarding whether *Chevron* compels the courts to give deference to an agency when the agency makes a determination as to the reach of its own jurisdiction. Compare *TAPS*, supra note 25, at 694 (citing *Oklahoma Natural Gas Co. v. FERC*, 28 F.3d 1281, 1283-84 (D.C. Cir. 1994)) (applying *Chevron* deference to agency's jurisdictional determinations), with *Midland Coal*

in our view the FERC and the court in *TAPS* correctly interpreted the reach of the FERC's jurisdiction in those areas under the FPA.

Less tenable, we think, was the FERC's assertion of jurisdiction over "wholesale distribution," which *TAPS* also affirmed. In Order No. 888, the FERC concluded that "a public utility's facilities used to deliver electric energy to a wholesale purchaser, whether labeled 'transmission,' 'distribution,' or 'local distribution' are subject to the Commission's exclusive jurisdiction under sections 205 and 206 of the FPA. . . ."¹⁰¹ According to the FERC, only those facilities that are "used to deliver electric energy from the wholesale purchaser to the ultimate consumer are 'local distribution' facilities subject to the rate jurisdiction of the state."¹⁰² The *TAPS* court, citing the FERC's undisputed authority over all wholesale power transactions in interstate commerce, concluded that the "FERC's assertion of jurisdiction over all wholesale transmissions, regardless of the nature of the facility, is clearly within the scope of its statutory authority."¹⁰³

We believe that these rulings conflict with the Supreme Court's decision in *Connecticut Light & Power Co. v. FPC*,¹⁰⁴ which was cited neither by the FERC in its Order No. 888, nor by the *TAPS* court. In *Connecticut Light & Power*, the Federal Power Commission (the FERC's predecessor) claimed the authority to require a distribution utility in Connecticut to keep its books in accordance with the Commission's Uniform System of Accounts, based on the fact that some amount of electric energy distributed by the utility came from a source in Massachusetts. On review of this ruling, the United States Court of Appeals for the District of Columbia Circuit affirmed. The circuit court concluded:

whether or not the facilities by which petitioner distributes energy from Massachusetts should be classified as "local" is not relevant to this case. The sole test of jurisdiction of the Commission over accounts is whether these facili-

Co. v. Office of Workers' Comp., 149 F.3d 558, 561 (7th Cir. 1998), citing *Love v. Thomas*, 858 F.2d 1347, 1352 n.9 (9th Cir. 1988) (concluding that no *Chevron* deference applies on judicial review of an agency's jurisdictional determination). See also Quiney M. Crawford, Comment, *Chevron Deference to Agency Interpretations that Delimit the Scope of the Agency's Jurisdiction*, 61 U. CHI. L. REV. 957 (1994) (concluding that courts should defer to agency interpretations of their own jurisdiction). In the *Mississippi Power & Light* case, Justices Scalia and Brennan took opposite sides on this issue, with Justice Scalia arguing in favor of giving deference and Justice Brennan against. Compare *Mississippi Power & Light Co.*, 487 U.S. at 380-81 (Scalia, concurring) ("it is settled law that the rule of deference applies even to an agency's interpretation of its own statutory authority or jurisdiction.") with (Brennan, J., dissenting):

I cannot, however, agree with Justice Scalia's conclusion that courts must defer to an agency's statutory construction even where, as here, the statute is designed to confine the scope of the agency's jurisdiction to the areas Congress intended it to occupy. . . . [T]his Court has never deferred to an agency's interpretation of a statute designed to confine the scope of its jurisdiction.

487 U.S. at 386-87. The Supreme Court may find it necessary to resolve this question in its upcoming review of the D.C. Circuit's *TAPS* decision.

101. FERC Order No. 888, *supra* note 18, at Jurisdictional Appendix (Appendix G).
102. *Id.* (footnote omitted).
103. *TAPS*, 225 F.3d at 696.
104. *Connecticut Light & Power Co. v. FPC*, 324 U.S. 515 (1945).

ties, "local" or otherwise, are used for the transmission of electric energy from a point in one state to a point in another.¹⁰⁵

The Supreme Court reversed, finding that the provisions of the FPA disclaiming federal jurisdiction over "facilities used in local distribution" of electric power,¹⁰⁶ together with a policy statement in the FPA confirming that the statute was intended "to extend only to those matters which are not subject to regulation by the States," precluded federal jurisdiction over a distribution utility merely on the basis that some of the power distributed by the utility came from an out-of-state source.¹⁰⁷ The Supreme Court reasoned:

Congress has said without qualification that the Commission shall not, unless specifically authorized elsewhere in the Act, have jurisdiction "over facilities used in local distribution." To construe this as meaning that, even if local, facilities come under jurisdiction of the Federal Commission because power from out of state, however trifling, comes into the system, would nullify the exemption and as a practical matter would transfer to federal jurisdiction the regulation of many local companies that we think Congress intended to leave in state control. It does not seem important whether out-of-state energy gets into local distribution facilities. They may carry no energy except extra-state energy and still be exempt under the Act. The test is whether they are local distribution facilities. . . . The order must stand or fall on whether this company owned facilities that were used in transmission of interstate power and which were *not* facilities used in local distribution.¹⁰⁸

It seems clear from the Supreme Court's *Connecticut Power & Light* decision that the FERC in Order No. 888 and the District of Columbia Circuit in *TAPS* erred in concluding that the FERC's jurisdiction over "transmission" and "sales for resale in interstate commerce" was broad enough to encompass carriage of a third party's electricity that occurs on distribution wires to the point where a wholesale transaction occurs. Indeed, there is a *deja vu* quality when *TAPS* is laid side-by-side with *Connecticut Light & Power*. In both cases, the federal commission and the circuit court managed to override the "local distribution" exemption on the basis of the FPA's affirmative grant of federal jurisdiction over interstate transmission and sales-for-resale.¹⁰⁹ Justice Jackson, writing for the majority in *Connecticut Light & Power*, disposed of this argument as follows:

105. *Connecticut Light & Power v. FPC*, 141 F.2d 14, 18 (D.C. Cir. 1994), quoted in *Connecticut Light & Power*, 324 U.S. at 522.

106. FPA § 201(b)(1), 16 U.S.C. § 824(b)(1) (1994).

107. FPA § 201(a), 16 U.S.C. § 824(a)(1994).

108. *Connecticut Light & Power*, 324 U.S. at 531 (emphasis added).

109. Compare the D.C. Circuit's opinion in *TAPS*, 225 F.3d at 696 ("FPA § 201(b) denies FERC jurisdiction over local distribution facilities 'except as specifically provided in this subchapter and subchapter III'") with the D.C. Circuit's opinion in *Connecticut Light & Power* (which was reversed by the Supreme Court), where the same circuit court stated that:

Section 201(b) means to give the Commission jurisdiction over any facility for the transmission of electric energy in interstate commerce. The "but" clause in the section is intended to make it clear that this jurisdiction extends even to local facilities where the Act provides for their regulation, as it does in the case of accounting practices.

141 F.2d at 18.

It is hard for us to believe that Congress meant us to read "shall have jurisdiction" where it had carefully written "but shall not have jurisdiction." The command "thou shalt not" is usually rendered as to forbid and we think here it was employed without subtlety or contortion and in its usual sense. If otherwise in doubt this provision should be read in harmony with the policy provision. So read, its terms seem plainly to state circumstances under which the Commission shall not have jurisdiction. As such it is the provision which loomed importantly in the minds and speech of its sponsors, perhaps was necessary to get the bill passed, and is one which the Commission must observe and the courts must enforce. . . .

