

## THE HAZY “BRIGHT LINE”: DEFINING FEDERAL AND STATE REGULATION OF TODAY’S ELECTRIC GRID

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**Synopsis:** In the 1935 Federal Power Act, Congress drew what the Supreme Court later described as a “Bright Line” between federal and state regulation of the electric power grid, giving federal regulators exclusive authority over wholesale electric sales in interstate commerce, and relegating retail sales to state regulators. This division of labor between state and federal regulators is still in effect today with only minor changes. However the grid they regulate has changed, and will change even more in the future. This article describes the current “Bright Line” between state and federal regulation. It then looks at whether this regulatory division of labor continues to be a workable model for the electric power industry in light of market developments and changes in the use of the grid (such as distributed generation and demand response). Finally, it reviews a number of options for needed changes in the regulatory model.

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## I. OVERVIEW

The division of labor between federal and state regulation of the electric power grid was established by the Federal Power Act (FPA) in 1935. With only minor changes, it is still in effect today. However, the grid that is regulated today is much different and will change even more as we go forward. This article reviews the current “Bright Line” between federal and state regulation, looks at whether that division of labor continues to be a workable model for regulation of the electric power industry, and reviews a number of options for changing the regulatory model.

## II. THE “BRIGHT LINE”

### A. *Original Packages and Attleboro*

In 1827, Chief Justice John Marshall in *Brown v. Maryland*<sup>1</sup> articulated what became known as the “Original Package” doctrine, which held that foreign goods imported into a state were not subject to taxation by the state if they remained in their original package and were not intermingled with the general mass of property in the state.<sup>2</sup> Over the course of the 19th century, the courts expanded the scope of this doctrine from a relatively narrow rule on state taxation of foreign imports to a much more general rule under the Dormant Commerce Clause<sup>3</sup> that encompassed state regulatory measures as well state taxation, and that applied to both interstate and foreign commerce.<sup>4</sup>

As the courts struggled to apply the Dormant Commerce Clause to the rapidly industrializing American economy, they adapted the Original Package doctrine to new technologies and emerging commercial practices—using tests such as whether the goods had been sold after import into the state and whether they had been removed from the original package and sold in smaller lots.<sup>5</sup> In the early 20th century, as interstate transmission of natural gas and electricity began, the courts were faced with commerce of goods that did not come in packages at all. They nonetheless attempted to apply the rules derived from the Original Package doctrine, as it developed in the 19<sup>th</sup> century, to these industries. In a series of cases

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1. *Brown v. Maryland*, 25 U.S. 419, 441-43 (1827).

2. Goods brought into a state “while remaining the property of the importer, in his warehouse, in the original form or package in which it was imported” are not subject to taxation by the state until intermingled with the mass of property in the state. *Id.* at 441-42.

3. The Dormant Commerce Clause is the Constitution’s implicit limitation on state regulation of, or discrimination against, interstate commerce. U.S. CONST. art. I, § 8, cl. 3; *See generally* *Pike v. Bruce Church*, 397 U.S. 137 (1970).

4. *Brown*’s principal ruling dealt with the Constitution’s bar on state taxation of imports and exports under Article 1, Clause 2 of Section 1. *Brown*, 25 U.S. at 441-49. Later Original Package cases focused on whether state taxation or regulation of goods brought in from other states violated the Dormant Commerce Clause.

5. In *Leisy v. Harden*, 135 U.S. 100 (1890), for example, the Court held that an Iowa statute, which prohibited, *inter alia*, the sale of beer, wine, and liquor imported from other states in their original casks and sold in the quantities in which they were imported, violated the Dormant Commerce Clause. The Court noted that the state had no authority to regulate the goods until they “[became] mingled in the common property within the state[.]” and the plaintiffs thus had the right to import beer into the state and sell it. *Id.* at 124. Once sold, it would become mingled in the common property in the state and would be subject to state regulation. *Id.* at 134.

dealing with interstate sales of electricity and natural gas, the Court laid out the limits on state authority to regulate these industries. In the key case of *Missouri v. Kansas Natural Gas Co.*,<sup>6</sup> the Supreme Court held that Missouri could not regulate wholesale sales of interstate natural gas that was transported by pipeline into Missouri to independent distributors. The Court reasoned that the gas transported into the state did not become part of the general mass of property in the state until after a sale at wholesale by the interstate pipeline and delivery to the mains of local distribution systems (analogous to *Brown*'s bar on state taxation of imported property in its original package and before its sale by the importer).

The natural gas and electricity cases culminated in *Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric Co.*<sup>7</sup> in which the Supreme Court held that the Dormant Commerce Clause barred states from regulating interstate wholesale sales of interstate electric power and that only Congress could regulate these sales. This case created what became known as the *Attleboro* gap: states could regulate retail sales and intrastate sales, but—unless Congress acted—no agency had authority to regulate interstate wholesale electric sales.

