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Examining EAct 2005: A Prospective Look at the Changing Regulatory Approach of the FERC

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Examining EPAct 2005: A Prospective Look at the Changing Regulatory Approach of the FERC

Heather Curlee*

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* Candidate for J.D., Washington and Lee School of Law, May 2007; B.A. Vanderbilt University, May 2004. I extend my deepest thanks to my advisor, Al Carr, for all his hard work and support throughout this endeavor. Without his kind words of encouragement, I would have never made it past the second page. I also thank my parents, Lori and Dave, for starting my education early and never letting me settle for less than my best.

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I. Introduction

"This is an issue about the future. It is an issue that affects our children . . . it is an issue about the economy [and] security."¹ High gasoline prices, high heating bills, and questions about foreign oil dependence have pushed the energy industry to the forefront of the political scene.² On August 8, 2005 Congress passed the Energy Policy Act of 2005 (EPAAct 2005)³ to address these concerns and plan for America's energy future. In the 1,700 pages of EPAAct 2005, Congress drastically changed the electric utility regulatory regime, and this new regulatory regime will play a large role in the achievement of the goals of EPAAct 2005.⁴

The prior electric utility regulatory regime was established by the 1935 Public Utility Act (1935 Act).⁵ Through two titles the 1935 Act created parallel tracks of regulation.⁶ Title I, the Public Utility Holding Company Act (PUHCA), directed the Securities and Exchange Commission (SEC) to simplify, restructure, and regulate electric utility holding companies.⁷ Title II amended the Federal Power Act (FPA) and gave the Federal Power Commission (now the Federal Energy Regulatory Commission—FERC) the power to oversee interstate wholesale sales of power.⁸ The SEC and the FERC have regulated on these parallel tracks for the past seventy years.⁹ EPAAct 2005

1. 151 CONG. REC. H2383, 2384 (2005) (statement of Rep. Blackburn).

2. *See* 151 CONG. REC. S6601 (2005) (discussing the many justifications for a comprehensive energy policy bill).

3. *See* Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (providing the provisions for a new regulatory structure).

4. *See id.* at tit. 12 (increasing the Federal Energy Regulatory Commission's role in energy regulation by repealing Title I of the Public Utility Act of 1935).

5. *See* Public Utility Act of 1935, 49 Stat. 803 (giving the SEC and the FERC their initial electric utility regulatory duties).

6. *See id.* at tits. I & II (delegating regulatory duties to both the SEC and the FERC).

7. *See id.* at tit. I (presenting the Public Utility Holding Company Act).

8. *See id.* at tit. II (amending the FPA); *see also* discussion *infra* Part II.B (detailing the factors that spurred Congress to amend the FPA). In 1977, Congress reorganized the Federal Power Commission as the Federal Energy Regulatory Commission. *See* CHARLES F. PHILLIPS, JR., *THE REGULATION OF PUBLIC UTILITIES* 655 (3d ed. 1995) (discussing the Department of Energy's reorganization).

9. *See* discussion *infra* Part III (discussing the regulatory history of both the SEC and the FERC).

repeals PUHCA, and creates a unified track of regulation, which will shape the future of the electric utility industry.¹⁰

The FERC is now the sole electric utility regulatory commission, and its regulatory behavior has the potential either to hinder or advance the mission of EPAct 2005.¹¹ Regulatory commissions develop unique regulatory personalities, and a commission's regulatory personality determines the characteristics of the resulting regulatory environment.¹² The 1935 Act, combined with the history and tradition of the respective commissions, influenced the development of two distinct regulatory commissions.¹³ In administering the 1935 Act, the FERC and the SEC formed two distinct regulatory personalities and produced extremely different regulatory environments.¹⁴ The SEC, using a proactive and comprehensive approach to regulation, produced an efficient and stable regulatory environment.¹⁵ In contrast, the FERC became a reactive agency characterized by fragmented policies, producing an inefficient and unstable regulatory environment.¹⁶ EPAct 2005 anticipates great developments and growth in the energy industry. It will be difficult to achieve these goals without a stable, predictable, and efficient electric utility regulatory environment.¹⁷