. . . [W]hatever reason or combination or reasons led Congress to put the provision in the Act, we think it meant what it said by the words "but shall not have jurisdiction, except as specifically provided in this Part or the Part next following . . . over facilities used in local distribution." Congress by these terms plainly was trying to reconcile the claims of federal and of local authorities over the industry. To define the scope of state controls, Congress employed terms of limitation perhaps less scientific, less precise, less definite than the terms of the grant of federal power. The expression "facilities used in local distribution" is one of relative generality. But as used in this Act it is not a meaningless generality in the light of our history and the structure of our government. We hold the phrase to be a limitation on jurisdiction and a legal standard that must be given effect in this case *in addition to the technological transmission test*.¹¹⁰

As we view it, the clear teaching of *Connecticut Light & Power* is that the FERC has no jurisdiction over any activities occurring on "local distribution facilities," but rather that local distribution facilities remain subject exclusively to regulation by the states. The FERC's conclusion in Order No. 888 that "a public utility's facilities used to deliver electric energy to a wholesale purchaser, whether labeled 'transmission,' 'distribution,' or 'local distribution' are subject to the Commission's exclusive jurisdiction under sections 205 and 106 of the FPA,"¹¹¹ cannot be reconciled with the Supreme Court's interpretation of the FPA in *Connecticut Light & Power*.¹¹²

110. *Connecticut Light & Power*, 324 U.S. at 528-31 (emphasis added). See also Thomas R. Powell, Note, *Physics and Law - Commerce in Gas and Electricity*, 58 HARV. L. REV. 1072 (1945) (commenting favorably on the Supreme Court's decision in *Connecticut Power & Light*):

In any event it would seem highly appropriate that both commission and courts should lean strongly toward faithful adherence to the spirit and the letter of the congressional reservation of state power and the coincident and coterminous restriction of national reach. In interpreting legislation containing negative clauses to mark terminal lines, a court which recognizes its duty to follow rather than to lead must give a much more restrictive reading of its scope than is required for legislation confined to conferring grants in broad language that leaves the interpreter morally free to push it as far as words and sense will justify.

Id. at 1089 (footnote omitted).

111. Order No. 888, *supra* note 18, at 31,969.

112. Besides conflicting with the Supreme Court's decision in *Connecticut Light & Power*, the FERC's rationale in Order No. 888 for its assertion of jurisdiction over "wholesale distribution" also collides with the rationale on which the FERC relied in the same order to support its assertion of jurisdiction over all third-party transmission services, both wholesale and retail. The FERC there reasoned that its "transmission" jurisdiction was broad enough to cover both wholesale and retail wheeling. See generally Order No. 888, Appendix G, section I, [Regs. Preambles] F.E.R.C. STATS. & REGS. ¶ 31,036, at 31,966-69 (1996). As the FERC concluded, "there is nothing in the statute, its legislative history, or the case law to indicate that the Commission's jurisdiction over rates, terms and conditions of transmis-

To quote again from Justice Jackson's opinion for the Court in that case:

Every facility from generator to the appliance for consumption may thus be called one for transmitting such interstate power. By this test the cord from a light plug to a toaster on the breakfast table is a facility for transmission of interstate energy if any part of the load is generated without the state.¹¹³

If, as we believe, Order No. 888 and *TAPS* erred in overlooking the teaching of *Connecticut Light & Power*, then we are somewhat at a loss to explain why the Supreme Court, in its order granting certiorari to review the *TAPS* decision, expressly did *not* accept the challenge raised by the state commissions with respect to the FERC's ruling on the wholesale distribution.¹¹⁴ The Court's apparent lack of concern on this issue seems to be at odds with the solicitude the Court recently showed towards state regulation of the local distribution of natural gas in *General Motors Corp. v. Tracy*,¹¹⁵ which approved Ohio's practice of taxing sales of natural gas by state-regulated local distribution companies at a lower, more favorable rate than sales by unregulated marketers. In any event, the upshot of the Court's refusal to grant certiorari on the "wholesale distribution" issue in *New York v. FERC* is that federal jurisdiction over wholesale distribution services will remain the law of the land for now. Ultimately, however, it must be acknowledged that there is at least a tension, if not an outright inconsistency, between this aspect of Order No. 888 and the holding of the Supreme Court in *Connecticut Light & Power*. This surely will invite further court challenges.¹¹⁶

sion in interstate commerce extends only to wholesale transmission and not retail transmission." *Id.* at 31,969. In a nutshell, this amounted to a "transmission-is-transmission" rationale, and on that basis the FERC found that its jurisdiction extends to all third-party transmission services without distinction between wholesale and retail transmission services. By the same token, the language in the FPA excluding from federal jurisdiction "facilities used in local distribution," and preserving state jurisdiction over the local distribution function, makes no mention of any distinction between "wholesale" distribution and "retail" distribution services. If "transmission is transmission," then "distribution is distribution." Under the FERC's own logic in support of its claim of jurisdiction over all transmission, and especially in light of the Supreme Court's decision in *Connecticut Light & Power*, the states should continue to have jurisdiction over all distribution, likewise without distinction between wholesale and retail services, and regardless of whether or to what extent the electricity can be traced to out-of-state sources.

113. *Connecticut Light & Power*, 324 U.S. at 529.

114. *TAPS*, 225 F.3d at 696.

115. *General Motors Corp. v. Tracy*, 519 U.S. 278 (1997).

116. If the FERC were to disclaim jurisdiction over wholesale distribution services (or if the FERC were required to do so by a court on judicial review), then there would be a need to discern whether a given facility over which a wholesale service was provided constituted a "local distribution facility" under FPA section 201. As the *TAPS* court explained, in Order No. 888, for the purpose of distinguishing retail *transmission* from retail *distribution* services, "FERC adopted a seven factor jurisdictional test to identify whether a facility is a local distribution facility subject to state jurisdiction or a facility engaged in interstate transmission subject to FERC jurisdiction." *TAPS*, 225 F.3d at 695. In a footnote, the *TAPS* court observed:

The Commission's seven factor test involves evaluating on a case-by-case basis whether the activities of the facilities in question correspond with seven specific indicators of local distribution:

- (1) Local distribution facilities are normally in close proximity to retail customers.
- (2) Local distribution facilities are primarily radial in character.
- (3) Power flows into local

2. Forum Shopping and “Sham” Transactions

One consequence of the FERC’s assertion of jurisdiction over “wholesale distribution” has been a series of proceedings in which entities have sought to encroach upon the customer base of an incumbent, franchised electric utility by exploiting the opportunity for federal jurisdiction over distribution circuits. Under the assumption that the FERC will regulate service—including service on distribution lines—all the way to the point where a “wholesale” transaction occurs, various parties have proposed to install certain *de minimis* facilities (such as a pole-mounted transformer, a service line, and/or a retail meter) on or near the end-use customer’s premises. This they deem to be a “wholesale” point of interconnection. They then claim a right to FERC-jurisdictional “wholesale distribution” service to the point of interconnection, and in some cases a mandate from the FERC forcing the utility to install the necessary interconnection facilities.¹¹⁷ In this manner, these entities have sought to avoid unwanted state requirements and charges related to the regulation of distribution service, and to serve selected retail customers previously served by the incumbent, state-regulated utility—in other words, to cherry pick selected customers from the existing utility’s system.