#### B. *The Federal Power Act*

In 1935, Congress enacted the FPA<sup>8</sup> to fill the *Attleboro* gap. Under the FPA, the Federal Power Commission (FPC)<sup>9</sup> was directed to regulate sales for resale and transmission in interstate commerce of electric energy.<sup>10</sup> Generation, local distribution, and wholly-intrastate sales and transmission were exempted from federal regulation,<sup>11</sup> and federal regulation was to extend “only to those matters which are not subject to regulation by the states.”<sup>12</sup> Over the next thirty years, the FPC proceeded to impose comprehensive utility regulation over public utilities involved in interstate transmission and wholesale sales. At the same time, the Supreme Court's Dormant Commerce Clause jurisprudence continued to evolve away from the mechanical 19th century concepts to the current balancing test.<sup>13</sup>

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6. *Mo. ex rel. Barrett v. Kan. Natural Gas Co.*, 265 U.S. 298 (1924).

7. *Public Utils. Comm'n v. Attleboro Steam & Elec. Co.*, 273 U.S. 83, 90 (1927).

8. Federal Power Act (FPA), 16 U.S.C. §§ 791-828c (2011).

9. The Federal Energy Regulatory Commission (FERC) succeeded in 1977 to almost all of the FPC's functions. Dep't of Energy Organization Act, Pub. L. No. 95-91, § 204, 402; 91 Stat. 565, 571-72, 583-585 (1977) (codified as 42 U.S.C. §§ 7134, 7172 and 16 U.S.C. §§ 792, 824, 824a).

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

11. *Id.*

12. FPA § 201(a), 16 U.S.C. § 824(a).

13. In *Baldwin v. G.A.F. Seelig*, 294 U.S. 511 (1935), the Court abandoned the Original Package doctrine and in *Pike* the Court rejected the last remnants of 19th century Dormant Commerce Clause jurisprudence. In *Ark. Elec. Coop. v. Ark. Pub. Serv. Comm'n*, 461 U.S. 375 (1983), the Court held that a state could regulate wholesale sales in interstate commerce by an electric cooperative not subject to FERC jurisdiction, essentially upending *Attleboro*. See generally Sam Kalen, *Dormancy Versus Innovation: A Next Generation Dormant Commerce Clause*, 65 OKLA. L. REV. 381 (2013).

### C. *Colton and the Bright Line*

In 1964, the Supreme Court decided *FPC v. Southern California Edison Co.*<sup>14</sup> (known as the “*Colton*” case) which involved a wholesale sale of out-of-state power by a public utility, Southern California Edison Company (SCE), to a municipal utility in the same state (the City of Colton). SCE and the state of California argued that under the policy rationale for the *Attleboro* holding, SCE’s wholesale sale would be “subject to regulation by the [state],”<sup>15</sup> and thus not subject to the FPA. The Court, however, held that the language of Section 201(a) of the FPA stating that “such federal regulation [under the FPA] however, to extend only to those matters which are not subject to regulation by the states”<sup>16</sup> was merely a “policy declaration . . . of great generality. It cannot nullify a clear and specific grant of jurisdiction, even if the particular grant seems inconsistent with the broadly expressed purpose.”<sup>17</sup> Rather, Congress had drawn “*a bright line easily ascertained, between state and federal jurisdiction,*” making federal jurisdiction “*plenary and extending it to all wholesale sales in interstate commerce.*”<sup>18</sup>

While Congress has made occasional adjustments to *Colton*’s Bright Line over the years,<sup>19</sup> it remains the fundamental federal/state division of labor for electric regulation in the United States.<sup>20</sup> *Colton*’s interpretation of the FPA in effect froze the 1927 division of labor between federal and state utility regulation articulated in *Attleboro*, which in turn relied on concepts articulated a century earlier in *Brown*. John Marshall indeed casts a long shadow.

### III. APPLYING THE BRIGHT LINE TO TODAY’S GRID

The FPA’s division of labor between state and federal regulation has, for decades, engendered controversy. The controversy has largely centered on states’ exercise of their long-standing state jurisdiction over local distribution, facility siting, and generation adequacy. Utilities and federal policymakers have complained that state generation and transmission siting decisions and state retail rate policies have frustrated federal energy policies, and Congress has enacted

14. Federal Power Comm’n v. S. Cal. Edison Co. (*Colton*), 376 U.S. 205, 206-07 (1964).

15. *Attleboro*, 273 U.S. at 88.

16. FPA § 201(a), 16 U.S.C. § 824(a).

17. *Colton*, 376 U.S. at 215 (citing *Conn. Light & Power Co. v. FPC*, 324 U.S. 515, 527 (1945)).

18. *Id.* at 215-216 (emphasis added).