10. See Energy Policy Act of 2005, Pub. L. No. 109-58, § 1263, 119 Stat. 594 (repealing PUHCA):

11. See RICHARD A. HARRIS & SIDNEY M. MILKIS, *THE POLITICS OF REGULATORY CHANGE: A TALE OF TWO AGENCIES* 3 (1989) ("The study of contemporary regulatory affairs offers a distinctive opportunity to grapple with weightier questions of democracy, citizenship, the evolution of the administrative state, and the role of ideas in American politics."). This Note focuses on the qualitative factors that impact and result from a regulatory regime change. For a full discussion of the concepts embodied in a qualitative analysis and a regulatory regime, see *id.* at 23–52. To examine the weightier questions effectively, it is necessary to bolster a case study with an historical and philosophical treatment to illuminate broader political implications and how underlying ideas help transform institutions. *Id.* at 3–4.

12. See J.R. DeShazo & Jody Freeman, *Public Agencies as Lobbyists*, 105 COLUM. L. REV. 2217, 2239 (2005) (discussing the culture and expertise of the FERC, and the influence of such factors on regulation).

13. See discussion *infra* Parts II–III (discussing the origin of the SEC and the FERC's foundational principles).

14. See discussion *infra* Part III (juxtaposing the regulatory personality and regulatory environment of the SEC against the regulatory personality and regulatory environment of the FERC).

15. See discussion *infra* Part III.A (discussing the factors that led to the SEC's proactive and comprehensive regulatory personality and providing decisions that reflect this personality).

16. See discussion *infra* Part III.B (discussing the factors that led to the creation of FERC's regulatory personality and providing decisions that illustrate the reactive and fragmented policies of the FERC).

17. See PHILLIPS, *supra* note 8, at 49 (discussing economic concepts of regulation). If regulation is supposed to be a substitute for competition, then the goal should be to provide a

EPAAct 2005 imposes significant changes in the electric utility regulatory regime, and these changes provide the FERC with the opportunity to reform its regulatory personality.¹⁸ If the FERC looks to the SEC as a regulatory role model and adopts a proactive and comprehensive approach to regulation, a stable and efficient regulatory environment will likely result, making the goals of EPAAct 2005 readily achievable.¹⁹ Recent FERC actions indicate that the FERC is embracing new patterns of regulation, but old habits die hard.²⁰ Although recent actions indicate a change in the FERC's regulatory approach, the next few years will be crucial in determining whether the FERC is embracing its new mission or regressing to familiar patterns.²¹ It will be difficult to achieve the goals of EPAAct 2005 unless the FERC adopts a new regulatory personality.

This Note focuses on the interplay between the regulatory personality of a commission and the resulting regulatory environment, specifically the degree to which the FERC's regulatory personality will hinder or advance the goals of EPAAct 2005. In Part II, this Note describes the historical background and founding principles of the electric utility regulatory commissions and discusses formation of the SEC and the FERC's foundational principles. Part III illustrates how the regulatory personalities of the SEC and the FERC have shaped electricity regulation and discusses the connection between regulatory environments and the achievement of Congressional goals. In Part IV, this Note shifts focus to recent FERC actions that suggest the FERC is developing a new regulatory personality. Additionally, Part IV discusses future regulatory patterns that will help to evaluate FERC's regulatory personality in the upcoming years. This Note concludes, in Part V, that the FERC has laid the foundation to produce an efficient and stable regulatory environment, but practitioners may need to hold the FERC accountable to its new regulatory path if the goals of EPAAct 2005 are to be achieved.

regulatory environment that produces results similar to a free market environment. *Id.* To facilitate the growth and development that occurs in market conditions, predictability is necessary to facilitate efficient corporate functions and provide an environment conducive to innovation. See *infra* Part III.A (showing that the SEC's predictable and stable regulatory environment furthered industry growth and development).

18. See *infra* Part II.A (describing how the PUHCA provisions influenced the SEC's regulatory personality); discussion *infra* Part II.B (discussing the statutory roots of the FERC's commitment to ratepayer protection).

19. See *infra* Part IV.A (discussing the FERC's disastrous generic rate of return rule).

20. See *infra* Part IV.C (discussing recent actions that illustrate a potential change in FERC's regulatory approach).

21. See *infra* Part IV (discussing prospective factors to consider in assessing the true change in FERC's regulatory approach).