This is a troubling line of cases, not only because of conspicuous inconsistencies in the FERC decisions themselves (some of which, like *Palm Springs*, emphasize a “substance-over-form” analysis, and others of which appear to adopt a “*de minimis*-is-enough” rule),¹¹⁸ but also because of the

distribution systems; it rarely, if ever, flows out. (4) When power enters a local distribution system, it is not reconsigned or transported on to some other market. (5) Power entering a local distribution system is consumed in a relatively restricted geographic area.

(6) Meters are based at the transmission/local distribution interface to measure flows into the local distribution system. (7) Local distribution systems will be of reduced voltage.

TAPS, 225 F.3d at 695 n.6, quoting Order No. 888, F.E.R.C. STATS. & REGS. ¶ 31,036, at 31,981. If state jurisdiction over *all* distribution, both wholesale and retail, were to prevail, as we think it should, then clearly this same test could readily be used for the purpose of distinguishing FERC-jurisdictional transmission facilities from state-jurisdictional local distribution facilities. Moreover, in the case of the three major California utilities, the FERC also issued a declaratory order in 1996 that specifically approved a state commission determination as to which of their facilities constituted “transmission” facilities and which constituted “local distribution” facilities. *Pacific Gas and Elec. Co.*, 77 F.E.R.C. ¶ 61,077 (1996).

117. These include a series of “sham wholesale interconnection” cases arising in California under FPA section 212(h), 16 U.S.C. § 824k(h); *City of Palm Springs*, 76 F.E.R.C. ¶ 61,127 (1996), *reh’g denied*, 84 F.E.R.C. ¶ 61,225 (1998); *Laguna Irrigation Dist.*, 84 F.E.R.C. ¶ 61,226 (1998) (proposed interconnection order), 88 F.E.R.C. ¶ 61,164 (1999) (final interconnection order), *reh’g pending*; *Fresno Irrigation Dist.*, 88 F.E.R.C. ¶ 61,231 (1999). They also include another similar scheme in Oklahoma found to be a “sham” by administrative law judge Stephen Grossman, see generally *Peoples Elec. Coop.*, 60 F.E.R.C. ¶ 63,004 (1992), but then later approved by the FERC in Opinion No. 426, 84 F.E.R.C. ¶ 61,229 (1998) (overruling Judge Grossman’s Initial Decision), *reh’d denied*, Opinion No. 426-A, 93 F.E.R.C. ¶ 61,218 (2000).

118. Compare *City of Palm Springs*, 76 F.E.R.C. ¶ 61,127, at 61,703 (articulating a form-over-substance analysis) with Opinion No. 426-A, *Peoples Elect. Coop.*, 93 F.E.R.C. ¶ 61,218, at 61,725 (2000) and Proposed Order Directing Interconnection and Establishing Further Procedures, *Laguna Irrigation Dist.*, 84 F.E.R.C. ¶ 61,229, at 62,089 (rejecting claims that *de minimis* facilities at issue in those cases were insufficient to qualify for FERC-jurisdictional wholesale service).

invitation they pose for forum shopping.¹¹⁹ The better thinking on this subject is that Congress intended to leave distribution regulation exclusively to the states and that the FERC's assertion of a federal role for regulating wholesale distribution is legally erroneous under *Connecticut Light & Power*.¹²⁰

D. Siting Of Generating Plants And Transmission Lines

1. The Commerce Clause

Until September 1999, the statutory scheme under which California's State Energy Resources Conservation and Development Commission (Energy Commission) approves new generation facilities largely presupposed an industry consisting of vertically integrated utilities that build facilities to meet demand in their own franchised territories. For example, in approving a proposed site, the Energy Commission was required to make a finding as to compatibility with the "12-year forecast of statewide and service area power electric demands 'required to be filed by utilities for approval by the Energy Commission.'"¹²¹ Thus, the "need" for a given project was determined, at least initially, by the extent to which it would meet the requirements of customers within the state.¹²² Statutory amendments adopted in September 1999, and September 2000, to expedite the permitting process eliminated "need" as a factor in the siting of at least some types of plants (including gas-fired facilities), in effect, relying on the market to determine the need for particular plants.¹²³

More recent legislative proposals to expedite siting decisions have nonetheless focused on demand within the state. Thus, for example, a bill introduced by Assembly Member Zettel on January 29, 2001, provided for fast-track processing of certain applications for simple-cycle generation facilities, provided that the Energy Commission finds, among other things, that "the facility fills a critical reliability need, as determined by the California Independent System Operator in consultation with the [Energy Commission] and will operate only when dispatched by the California In-

119. The state commissions in *TAPS* argued that this would "only encourage energy marketers to choose their regulator by using middlemen to shift the point at which title to the power transfers, and thus undermine the jurisdictional certainty that Order 888 states is necessary for competition." *TAPS*, 225 F.3d at 695-96.

120. It should be noted that Mr. Lindh, one of the authors of this article, is counsel for PG&E in the *Laguna Irrigation District* case, which as of March 2001, was still pending at the FERC on rehearing.

121. CAL. PUB. RES. CODE § 25,514(a)(1) (2000). Applicants likewise were required to demonstrate need on the basis of state load projections. CAL. PUB. RES. CODE § 25,520(e).

122. In this respect, the California statute is not atypical. Other states have vested in a statewide agency—to the exclusion of local jurisdictions—the authority to approve siting of transmission and generation facilities based on demand as forecast by local utilities or state agencies. See, e.g., N.Y. PUB. SERV. CODE §§ 160-172 (2000).

123. 1999 Cal. Stat. 581, §11 (Senate Bill 110) amending CAL. PUB. RES. CODE §25,540.6; 2000 Cal. Stat. 329, §5 (A.B. 970) amending CAL. PUB. RES. CODE §25,550.

dependent System Operator.”¹²⁴

Similarly, the executive orders issued by Governor Davis on February 8, 2001, were explicit in favoring the development of generation capacity for in-state consumption. For example, the Governor directed that local air pollution control and air quality management districts modify certain emissions limits “as necessary to ensure that power generation facilities that provide power under contract to the Department of Water Resources (DWR) are not restricted in their ability to operate.”¹²⁵ As seen above, the DWR was authorized by the Legislature in early 2001 to purchase power to meet otherwise unmet retail needs within the state. Similarly, the same order directed the State Air Resources Board to make certain emissions credits available at a half price to “a power plant that agrees to sell its power under contract to the Department of Water Resources.”¹²⁶

That in-state usage should be the focus, or even a precondition, of expedited siting proposals is hardly surprising when one considers the relevant political context. In his “State of the State” address on January 8, 2001, Governor Davis openly suggested that Californians have a prior claim on power generated within the state:

On many days, 10 to 12 percent of the electricity generated in California leaves our state in search of even more exorbitant prices elsewhere. On some occasions, the merchant generators have brought the State to the very brink of blackouts by refusing to sell us back our own power because they could find higher prices elsewhere. Think about it: they’re refusing to sell us our own power.¹²⁷

Again, in issuing the above-described executive orders to expedite the siting authorization for new or repowered generation, the Governor declared:

These are megawatts produced in California that will stay in California to serve the people of this great state. They will keep the lights on during peak periods of the summer, and they will reduce our dependence on out-of-state generation.¹²⁸

Rhetoric of this sort raises concern as to the exercise of state siting authority in a manner that favors in-state demand. Such favoritism may take the form of focusing exclusively on in-state need when weighing the benefits and drawbacks of a given proposal, or, as in the case of Executive Order D-24-01, conditioning favored regulatory treatment on the project sponsor’s granting priority to local, over out-of-state demand. Either form of favoritism conflicts with fundamental principles of nondiscrimination under the Commerce Clause of the United States Constitution.