19. See, e.g., Public Utility Regulatory Policies Act of 1978 (PURPA) § 210, 16 U.S.C. § 824a-3 (2011); see also FPA §§ 210-11, 215, 221-22, 16 U.S.C. §§ 824i, 824j, 824o, 824u, 824v (2011) (amended by the Energy Policy Act of 1992 and Energy Policy Act of 2005).

20. Under subsequent case law relating to the “interstate commerce” requirement under the FPA, wholesale sales or transmission that use the interstate grid are generally considered to be in interstate commerce. In *Conn. Light & Power Co. v. Fed. Power Comm’n*, 324 U.S. 515, 529 (1945), the Court held that federal jurisdiction followed “the flow of electric energy, an engineering and scientific, rather than a legalistic or governmental test.” 324 U.S. at 529. Later cases adopted a comingling test under which a utility was jurisdictional if the FPC could show that any portion of the electricity transmitted by the utility went to another state. *FPC v. Fla. Power & Light Co.*, 404 U.S. 453 (1972), *reh’g denied*, 405 U.S. 948 (1972). As Justice Douglas’ dissent presciently stated, “the comingling method will now mean that every privately owned interconnected facility [outside of Texas] is within the FPC’s jurisdiction”. *Id.* at 471 (Douglas, J., dissenting).

several modifications to the FPA in response to these complaints.<sup>21</sup> State regulators have complained of FERC encroachment on states’ ability to regulate local distribution companies and transmission services associated with serving retail load.<sup>22</sup> However, the Bright Line’s wholesale/retail division of labor remained basically workable for many years. Utilities were largely vertically integrated. Power flowed from large central-station generating facilities through high-voltage transmission systems either for sale at wholesale to other utilities or for delivery through local distribution facilities to end-users. It was clear which sales were at wholesale and which at retail, and the FERC was fairly readily able to distinguish transmission from distribution.

More recently, however, a host of new jurisdictional issues have challenged the states, the FERC, and the courts in applying the 1964 Bright Line. These issues arise from the deployment of distributed generation (including associated net-metering policies and feed-in tariffs), the development of FERC-regulated organized wholesale markets, and demand response policies in those markets. The result of these changes is that the same person may be both a retail purchaser from, and a seller at wholesale to, an electric utility (or may otherwise participate in FERC-regulated wholesale markets). These developments make it clear, as we discuss below, that the Bright Line is no longer “easily ascertained,” hopelessly complicating the neat division of labor from the 1935 FPA.

#### A. *Application of the Bright Line to Distributed Generation*

The increasing deployment of distributed generation resources, such as rooftop solar, that are capable not only of supplying the load of the host customer, but also of sending power into the grid has resulted in a series of significant questions with respect to who regulates these transactions. The utility continues to deliver power to the customer when the distributed resource is unavailable or is insufficient to meet its load. This service would ordinarily be regarded as a retail transaction. On the other hand, the sale of surplus power from the distributed generation facility to the utility to which it is connected is, at least in theory, a sale for resale in interstate commerce if the utility is connected to the interstate grid.<sup>23</sup> Congress in 1978 enacted section 210 of PURPA that exempted a subset of distributed generation—cogeneration (sometimes referred to as combined heat and power) and small power production generation (e.g. renewable)—from regulation under state and federal utility regulatory laws.<sup>24</sup> This was coupled with a “must buy” obligation on the part of the utility, an avoided cost limitation on the

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21. Section 210 of PURPA, 16 U.S.C. § 824a-3, (which provided a separate regulatory scheme for cogeneration and small power production generation), and section 216 of the FPA, 16 U.S.C. § 824p, (which provided for backstop of FERC transmission siting authorities) were enacted to deal with specific federal energy policy issues raised by the 1935 division of labor.

22. See generally *Colton*, 376 U.S. at 205; *N.Y. v. FERC*, 535 U.S. 1 (2002).

23. For a contrary view, see generally Frank R. Lindh & Thomas W. Bone, Jr., *State Jurisdiction Over Distributed Generation*, 34 ENERGY L.J. 499 (2013).

24. PURPA § 210(e), 16 U.S.C. § 824a-3(e).

price that the utility would have to pay for the output of the facility,<sup>25</sup> and a requirement to provide backup power at non-discriminatory rates.<sup>26</sup>

Meanwhile, states developed net metering policies that allow a customer to net out sales to the utility against retail sales to the customer. These policies in effect require distribution utilities to purchase surplus output of roof-top solar generation and similar resources at the utility's retail rate—usually far in excess of avoided cost—even though this too was a wholesale sale seemingly subject to FERC jurisdiction if the utility is connected to the interstate grid.<sup>27</sup> States have also attempted to implement feed-in tariffs under which distribution utilities purchase the output of renewable generation facilities at a standard rate set by statute or state regulators, again, a seemingly wholesale sale to the utility.