124. A.B. X1-20, General Assembly Bill, Extraordinary Session (CA, 2001).

125. Executive Order D-24-01 (Feb. 8, 2001), *available at* <http://www.governor.ca.gov>.

126. *Id.*

127. Press Release, State of State Address, (Jan. 8, 2001), *available at* <http://video.dot.ca.gov/state/transcript.html>.

128. Hon. Gray Davis, Transcript of Press Conference, (Feb. 8, 2001), *available at* http://www.governor.ca.gov/state/govsite/gov_homepage.jsp.

Read literally, the Commerce Clause does not limit the powers of the several states; it simply grants Congress the power “to regulate Commerce with foreign Nations and among the several states and with the Indian Tribes.”¹²⁹ Since the Supreme Court’s 1853 decision in *Cooley v. Board of Wardens*,¹³⁰ however, the Commerce Clause has been construed to restrict the states’ authority to regulate interstate commerce in certain respects, at least in the absence of explicit approval by Congress. Under “negative” or “dormant” Commerce Clause jurisprudence, state regulation that affords disparate, and less favorable, treatment to interstate commerce will ordinarily be struck down: “[d]iscrimination against interstate commerce in favor of local business or investment is *per se* invalid, save in narrow class of cases in which a municipality can demonstrate under rigorous scrutiny that it has no other means to advance a legitimate local interest.”¹³¹ State laws that have been held to be discriminatory, and thus invalid in the absence of a compelling justification, include: laws that require the local processing of resources found within the state,¹³² laws that preclude or discriminate against use of out-of-state products,¹³³ or, of particular relevance here, laws that give in-state needs or users prior call on the state’s natural resources. Examples of the last category are a New Hampshire law that prohibited the exportation of inexpensive hydroelectric power,¹³⁴ and a West Virginia law that prohibited the export of natural gas by pipeline unless in-state needs had been met.¹³⁵

Congress may (and sometimes does) delegate to the states the power to regulate certain aspects of activities that are part of interstate commerce. But, as the Supreme Court has emphasized, Congress must “manifest its unambiguous intent” to shield state regulation from Commerce Clause strictures before a federal statute will be read as doing so.¹³⁶ A statute that merely declares, without more, that its provisions are not intended to displace otherwise proper state authority will not be construed

129. U.S. CONST., art. I, § 8, cl. 3.

130. *Cooley v. Board of Wardens*, 12 How. 299 (1853).

131. *C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383 (1994). Justice Scalia has taken the view that the “‘negative’ Commerce Clause is an unjustified judicial invention, not to be extended beyond its existing domain.” *General Motors Corp. v. Tracy*, 519 U.S. 278, 312 (1997) (Scalia, J., concurring), *citing* *Tyler Pipe Indus., Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232, 263 (1987) (Scalia, J., concurring in part and dissenting in part).

132. *See, e.g., Clarkstown*, 511 U.S. at 391 (1994) (invalidating ordinance requiring that local waste be processed at a local plant).

133. *See, e.g., Wyoming v. Oklahoma*, 502 U.S. 437 (1992) (invalidating requirement that an Oklahoma utility use Oklahoma coal for at least 10% of its needs).

134. *New England Power Co. v. New Hampshire*, 455 U.S. 331 (1982).

135. *Pennsylvania v. West Virginia*, 262 U.S. 553 (1923). State regulation that impedes or burdens interstate commerce may fall afoul of the Commerce Clause even if it is not discriminatory or protectionist in nature. Such regulation, the Supreme Court has said, is subject to a balancing test, under which the courts will weigh the burden on interstate commerce against the local interest sought to be achieved and the availability of less burdensome alternatives. *See generally* *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

136. *Wyoming*, 502 U.S. at 458.

as giving the states the affirmative power to regulate or discriminate against interstate commerce.¹³⁷

In *Tampa Electric Co. v. Garcia*,¹³⁸ decided in April 2000, the Supreme Court of Florida concluded that Congress had granted the states leeway in the exercise of their siting authority to favor in-state usage. Under the Florida statute at issue, construction of a new generating plant with capacity greater than seventy-five megawatts required certification of “public need” by the Florida Public Service Commission. The Florida court in *Garcia* held that the state statutory scheme “was not intended to authorize the determination of need for a proposed power plant output that is not fully committed to use by Florida customers who purchase electrical power at retail rates.”¹³⁹ The court rejected the argument that, thus construed, the siting statute would violate the dormant Commerce Clause and was preempted by the Energy Policy Act of 1992.¹⁴⁰ Noting that section 731 of the Energy Policy Act explicitly disclaims any intent to interfere with “the authority of any State or local government relating to environmental protection or the siting of facilities,” the court concluded “power-plant siting and need determination are areas that Congress has expressly left to the states.”¹⁴¹

We believe that the Florida court’s reliance on section 731 of the Energy Policy Act was misplaced. As seen above, United States Supreme Court precedent requires an “unambiguous” expression of congressional intent in order to shield protectionist state regulation from invalidation under the Commerce Clause. By its terms, section 731 does no more than leave unaffected whatever authority the states had, prior to enactment of the Energy Policy Act, to regulate siting decisions; certainly nothing in section 731 can be read as an affirmative grant of authority to the states to discriminate in favor of their own residents against interstate commerce.¹⁴²

Siting criteria other than need also may give rise to discrimination under the Commerce Clause. Thus, for example, Indiana’s power plant siting statute requires a finding, in the case of a proposed coal-fired plant, that the plant will use Indiana coal unless “economic considerations” or “governmental requirements” justify otherwise.¹⁴³ This provision, on its face, conflicts with the Commerce Clause as construed in *Wyoming v. Oklahoma*.¹⁴⁴ Unless “economic considerations” and “governmental requirements” are read so broadly as to allow the plant operator to choose coal from whatever source it would select otherwise—i.e., unless the provision is simply hortatory—the Indiana statute appears to discriminate impermis-

137. *New England Power Co.*, 455 U.S. at 343.

138. *Tampa Elec. Co. v. Garcia*, 767 So. 2d 428 (Fla. 2000); *cert. denied sub nom. New Smyrna Utils. Comm’n v. Tampa Elec. Co.*, No. 00-1052, 2001 WL 208764 (Mar. 5, 2001).

139. *Tampa Elec. Co.*, 767 So. 2d at 435.

140. *Id.* at 435.

141. *Tampa Elec. Co.*, 767 So. 2d at 436.

142. *See generally New England Power Co.*, 455 U.S. at 341.

143. IND. CODE § 8-1, 8-1-8.5-4 (2000).

144. *Wyoming v. Oklahoma*, 502 U.S. 437 (1992).

sibly against interstate commerce. On the other hand, under the Florida court's reading of section 731, such discrimination would be treated as having been authorized by Congress and thus immune to Commerce Clause attack.