A series of net metering cases have attempted to define the jurisdictional line between retail sales to end-users and wholesale sales by end-users to the grid. The current tortured state of play for net metering is that if distributed generation deliveries into the grid are less than consumption by the end-user during the applicable billing period, they are subject to state jurisdiction.<sup>28</sup> However, if a net surplus is delivered into the grid during the billing period, the FERC exercises jurisdiction either by regulating the sales under the FPA or by requiring the distributed generator to make a “qualifying facility” filing under section 210 of PURPA (which in most cases triggers PURPA's “must buy” requirement and avoided cost limits).<sup>29</sup> The FERC initially rejected state-required feed-in tariffs at purchase rates above the purchasing utilities system-wide avoided cost, but eventually settled on a rule that permitted a resource-specific avoided cost (e.g., avoided cost for solar generation).<sup>30</sup>

These rules, as they have developed, raise numerous technical and administrative issues and make little sense from a policy point of view. Technically, they raise questions as to whether a sale of surplus output during a billing period triggers avoided cost pricing for the entire distributed generation output (the normal rule under section 210 of PURPA) or only for the net amount sold into the grid; whether states can require utilities to allow carryover of surpluses from one billing period to the next; and whether billing periods can be reduced to one day, one hour or one minute segments.<sup>31</sup> From a policy point of view, there seems little reason for the FERC to take action under federal law to bar state policies that require above-avoided-cost purchases of distributed

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25. Avoided cost is “the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the Qualifying Facility or Qualifying Facilities, such utility would generate itself or purchase from another source.” 18 C.F.R. § 292.201(b)(6) (2015); *see also* PURPA § 210(d), 16 U.S.C. § 824a-3(d).

26. PURPA §§ 210(a)-(d), 16 U.S.C. §§ 824a-3(a)-(d).

27. Congress, in 2005 amended Title I of PURPA to require state commissions and non-regulated utilities to consider and determine whether to implement net metering. PURPA § 111(d)(11), 16 U.S.C. § 2621(d)(11) (enacted by Energy Policy Act of 2005, Pub. L. No. 109-58, § 1251, 119 Stat. 594, 962 (2005)).

28. *See generally* Southern Cal. Edison Co. v. FERC, 603 F.3d 996 (D.C. Cir. 2010), *remanded sub nom. Duke Energy Moss Landing v. Cal. Indep. Sys. Operator Corp.*, 132 F.E.R.C. ¶ 61,183 (2010), *reh'g denied*, 134 F.E.R.C. ¶ 61,151 (2010), *aff'd sub nom.*, Calpine Corp. FERC, 702 F.3d 41 (D.C. Cir. 2012).

29. *Sun Edison LLC*, 129 F.E.R.C. ¶ 61,146 at P 18 (2009).

30. *See generally* Southern Cal. Edison Co., 603 F.3d at 996 (rejecting as inconsistent with PURPA's avoided cost rules).

31. *Mid-American Energy Co.*, 94 F.E.R.C. ¶ 61,340, at p. 62,263 (2001).

generation output, so long as ratepayers in the state bear the economic burden of the higher price.

### *B. Application of the Bright Line to Organized Markets*

In the United States, about two-thirds of electric power is delivered through Regional Transmission Organizations and Independent System Operators (usually referred to as RTOs), which operate the transmission grid within a defined region, provide transmission services, and operate wholesale energy markets (and in some cases capacity markets) for their respective region. RTOs, the transmission services they provide and the energy capacity market they operate (outside of Texas) would seem to be subject to the FERC’s exclusive jurisdiction over transmission and wholesale sales in interstate commerce. But here, as with distributed generation, drawing the line between wholesale and retail has become increasingly difficult. Several recent controversies and the litigation they have engendered illustrate this difficulty.

#### 1. Demand Response

RTO tariffs for a number of years have permitted end-users to offer “demand response” (a temporary reduction in the end-users electric load) into wholesale energy and capacity markets as if it were generation. The FERC, in its Order No. 745, required that RTO energy markets which allowed demand response participation to provide the same price to demand response as they did for energy offered by electric generators.<sup>32</sup> In *EPSA v. FERC*<sup>33</sup> the United States Court of Appeals for the District of Columbia Circuit held not only that FERC’s pricing rule in Order No. 745 was arbitrary and capricious, but that FERC had no authority to regulate demand response offered into FERC-regulated wholesale markets on the ground that the FERC was trying to regulate retail markets. This decision, currently before the Supreme Court, illustrates the difficulty courts, the FERC, and the states face in applying the Bright Line to today’s grid, in circumstances where end-users are both retail customers and participants in wholesale markets. This is more than just an academic concern because the *EPSA* decision, if it stands, may remove a key element of elasticity of demand that could moderate prices in organized energy markets, resulting in higher market-clearing prices<sup>34</sup> and, in some cases, unnecessary dispatch of fossil-fuel generators that would otherwise operate less in these markets. Higher market clearing prices and unnecessary

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32. Order No. 745, *Demand Response Compensation in Organized Wholesale Energy Markets*, F.E.R.C. STATS. & REGS. ¶ 31,322, 76 Fed. Reg. 16,658 (2011) [hereinafter Order No. 745]; *order on reh’g*, Order No. 745-A, 137 F.E.R.C. ¶ 61,215 (2011); *reh’g denied*, order no. 745-B 138 F.E.R.C. ¶ 61,148 (2012); *vacated sub nom.*, Elec. Power Supply Ass’n v. FERC (*EPSA*), 753 F.3d 216 (D.C. Cir. 2014); *cert granted in part sub nom.*, FERC v. Elec. Power Supply Ass’n, 135 S. Ct. 2049 (2015).

33. *EPSA*, 753 F.3d at 225.

34. In these auction markets, the market-clearing price is set by the highest accepted bid. Demand-response bids that undercut fossil generation bids result in a lower market clearing price and less fossil-fuel generation. The D.C. Circuit’s *EPSA* decision holding that the FERC has no jurisdiction over demand response leaves open the question of whether RTOs are precluded from incorporating demand response in their tariffs, even if it is not FERC-jurisdictional. *Id.* at 219-25.

fossil-fuel generator dispatch will, in turn, raise consumer electric rates and could increase emissions of CO<sub>2</sub> and other pollutants.<sup>35</sup>

## 2. Capacity Markets

As noted above, all RTOs operate the transmission system within their footprint, and all operate energy and ancillary service auction markets. Three Northeast RTOs (New York Independent System Operator, Inc., PJM Interconnection, L.L.C., and ISO New England Inc.) also operate mandatory auction-based capacity markets through which load-serving entities (i.e., retail sellers of electricity) must acquire capacity rights sufficient to cover their peak demand.<sup>36</sup> Like the energy markets, generators bid into the capacity markets and the highest accepted bid sets the market-clearing price. These capacity markets were developed, among other reasons, because bid caps in RTO energy markets and other constraints on wholesale energy prices limited generator revenues and were thought to imperil continued operation of existing generation facilities and discourage construction of new facilities.<sup>37</sup>

After some experience with the Northeast capacity markets, several states and a number of utilities complained that these markets unnecessarily raised consumer prices (by imposing high capacity costs on retail electricity sellers), but were ineffective in eliciting investment in needed new generation.<sup>38</sup> As a result, they took steps to ensure that new generation facilities they regarded as necessary either for environmental reasons or consumer protection would be built. Because the addition of this new generation into RTO markets would reduce (“suppress” in FERC parlance) capacity prices in these markets, the FERC developed “Buyer-Side Mitigation” (BSM) measures that imposed minimum offer price requirements, which had the effect of excluding many of these new resources from the capacity market auction. *New England Power Generators v. FERC*<sup>39</sup> and related cases<sup>40</sup> upheld FERC’s BSM policies.

In response to perceived flaws in FERC’s capacity market policies, two states (Maryland and New Jersey) attempted to direct utilities under their jurisdiction to offer competitive solicitations for new generation capacity in their respective states. The U.S. Court of Appeals for the Fourth Circuit in *PPL Energy, LLC v. Nazarian*<sup>41</sup> held that the FPA preempted Maryland from directing its distribution

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35. The emission consequences of demand response are complicated. Demand response successfully bid into organized energy markets will reduce generation dispatched by the RTO into those markets, but it will not always be fossil-fuel generation that is reduced. In addition, to the extent that demand on the grid is reduced because end-users are cranking up uncontrolled emergency generators, demand response may actually increase emissions. Finally, demand response bid into capacity markets may lower capacity prices and drive existing generation out of the market place. What is driven out could be fossil or nuclear, depending on the generator’s cost structure.

36. Order No. 745, *supra* note 26, at P 14.

37. *EPISA*, 753 F.3d at 232, 234; *See generally* Order No. 745, *supra* note 32.

38. *EPISA*, 753 F.3d at 231.

39. *New England Power Generators Ass’n v. FERC*, 757 F.3d 283 (D.C. Cir. 2014).

40. *N.J. Bd. of Pub. Utils. v. FERC*, 744 F.3d 74 (3rd Cir. 2014).