As noted above, legislation pending before the California Legislature would require that generators receiving certain state funding provide a priority for California consumers.¹⁴⁵ Whether such a discriminatory scheme of subsidization, as distinct from discriminatory permitting or even tax exemption, would violate the Commerce Clause is unclear. While the Supreme Court has upheld subsidization favoring in-state businesses or consumers where it concluded that the state was acting as a "market participant,"¹⁴⁶ it has not squarely ruled on the constitutionality of discriminatory subsidies.¹⁴⁷

2. Federal Siting Authority: Pros and Cons

Concern that state siting authority over electric transmission facilities may be exercised in a manner that fails adequately to take into account multi-state or regional needs has precipitated proposals to confer upon the FERC the authority to approve the construction and siting of transmission facilities, much in the manner of that the FERC currently approves the construction and siting of interstate natural gas pipeline facilities. Legislation providing such authority was introduced in the 106th Congress.¹⁴⁸ Testifying before a House subcommittee in March 2001 Commissioners Massey and Breathitt supported such legislation.¹⁴⁹

There are obvious and legitimate reasons for retaining transmission siting authority at the state level. State authorities are likely to be more familiar with geographic and other local conditions. Affected citizens and their political representatives will have readier access (or at least perceive that they do) to state agencies.

On balance, however, the arguments in favor of federal siting authority for electric transmission lines are more persuasive. The FERC is experienced in siting large energy projects and has well-established procedures—notably local public hearings—for enabling local citizens to make their views known.¹⁵⁰ There is no reason to believe that the FERC will be

145. See generally *supra* note 76.

146. See generally *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 809 (1976) (upholding state subsidization of in-state scrap processors of abandoned cars). See also *Reeves, Inc. v. Stake*, 447 U.S. 429 (1980) (state-owned cement plant may give priority to in-state residents in times of shortage).

147. See generally *Camp Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 589 (1997).

148. See, e.g., S. 1273, 106th Cong. (2000) (Sen. Bingaman); S. 2098, 106th Cong. (Sens. Murkowski and Landrieu). See also S. 2071, 106th Cong. (2d Sess. 2000).

149. Electricity Markets: California before the Subcommittee on Energy and Air Quality of the House Committee on Energy and Commerce, 107th Cong. (2001) (statements of William L. Massey and Linda Breathitt, Commissioners, Federal Energy Regulatory Commission), available at <http://www.house.gov/commerce/hearings/03202001>.

150. Under its "FERC First" initiative, the FERC has reorganized its staff to vest in a new Office of Energy Projects the responsibility for siting gas pipeline and hydroelectric projects.

institutionally less sympathetic than state siting agencies to local environmental or preservation concerns, constrained as it is by statutes such as the National Environmental Policy Act,¹⁵¹ the Endangered Species Act,¹⁵² and the National Historic Preservation Act.¹⁵³ More importantly, the FERC is better situated than state siting agencies to assess the overall need for a given transmission project and to weigh, in an even-handed manner, the benefits and detriments of various alternatives. It is also better insulated from purely local political pressures of the sort that may have deterred construction of generation or transmission capacity in California. Further, while state courts reviewing state agency decisions, no less than federal courts, are bound by the dormant Commerce Clause, they are (as the Florida case indicates) a less reliable shield against parochialism.

A similar policy argument—up to a point—can be made in favor of giving the FERC siting authority over electric generating plants as well. Again, the FERC is an expert, from its experience in licensing of hydroelectric projects, in weighing the need for a local generation plant against the resulting detrimental effects, and fashioning appropriate conditions. It is also true that the potential for parochial state decision-making, unchecked by the courts, occurs in the case of generation as well as transmission. But there are critical differences. In particular, the siting of a single generation plant is far less likely to affect the siting of facilities and the reliability of service in other states. Changing the location of one proposed generation plant will probably not require changing the location of others. In contrast, changing the route of one segment of a multi-state transmission project, will almost inevitably affect other segments as well. For that reason, the balance would seem to tip against federal siting authority over non-hydroelectric generating plants.

E. The California ISO and Power Exchange: Federal-State Governance Issues

As noted above, in initially authorizing establishment of the ISO and Power Exchange, the FERC expressly overruled two aspects of the state restructuring legislation that the Commission found would interfere with its exclusive jurisdiction over interstate commerce. First, the FERC rejected governance rules for the ISO and the Power Exchange that would have subjected their decisions to oversight by a California state agency, the Electricity Oversight Board.¹⁵⁴ Second, the FERC rejected a California residency requirement for members of the boards of these two new organizations, finding this requirement to be “unduly discriminatory” against

151. 42 U.S.C. §§ 4321-4370a, 7101-7352(1994).

152. 16 U.S.C. §§ 1531-1544 (1994).

153. 16 U.S.C. §§ 470-470x-6(1994).

154. *Pacific Gas and Elec. Co.*, 77 F.E.R.C. ¶ 61,204, at 61,817-19 (1996). As the FERC stated, the proposed Oversight Board was deemed “unacceptable, among other things, because it appears to be designed to favor California Interests rather than the interests of all users of the ISO and PX.” *American Serv. Power Corp.*, 81 F.E.R.C. ¶ 61,141, at 61,453 n.97 (1999).

out-of-state interests.¹⁵⁵ The FERC reaffirmed these rulings in subsequent orders.¹⁵⁶

It would be difficult to find fault with the FERC's rejection of a California residency requirement for ISO and Power Exchange board members, and its refusal to allow a significant governance role for the state's Electricity Oversight Board with respect to ISO and Power Exchange activities. The FERC's avowed goal was to prevent these nascent institutions, and indeed the emerging California market, from becoming insular and parochial in focus. This certainly appears to have been an appropriate response by a federal agency charged with the responsibility to oversee a very broad, highly interconnected interstate market. But, quite apart from the wisdom of the FERC's rulings on their merits, there can be no doubt that, under the Supremacy Clause, these rulings preempted and, thus rendered void, the contrary provisions of California's restructuring legislation.¹⁵⁷

In its December 15, 2000 Order *Directing Remedies for California Wholesale Electric Markets*, the FERC overruled additional provisions of the California restructuring legislation concerning ISO governance, this time the requirement for a "stakeholder" board made up of interested industry and consumer representatives.¹⁵⁸ In its earlier orders authorizing establishment of the ISO and the Power Exchange, the FERC had approved the provisions of the state restructuring legislation calling for interested "stakeholder" boards for both the ISO and the Power Exchange, composed of various industry and consumer representatives.¹⁵⁹ In its December 2000 order, the FERC reversed its position and directed that the ISO's existing stakeholder board be replaced with a disinterested board by April 2001. Because the Commission in the same order abolished the Power Exchange's tariff, it found "no need at this time to require replace-

155. 77 F.E.R.C. ¶ 61,204, at 61,819 (1996).

156. See generally *Pacific Gas and Elec. Co.*, 81 F.E.R.C. ¶ 61,122, at 61,450-52 (residency requirement) and 61,452-53 (Oversight Board functions); *reh'g and stay denied*, 82 F.E.R.C. ¶ 61,223 (1998). The California legislature thereafter passed new legislation to address in substantial part the concerns expressed by the FERC. At the state's request, the FERC then issued a declaratory order indicating that it would accept the revised plan on an interim basis. *California Elec. Oversight Bd.*, 88 F.E.R.C. ¶ 61,172 (1999); *reh'g denied*, 89 F.E.R.C. ¶ 61,134 (1999).