41. *PPL Energyplus, LLC v. Nazarian*, 753 F.3d 467 (4th Cir. 2014), *petition for cert. filed*, No. 14-614, 2014 WL 6706153 (U.S. Nov. 26, 2014).



utilities to enter into contracts with a merchant generator that would in the court’s view subsidize the generator’s entry into, and suppress prices in, FERC-regulated wholesale capacity markets, which the Court observed are “quite sensitive to external tampering.”<sup>42</sup> A companion New Jersey case in the U.S. Court of Appeals for the Third Circuit reached the same result.<sup>43</sup> These cases are significant because they go far beyond excluding “subsidized” resources from capacity markets—they bar their construction and operation altogether.<sup>44</sup>

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These controversies illustrate the difficulty in applying the 1964 Bright Line to today’s electric power industry.<sup>45</sup> Distributed generation, net metering, and demand response programs defy the notion that there is a clear distinction between wholesale and retail markets: Retail purchasers of electricity sell electricity at wholesale. They also sell demand response (reductions in retail demand) into wholesale markets. Moreover, in regulating utilities selling electricity at retail, states frequently direct them to enter into purchase power agreements (PPAs) with new or existing facilities. These PPAs may have the effect of lowering market clearing prices in FERC-regulated markets.

### C. Policy Implications

As the above examples illustrate, for today’s grid, the Bright Line is no longer “easily ascertained.” More significantly, even if the 1964 Bright Line could be easily ascertained, it would make little policy sense for today’s grid, and even less for tomorrow’s.

- RTOs and multi-state utility systems operate much of the grid and most organized wholesale markets under FERC supervision. However, key management decisions on siting of generation and transmission facilities and on generation mix are made on a state-by-state basis, resulting in frequent collisions between state actions and regional needs.
- States have, and will continue to have, the major responsibility for protecting the interests of retail electric consumers, regulating land use (for non-federal lands), and protecting air and water quality in the state (subject to minimum federal standards under the Clean Air Act (CAA) and the Clean Water Act). States’ ability to carry out these responsibilities is unnecessarily constrained by the preemptive effects of the current jurisdictional arrangement under the FPA.

42. *Id.* at 473.

43. *PPL Energy Plus, LLC v. Solomon*, 766 F.3d 241, 246 (3d Cir. 2014), *petition for cert. filed*, No. 14-623 (U.S. Nov. 26, 2014). Both cases are the subject of petitions for *certiorari* pending before the Supreme Court.

44. In 2014, the FERC declined to enter the controversy on grounds that the courts had already determined the contracts involved were void. *CVP Shore, L.L.C.*, 148 F.E.R.C. ¶ 61,096 at P 1 (2014).

45. In *ONEOK, Inc. v. Learjet, Inc.*, 135 S. Ct. 1591 (2015), the Supreme Court found that the Natural Gas Act did not preempt state antitrust laws to the extent they applied to jurisdictional interstate pipelines’ gas market manipulation that affected retail prices for natural gas.

- Section 110 of the CAA<sup>46</sup> sets up a cooperative federal/state framework for regulating “criteria” pollutants (such as ozone, fine particulate matter, and sulfur dioxide). Environmental Protection Agency (EPA) will use a similar framework under section 111(d) of the CAA to regulate CO<sub>2</sub> emissions from existing power plants.<sup>47</sup> Under these provisions, EPA sets the basic standards or goals<sup>48</sup> for the pollutant and states submit State Implementation Plans that impose the emission controls on individual sources that are necessary to bring the state into compliance with the standards or goals. EPA has authority to impose a federal implementation plan if the state fails to submit an adequate implementation plan. Power plant emissions make a substantial contribution to emissions of criteria pollutants and CO<sub>2</sub> that states need to control under their plans. However, states lack authority over key aspects of operation of the grid, operation of which may be necessary for compliance with criteria pollutant standards or CO<sub>2</sub> goals set by EPA.<sup>49</sup> Specifically, states in RTO regions lack authority to direct re-dispatch of fossil-fuel generation units (which is the province of the FERC-regulated RTOs) and have difficulty in directing distribution utilities over which they have jurisdiction to acquire the output of new, cleaner generation resources, as the Maryland and New Jersey cases indicate.<sup>50</sup>

EPA and some states have looked to multi-State CAA implementation regimes, as a way to reconcile state-centric CAA compliance with the reality of the interstate grid. But putting a multi-state CAA implementation plan in place is likely to be a complex undertaking requiring EPA, the FERC, and state utility regulatory approvals, each of which may be encumbered with conditions that may be unacceptable to other agencies.

Finally, trying to apply the Bright Line to tomorrow’s grid may be even more problematic than applying it to today’s. New technologies and new commercial practices, including:

- micro-grids—where retail customers in an area take power from, and deliver the output of distributed generation into, a local network which in turn may purchase or sell at wholesale to a distribution utility;
- energy storage—where end-users may charge storage at retail and discharge and sell at wholesale;
- automated demand response—where an RTO can signal retail customers to reduce demand or charge or discharge batteries or other storage; and
- real-time pricing—which permits customers to increase or decrease energy use based on wholesale prices;

all challenge the assumption that we can easily distinguish between wholesale and retail service. They may require new forms of regulation that probably cannot be accommodated by the existing wholesale/retail division of labor.

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46. Clean Air Act (CAA) § 110, 42 U.S.C. § 7410 (2012).