157. It is well-established that federal preemption of state law can occur, not only as a direct effect of a statute enacted by Congress, but also as a consequence of rulings by a federal administrative agency (such as the FERC) pursuant to a statutory delegation of authority to the agency. See generally *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 369 (1986), citing *Fidelity Federal Savings & Loan Assn. v. De la Cuesta*, 458 U.S. 141 (1982), and *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691 (1984). See also *North Carolina Utils. Comm'n v. FCC*, 537 F.2d 787 (4th Cir. 1976), *cert. denied*, 429 U.S. 1027 (1976) (*NCUC I*); *North Carolina Utils. Comm'n v. FCC*, 552 F.2d 1036 (4th Cir. 1977) (*NCUC II*), discussed *infra* note 169.

158. 93 F.E.R.C. ¶ 61,294.

159. See generally 81 F.E.R.C. ¶ 61,122, at 61,446-48 (describing thirteen different classes of ISO board members) and 61,453 (approving the ISO board structure, with modifications related to a California residency requirement and Electricity Oversight Board supervision); 77 F.E.R.C. ¶ 61,204, at 61,816-17.

ment of [the Power Exchange's] Governing Board."¹⁶⁰ The Commission acknowledged a conflict between its new order and the provisions of the state restructuring legislation requiring a stakeholder-type board composition:

We recognize concerns raised by the ISO and others that, without changes to State law, our directive to immediately change the status of the existing Board presents a conflict between State and Federal requirements. We conclude that it is necessary to take this step in order to remedy the dysfunctions in wholesale interstate electricity markets in California and to assure just and reasonable rates. Our hope, however, is to reach a mutually agreeable State/Federal consensus on how the new Board is to be selected and to eliminate conflicts between State and Federal requirements as expeditiously as possible.¹⁶¹

As of March 2001, the process the FERC had envisioned for resolving—without litigation—the conflict between state-law requirements and the FERC's own requirements regarding board composition appeared to have reached an impasse. State legislation enacted in January 2001, purportedly in order to make the ISO and Power Exchange boards "more accountable to the people of this state," eliminated the stakeholder boards, as the FERC had ordered, but replaced them with new, five-member boards appointed by the Governor.¹⁶² This prompted a stinging (and not, we think, unjustified) rebuke by the FERC's then-Chairman Hoecker, in a concurring opinion issued on January 18, 2001, immediately prior to his leaving office. Under a heading entitled "Separating Markets and Politics," Chairman Hoecker wrote:

California's recent legislation changing the ISO governance board reflects, in my view, another triumph of expedience over cooperation and understanding of the electric system. While stacking the board of a FERC-jurisdictional public utility with state political appointees may not raise ire in California, it is an unacceptable intrusion—not unlike the mistakes of A.B. 1890—into federally regulated power markets. Such a measure surely imperils the California ISO's eligibility as an RTO under Order No. 2000. Because the state is now clearly a market participant, the independence of the board is bound to be compromised. Consequently, the state's decisions are no longer entitled to the kind of deference we have accorded it since A.B. 1890. More than that, this action evinces a bald¹⁶³ disregard for federal jurisdiction and a rejection of cooperative solutions.

F. Generator-Grid Interconnections

One feature of the FERC's December 2000 Order that provoked relatively little controversy was a directive to the ISO and the three investor-owned utilities to file detailed tariff provisions governing interconnection

160. 93 F.E.R.C. ¶ 61,294, at 62,013.

161. *Id.* at n.104.

162. A.B. X-1, 2001 Cal Legis Serv. 1 (West).

163. 93 F.E.R.C. ¶ 61,294, at 62,030-31 (2000) (second concurring opinion of Chairman Hoecker) (addendum issued Jan. 18, 2001).

of third-party generating plants to the ISO-controlled grid.¹⁶⁴ The Commission referred to a number of prior cases in which it had accepted, and elaborated upon, defined standards whereby third-party generating plants could request interconnection with an interstate grid.¹⁶⁵ The terms and conditions of interconnection—including: the costs imposed on the generator, the place a given request will be given in the transmission-owner’s “queue” of pending interconnection requests, and the time-frames for the transmission owner to perform various studies—are issues of great practical significance for the sponsors of generation projects. By asserting jurisdiction over third-party generator interconnections, and by requiring the grid operator to include in its FERC tariff a clear statement of the standards for such interconnections (including cost responsibility), the FERC’s orders allow the developers of generation projects a much higher level of certainty regarding this crucial aspect of their planning. We can perceive no basis for doubting the correctness of the FERC’s view that the entire subject of grid interconnections by third-party generating plants falls exclusively within the FERC’s jurisdiction over interstate transmission, even though the states retain jurisdiction over siting and other issues related to construction of the generating plants themselves.¹⁶⁶

In at least one case to date, the FERC also has claimed jurisdiction over interconnection of utility-owned power plants to the interstate grid.¹⁶⁷ It may be argued, however, that, in the case of a traditional, vertically-integrated utility that continues to operate its own power plants for the exclusive purpose of rendering a fully-bundled sales service to its retail customers in the traditional manner, the state, rather than the FERC, should continue to regulate the interconnection of such utility-owned power plants to the utility’s transmission system. This would seem to be the natural consequence of the FERC’s decision in Order No. 888, as affirmed by *TAPS*, not to mandate federal unbundling of traditional, state-regulated retail service by electric utilities, but rather to defer to state regulation of such bundled service.¹⁶⁸ On the other hand, as with the provision of transmission services, the vertically-integrated utility must abide by the FERC’s over-arching prohibition against undue discrimination towards third-parties and undue preference in favor of the utility’s own uses of the transmission system. Thus, for example, a state scheme that purported to

164. *Id.* at 62,016.

165. 93 F.E.R.C. ¶ 61294, at nn.112 & 113 (citing *Southwest Power Pool, Inc.*, 92 F.E.R.C. ¶ 61,109 (2000); *Commonwealth Edison Co.*, 91 F.E.R.C. ¶ 61,083 (2000), *order on compliance filing*, 92 F.E.R.C. ¶ 61,018 (2000); *Entergy Services, Inc.*, 91 F.E.R.C. ¶ 61,149 (2000); *American Elec. Power Serv. Corp.*, 91 F.E.R.C. ¶ 61,308 (2000)). *See also Tennessee Power Co.*, 90 F.E.R.C. ¶ 61,238 (2000).

166. Under the broad language of the FPA section 205, it does not seem important to determine whether interconnection is a separate, jurisdictional “service” or merely an activity performed “in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission,” since section 205 grants the FERC regulatory authority in either event.

167. 91 F.E.R.C. ¶ 61,149, at 61,559.

168. It should be noted that Enron Power Marketing, Inc. has challenged this ruling in the case now pending before the United States Supreme Court. *See generally supra* note 33.

give utility-owned power plants more favorable cost treatment for grid interconnections than the treatment afforded to third-party plants would almost certainly run afoul of the FERC's non-discrimination rule and would be preempted by the FERC rule even if approved by a state regulatory commission in the retail utility's tariff.¹⁶⁹ In light of the pre-emptive effect of the FERC non-discrimination rule, it may be of little more than academic interest to argue that the states retain jurisdiction over interconnection of utility-owned power plants.¹⁷⁰

G. Grid Reliability

At present, transmission system reliability is essentially a matter of voluntary compliance by transmission-owning utilities with reliability standards adopted by the North American Electric Reliability Council (NERC) and by regional reliability councils such as the Western Systems Coordinating Council (WSCC) in the western states. In congressional testimony over the past year, the FERC has repeatedly called for enactment of federal legislation giving the FERC authority to oversee the reliability of the interstate transmission grid.¹⁷¹ Former FERC Chairman Hoecker described this to Congress as "a fundamental issue of interstate commerce" and hence more properly a subject for federal jurisdiction rather

169. A companion pair of cases in the United States Court of Appeals for the Fourth Circuit involving customer-owned telephone equipment illustrates how the FERC's non-discrimination requirement would preempt any conflicting state rule regarding generator interconnections. *North Carolina Utils. Comm'n v. FCC*, 537 F.2d 787 (4th Cir.), cert. denied, 429 U.S. 1027 (1976) [hereinafter *NCUC I*]; *North Carolina Utils. Comm'n v. FCC*, 552 F.2d 1036 (4th Cir. 1977) [hereinafter *NCUC II*]. In those cases, the Fourth Circuit held that a Federal Communications Commission (FCC) rule authorizing customers to own their own telephone equipment and setting standards for third-party equipment providers, preempted any contrary state rules that required customers to use only telephone equipment provided by their local telephone company. The federal rules were preemptive, the court found, even though it was shown that the affected telephones and telephone equipment were used over 97% of the time for local and intrastate calls under state jurisdiction, as distinct from toll calls under FCC jurisdiction. The court found "no statutory basis for the argument that FCC regulations serving other important interests of national communications policy are subject to approval by state utility commissions." *Id.* at 1046-47. It should be noted that the federal statute at issue in the Fourth Circuit's telephone cases (the Communications Act of 1934) contains provisions strikingly similar to the FPA regarding preservation of state jurisdiction over local and intrastate activities, and granting jurisdiction to the federal regulatory body over interstate activities. Compare 47 U.S.C. § 152 (Communications Act), with 16 U.S.C. § 824 (FPA). The basic jurisdictional and substantive provisions of the two statutes—the Communications Act and the FPA—were enacted in the same New Deal era, only one year apart, in 1934 and 1935, respectively.

170. The same can be said regarding interconnection of "qualifying facilities" (QFs) under PURPA, whose output is sold to the local utility. Although the interconnection of QFs appears to have resided with the states prior to Order No. 888, henceforth it appears that the FERC will have jurisdiction over such interconnections. The FERC's assertion of jurisdiction would be especially strong in the case of a QF that engages both in sales to the local utility under PURPA as well as wholesale sales to other purchasers.

171. Pending Electricity Litigation: Before the Senate Comm. on Energy and Natural Resources, 106th Cong. (2000) (statement of Chairman James J. Hoecker, Federal Energy Regulatory Commission) 2000 WL 19303065 at *14, *16-18.

than state jurisdiction.¹⁷² Even the reliability councils themselves have begun to call for federal reliability legislation.¹⁷³

Whether Congress ultimately acts on these proposals, it seems clear in any event under Order No. 888, and especially after the transfer of a utility's transmission system operations to a Regional Transmission Organization, that state commissions should not retain any authority to regulate the reliability of an interconnected transmission system. The states, to be sure, still have authority over the siting of transmission facilities, as discussed in Part II. But reliability, like other aspects of system operations, should be viewed as falling exclusively within the realm of interstate commerce, and as such should be beyond the jurisdictional reach of a state commission.

Nonetheless, the lack of explicit federal statutory authority over transmission system reliability leaves something of a vacuum, and inevitably has been a tendency on the part of state officials to step forward and assert jurisdiction to address reliability issues. In *Northern States Power Co. v. FERC*,¹⁷⁴ the United States Court of Appeals for the Eighth Circuit overturned a series of FERC orders that directed a utility to amend its "curtailment priorities" so as to ensure, consistent with Order No. 888, that curtailments due to congestion on the transmission system would be spread equally between wholesale interstate customers and the utility's traditional "native load" customers. The court there held that the FERC had exceeded its statutory authority by directly regulating the quality of retail service in a way that was inconsistent with state regulation. The eighth circuit's decision has been strongly (and in our view correctly) criticized by commentators as inconsistent with established principles of federal preemption.¹⁷⁵

172. *Id.* at 18.

173. It was reported that the NERC and others sent a letter to the Speaker of the House of Representatives, dated September 12, 2000, calling for federal reliability legislation of the type the FERC has supported. *See generally Energy Daily*, Vol. 28, Sept. 14, 2000 at 1.

174. *Northern States Power Co. v. FERC*, 176 F.3d 1090 (8th Cir. 1999), *cert. denied*, 120 S. Ct. 1221 (2000).

175. *See generally* William H. Penniman and Paul B. Turner, *A Jurisdictional Clash Over Electricity Transmission: Northern States Power v. FERC*, 20 ENERGY L.J. 205 (1999). Although the authors of the foregoing Energy Law Journal (ELJ) article expressed the hope that the United States Supreme Court would review the Eighth Circuit's decision (*See generally id.* at 232), in fact the case became moot while the petition for a writ of certiorari was pending, because the utility withdrew its earlier tariff filing. At the suggestion of the Solicitor General, speaking on behalf of the FERC, the Supreme Court denied certiorari. *See generally* Brief for the FERC in Opposition, *Enron Power Mktg., Inc. v. Northern States Power*, 528 U.S. 1182, *cert. denied*, (U.S. Feb. 22, 2000) (No. 99-916). Although it recommended against granting the writ of certiorari, the Solicitor General's brief nonetheless argued that the Eighth Circuit's decision was wrong as a matter of law. But, consistent with the government's long-standing position regarding cases that become moot before certiorari is granted, the Solicitor General recommended against granting the writ of certiorari and vacating the lower court decision, as the petitioners in that case urged. The Supreme Court denied the writ on February 22, 2000. In congressional testimony, FERC Commissioner, William Massey, explained in fairly colorful terms how he thought the Eighth Circuit's approach would result in unreasonable discrimination against interstate, wholesale transactions: "By way of analogy, imagine that you are driving around the Washington, D.C. beltway. As you cross into Virginia, a flashing sign warns, 'Congestion ahead! All vehicles not licensed in Vir-

Meanwhile, since the onset of the electric industry restructuring in California in 1998, two federal-state issues concerning reliability have surfaced. The first of these involved a still-unresolved conflict between federal and state law arising out of a massive power failure in San Francisco on December 8, 1998; the other, triggered by rolling blackouts in the midst of the energy crisis during early 2001, actually involved a fairly smooth meshing of complementary federal and state requirements.