47. CAA § 111(d), 42 U.S.C. § 7411(d). Under Section 111(d) of the CAA, EPA has set CO<sub>2</sub> emission rate goals for each state. Carbon Pollution Emission Guidelines for Existing Stationary Sources: Electric Utility Generating Units, 79 Fed Reg. 34,829 (proposed June 18, 2014) (to be codified at 40 C.F.R. pt. 60).

48. EPA sets ambient air quality standards (maximum atmospheric concentrations) for criteria pollutants, and state emission rate goals for CO<sub>2</sub> from existing power plants.

49. Meeting EPA’s State CO<sub>2</sub> emission rate goals is likely to require, among other things, redispatch of generation in the state (*i.e.*, dispatching gas generators instead of coal).

50. See generally *Nazarian*, 753 F.3d at 467; *Solomon*, 766 F.3d at 254.

#### IV. OPTIONS FOR CHANGING THE REGULATORY DIVISION OF LABOR

As the grid’s operation changes and states, EPA, and utilities are challenged by needs for reduction in emissions of CO<sub>2</sub> and conventional pollutants, policymakers may wish to rethink the 1964 Bright Line and consider a new regulatory framework that (1) recognizes that the interstate nature of grid operations may make state-by-state decisions on facility siting, generation mix, resource adequacy, demand response, and net-metering infeasible, but (2) does not attempt to centralize all regulatory decision-making in the FERC. Several options for redrawing the Bright Line are set out below.

##### A. *Regional Regulation*

One possible approach could be legislative changes that redraw the Bright Line in a fashion that better accommodates today’s regulatory needs. Assuming that turning over all of utility regulation either to the FERC or to individual states is politically and practically infeasible, policy-makers can look at a number of options to set up regional regulating bodies that would subsume all of the FERC’s responsibilities in the region and most or all state responsibilities.<sup>51</sup>

##### 1. Interstate Compacts

Under the authority of the Compact Clause of the Constitution,<sup>52</sup> states could negotiate and Congress could approve (or disapprove) regional interstate compacts under which an interstate regulatory entity exercises full electric power regulatory authority in the states that are party to the agreement, displacing both federal and state regulation. For this option to be workable, two features (at least) must be included. First, the regional regulatory entity will need governance provisions that ensure it will be able to make decisions. Unanimous consent or super-majority requirements could paralyze the agency, rendering the regulatory system even worse than today’s. Second, states (and the FERC) will have to agree to a common regulatory framework, workable hearing procedures, and provisions for judicial review. Retaining the vestiges of state-by-state regulation will obviate much of the advantage of a regional agency.

##### 2. Federal Regional Regulatory Agency

Using the Commerce Clause rather than the interstate compact mechanism, Congress, on application of states, could establish a multi-state federal regulatory agency consisting of members appointed by the President from the FERC and the

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51. The FERC would still need to deal with “seams” issues at the boundaries of the regional regulatory agency, in much the same way it does with inter-RTO seams issues and with interconnections between ERCOT (the portions of the grid that Texas regulates) and the interstate grids that the FERC regulates (the Eastern and Western Interconnections.).

52. U.S. CONST. art. I, § 10, cl. 3. *See also* FPA § 216(i), 16 U.S.C. § 824p (similar use of interstate compacts).

states involved.<sup>53</sup> The regional federal agency would exercise plenary utility-regulatory authority,<sup>54</sup> displacing both federal and state regulation. As in the case of the interstate compact option, the regional agency would need workable governance provisions and a unitary regulatory framework, probably embedded in the statute establishing the agency.

### B. *Adjusting Regulatory Jurisdiction as the Need Arises*

Rather than spelling out in advance how a regional regulatory regulating agency might be structured, another approach is to permit adjustments in the current jurisdictional arrangements as the need arises, through jurisdiction agreements or joint boards, as spelled out below.

#### 1. Jurisdictional Agreements

Under this option, similar to provisions of a number of federal statutes,<sup>55</sup> the FERC and state commissions would be authorized to enter into jurisdictional agreements that departed (in either direction) from current Bright Line in order to rationalize respective state, multi-state, and/or federal regulatory jurisdiction. For example, states might agree to the FERC's exercise of authority over demand response bid into wholesale markets, in return for allowing states greater latitude to make generation choices without being preempted under the FPA or hampered by BSM rules. This option would require congressional authorization for the FERC to enter into such agreements, but would not require congressional approval of the agreements themselves. State legislative authorization would probably also be required.

#### 2. Federal/State Joint Boards

Section 209 of the FPA authorizes the FERC (1) to hold joint hearings with state commissioners,<sup>56</sup> and (2) to set up joint boards, consisting of state utility commissioners to consider matters otherwise within the FERC's jurisdiction.<sup>57</sup> The joint hearing provision permits the FERC and states to hear cases together, but provides for no joint decisional procedure. The joint board provision is essentially a limited delegation of FERC decision-making to a board of state commissioners. There is no federal representation on a joint board. Decisions of a joint board have the legal effect specified in FERC orders and regulations. A joint board does not exercise any state jurisdiction and the states involved are not bound by a joint board decision—that is, they are free to litigate the final order in

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53. See, e.g., CAA § 176A, 42 U.S.C. § 7506a, under which EPA establishes interstate transport commissions consisting of members from each state and EPA representatives.

54. In *FERC v. Mississippi*, 456 U.S. 742 (1982), *reh'g denied*, 458 U.S. 1131 (1982), the Supreme Court recognized that Congress, if it chose to, could regulate virtually all aspects of the electric power system, including retail sales, under the Commerce Clause. *Id.* at 764.

55. See, e.g., National Labor Relations Act of 1935, Pub. L. No. 74-198, §§ 10(a), 14(c), 49 Stat. 449, 453, 457 (codified as amended at 29 U.S.C. §§ 160(a), 164(c) (1984) and (1959)); Atomic Energy Act of 1954, Pub. L. No. 83-703, § 244, 68 Stat. 919, 958-59 (codified as amended at 42 U.S.C. § 2021 (2005)); CAA § 111(c), Pub. L. No. 91-604, § 111(c), 84 Stat. 1676, 1684 (1970) (codified as amended at 42 U.S.C. § 7411(c) (1977)).

56. FPA § 209(b), 16 U.S.C. § 824h(b).

57. FPA § 209(a), 16 U.S.C. § 824h(a).

the proceeding. This mechanism is rarely used, probably because it seems to be incapable of resolving federal/state conflicts and even on federal issues produces little certainty.

Existing law, however, does provide a potential path to improve federal/state coordination. States and the FERC could agree to use a combined joint hearing and joint board procedure: A joint hearing would be held in a particular proceeding before a panel consisting of a FERC commissioner and the state commissioners. Then, the panel acting as a joint board with the FERC commissioner as a non-voting member would decide the case. The FERC, after notice and comment, would review and decide whether to affirm the joint board determination, pursuant to a FERC policy statement that gave it presumptive validity, if the FERC commissioner concurred. Such a procedure could be more effective if states also gave a joint board proceeding similar presumptive validity, perhaps on a reciprocity basis (i.e., FERC would provide for presumptive validity if states did likewise).

But, given the cumbersome and inconclusive nature of the existing joint hearing/joint board authorities, a more effective course could be a legislative change in section 209 of the FPA. Congress could revise the current joint board procedure to provide that the board would exercise state and federal jurisdiction for particular cases or rulemakings, by agreement of the FERC and state commissions. A FERC commissioner would be a member of the board, and board decisions would be final agency action, subject to review in federal courts. Such legislation could also provide that a state that agrees to participate on a joint board proceeding is bound by its outcome.

### C. *Muddling Through*

Another potential option (and perhaps the most probable one) is to muddle through under the existing regulatory system. If Congress is unable to address the issues presented by the current regulatory division of labor, then the FERC and the courts will have to try, if they can, to make the existing framework function. Whether this is even possible is a significant question. But in any case, muddling through will entail litigation, uncertainty, and delay, as the saga of the *EPSA* controversy illustrates.<sup>58</sup> The FERC proposed its Order 745 rule in March 2010, and finalized it in March 2011.<sup>59</sup> The D.C. Circuit overturned the rule in May 2014.<sup>60</sup> In all likelihood, the Supreme Court will issue its decision in early 2016, 6 years after the rule was proposed and 5 years after it was finalized. Even if the FERC ultimately prevails, these jurisdictional challenges have created massive uncertainty over the last 5 years and unnecessarily delayed the full consumer benefit of demand response in organized RTO markets.

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58. *EPSA*, 753 F.3d at 216.

59. Order No. 745, *supra* note 32.

60. *EPSA*, 753 F.3d at 216.

## V. CONCLUSION

Nearly two centuries after *Brown* and almost a century after *Attleboro*, the division of regulatory authority over the electric power industry is still largely dictated by *Attleboro*'s wholesale/retail distinction which in turn was derived from the mechanical 19<sup>th</sup> century Original Package doctrine rules.<sup>61</sup> But, for much of today's grid, the wholesale/retail distinction is increasingly unworkable. Congress, federal, and state regulators and the courts need to look at ways of combining state and federal regulation under a single agency or single regulatory proceeding. Alternatively, they can try to redraw the Bright Line in a manner that is better suited to management of today's (and tomorrow's) grid, through jurisdictional agreements or other mechanisms that clarify respective state and federal responsibilities. But unless this division of labor is updated, electric power regulation is likely to become an obstacle rather than an enabler of efficient and reliable operation of the electric grid and its necessary modernization.

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61. *Brown*, 25 U.S. 419 (1827); *Attleboro*, 273 U.S. 83 (1927).