On December 8, 1998, only eight months after the California ISO began operations, the main transmission lines leading north into the San Francisco peninsula failed due to human error at a PG&E substation where maintenance work was occurring. This caused the two power plants located in San Francisco to trip off line. Substantial portions of San Francisco immediately lost power for periods of up to six hours. Because the outage originated on the high-voltage transmission lines, both the utility and the ISO took the position that a subsequent investigation and imposition of possible sanctions fell exclusively within the ISO's province under its FERC-approved tariff, and indeed the ISO later imposed a financial penalty on the utility. The state public utilities commission, however, initiated its own investigation into the outage and claimed the authority to impose sanctions on the utility.¹⁷⁶ As of early March 2001, the matter was still pending before the state commission.

In our view, while the California state commission's interest in the San Francisco outage was understandable—indeed, the commission's own headquarters building in San Francisco was blacked out along with most of the rest of the city—the state commission erred in claiming jurisdiction to investigate and penalize the utility for this transmission outage. The ISO's federal tariff contained elaborate and explicit provisions on all aspects of system operations, including investigation and corrective measures related to unplanned outages. The state commission failed to recognize that these FERC-approved tariff provisions completely displaced its authority over the same subject matter. Indeed, a state commission should have no more authority to investigate or penalize an outage on the electric transmission grid than it would over a rupture on an interstate pipeline that serves gas utilities in the state—even though in both circumstances the effects are likely to spill over into the distribution-level systems regulated by the state authorities. Especially where the transmission system operator's FERC tariff includes (as does the California ISO's) an elaborate set of provisions for investigation and penalties for unplanned outages, a transmission-level outage is a matter that should be deemed to fall exclusively within the jurisdiction of the federal authorities.

On the subject of rolling blackouts—a type of planned outage needed to address a shortfall in supply or other system emergencies—California also has had the unhappy experience of testing the relationship between

ginia exit immediately!" *Supra* note 149.

176. California Public Utilities Commission, Order Instituting Investigation, R.98-12-013 (DEC. 8, 1998).

federal and state authority, but with good results to date. The California ISO's tariff contains extensive provisions giving the ISO clear authority to order the local utilities to shed load as necessary to address a system emergency.¹⁷⁷ In turn, all of the California-regulated utilities have provisions in their respective state-jurisdictional tariffs specifying the priorities pursuant to which they will shed load during such an emergency.¹⁷⁸ The state commission reviews and approves the utility tariffs, while the FERC has jurisdiction over the ISO tariff. As of March 2001, this scheme appears to have worked amicably during the rolling blackouts California was forced to endure during the first quarter of 2001, and no apparent conflicts have arisen.

H. FERC Authority Over Service on State-Owned Transmission Facilities

California's proposed purchase of transmission facilities owned by Edison, PG&E, or SDG&E would, at first blush, seem to remove those facilities from federal regulation, inasmuch as governmental entities, as noted above, generally are not subject to the FERC's jurisdiction.¹⁷⁹ Under section 203 of the FPA, however, transfer of the transmission facilities by the current owners would require the FERC's approval.¹⁸⁰ In a parallel, but considerably smaller transaction three years ago, the Commission approved a proposal by Long Island Lighting Company to sell its transmission facilities to the Long Island Power Authority, a state agency.¹⁸¹ In finding that transaction consistent with the public interest, the FERC relied upon the Power Authority's undertaking to comply voluntarily with the FERC's open-access requirements.¹⁸² The Commission also noted that the Power Authority had not paid more than book value for the facilities and had committed not to raise transmission rates for three years.¹⁸³ Any FERC consent under section 203 to California's acquisition of some or all utility transmission assets within the state could be similarly conditioned.¹⁸⁴

177. See, e.g., Cal ISO Tariff § 4.4.4 (Oct. 13, 2000), available at <http://www.casio.com/publicinfo/tariffs>.

The ISO shall have the authority to direct a UDC [utility distribution company] to disconnect Load from the ISO Controlled Grid if necessary to avoid an anticipated System Emergency or to regain operational control over the ISO Controlled Grid during an actual System Emergency. The ISO shall direct the UDCs to shed Load in accordance with the prioritization schedule developed pursuant to section 2.3.2.6. When ISO Controlled Grid conditions permit restoration of Load, the ISO shall restore Load according to the prioritization schedule developed pursuant to section 2.3.2.6 hereof.

178. See generally Pacific Gas and Electric Co., CPUC Tariff, Electric Rule 14 – *Shortage Of Supply And Interruption Of Delivery*, available at <http://www.pge.com>.

179. See *infra* section I(A).

180. 16 U.S.C. § 824b (2000).

181. *Long Island Lighting Co.*, 82 F.E.R.C. ¶ 61,129 (1998)

182. *Id.* at 61,465.

183. 82 F.E.R.C. ¶ 61,129, at 61,462.

184. The Federal Power Commission, in 1946, ruled 3-2 that the transfer of jurisdictional facilities to a non-jurisdictional entity did not require its approval under section 203. *Nebraska Power Co.*, 5 F.P.C. 8 *reh'g denied*, 5 F.P.C. 408 (1946). Although the issue was not directly addressed in *Long Island Lighting*, it seems unlikely, in light of the FERC's expansive reading of its jurisdiction under sec-

Whether the Commission could subsequently *enforce* against a state agency or other non-jurisdictional entity conditions imposed under section 203, other than by ordering rescission of the transfer, has not been adjudicated. Section 314(a) of the FPA authorizes the FERC to seek an injunction in federal district court when it appears that “any person” is engaged or about to engage in a violation of a Commission order.¹⁸⁵ Similarly, section 316(b) provides for certain penalties against “any person” who violates a Commission order.¹⁸⁶ The definition of “person” in section 201, however, includes only individuals and corporations, thus appearing to exclude state agencies.¹⁸⁷ To the same effect, forfeitures under section 315(a)¹⁸⁸ for violation of Commission orders may be awarded only against hydroelectric licensees and “public utilities,” a category that excludes state agencies.¹⁸⁹ It would appear, then, that the FERC’s only remedy for the failure of the state, or one of its agencies, to comply with section 203 conditions would be to rescind its approval of the transfer.

IV. CONCLUSION

The careful division of regulatory jurisdiction between the federal government and the states enacted in the FPA nearly three-quarters of a century ago reflects a philosophy, as Justice Jackson wrote for the Court in *Connecticut Light & Power*, that it is “wise to keep the hand of state regulatory bodies in this business, for the ‘insulated chambers of the states’ are still laboratories where many lessons in regulation may be learned by trial and error on a small scale without involving a whole national industry in every experiment.”¹⁹⁰ The “lessons” from the California experiment with electric industry restructuring to date are not only economic—how markets should or should not be designed—but political and legal as well. In particular, when experimentation goes awry, state authorities are likely to seek, above all, to protect the interests of their own constituents. In these circumstances the constitutional limitations on states’ powers—limitations embodied in the Supremacy Clause and the Commerce Clause—properly come into play.

tion 203 in more recent orders, that the FERC would adopt a similar position today. *See, e.g., Enova Corp. and Pacific Enterprises*, 79 F.E.R.C. ¶ 61,107 (1997).

185. 16 U.S.C. § 825m(a) (1994).

186. 16 U.S.C. § 825o(b) (1994).

187. 16 U.S.C. § 796(4) (1994). The definition of “corporation” excludes municipalities. 16 U.S.C. § 796(3) (1994).

188. 16 U.S.C. § 825(n) (1994).

189. *See, e.g.,* 16 U.S.C. § 824(e), providing that only “persons” may be “public utilities.”

190. *Connecticut Light & Power Co.*, 324 U.S. at 530.