II. Parallel Tracks of Regulation

It would be difficult to understand the nature and consequences of the changes in the electric utility industry today without a clear understanding of the traditional structure of the industry and patterns of regulation.²² The 1935 Act was designed to address two specific problems in the electric utility industry.²³ In the two-titled Act, Congress vested the SEC and the FERC with the power to solve two distinct problems.²⁴ In Title I, Congress directed the SEC to further investor protection by regulating complex corporate holding company structures.²⁵ In Title II, Congress closed a regulatory gap and vested the FERC with the duty to protect ratepayers by, among other things, regulating the rates of interstate wholesale sales of electricity.²⁶ Thus, the 1935 Act laid the foundation for two fundamentally different regulatory commissions, but only the SEC was successful in producing a stable and efficient regulatory environment.²⁷

A. The SEC Protects the Investors

Congress vested the SEC, the agency most familiar with economic matters, with the responsibility of regulating complex holding company systems.²⁸ A holding company is a corporation formed for the express purpose of controlling other corporations by the ownership of a majority of their voting capital.²⁹ Holding companies allow a group of investors to control a large share

22. See Paul L. Joskow, Douglas R. Bohi, & Frank M. Gollop, *Regulatory Failure, Regulatory Reform, and Structural Changes in the Electrical Power Industry*, BROOKINGS PAPERS ON ECON. ACTIVITY: MICROECON. Vol. 1989 at 125, 128 (1989) (providing a history of the electric power industry and discussing the importance of background historical knowledge).

23. See DOUGLAS W. HAWES, *UTILITY HOLDING COMPANIES* § 2-2 (3d ed. 1987) (providing a history of the Public Utility Act).

24. See Public Utility Act of 1935, tits. I & II, 49 Stat. 803 (setting forth the regulatory regime).

25. See *id.* at tit. I (bestowing regulatory duties upon the SEC).

26. See *id.* at tit. II (amending the FPA to give the FERC additional jurisdiction).

27. See *infra* Part III.A (discussing the SEC's successful regulatory approach).

28. See JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE* 261-62 (3d ed. 2003) (describing the history and development of PUHCA). PUHCA was intended to supplement, not supplant, state regulation. See *id.* (discussing the established state regulatory system).

29. See WILLIAM MOSHER & FINLA CRAWFORD, *PUBLIC UTILITY REGULATION* 322 (1933) (defining the term "holding company"). At common law, a corporation could not own stock of another corporation unless the ownership was in satisfaction of debt or a preliminary step to a merger. See HAWES, *supra* note 23, § 2-3 (providing the history of development in the electric

of the market with only a minimal investment of capital, thereby producing gains for the principal investors.³⁰ During the early 1920s, investment bankers and promoters encouraged holding company expansion to maximize profits, commissions, and fees from sales in light of the surge of growth and development in the electric utility industry.³¹ Holding companies had the ability to control several corporations for a common object, to perpetuate corporate control, and to permit the capitalization of controlling stock interest.³²

As the popularity of holding companies increased, so did the abuses.³³ Promoters and bankers often used pyramidal capital and corporate structures in order to create huge holding company systems.³⁴ After forming these complex structures, the organizers frequently inflated the value and assets of the operating and holding companies.³⁵ Large holding companies purchased other holding companies and created a complex series of contracts that concentrated voting control in the hands of a few shareholders.³⁶ These complex systems

energy field). It was not until 1888 that the New Jersey legislature first authorized corporations to include in their charters the power to hold stock in other companies. *Id.*

30. See MOSHER & CRAWFORD, *supra* note 29, at 322–24 (enumerating the advantages of holding companies and providing a full description of the mechanics of holding companies).

31. See HAWES, *supra* note 23, § 2-3 (supplying an overview of holding company development). In the early 1900s, the electricity industry experienced a surge of growth and development, and generating capacity approximately doubled every five years between 1902 and 1927. See SEC, DIV. INV. MGMT., THE REGULATION OF PUBLIC-UTILITY HOLDING COMPANIES 11 at 2 (1995) [hereinafter SEC REPORT] (providing a history of the development of electric utility holding companies).

32. See MOSHER & CRAWFORD, *supra* note 29, at 322–24 (describing the abuse of holding companies). For a full discussion of the advantageous uses of the holding company structure and the methods of exploiting control, see *id.* at 322–50.

33. See FED. TRADE COMM'N, REPORT ON UTILITY CORPORATIONS, pt. 73-A, at 62, S. Doc. No. 92, 70th Cong., 1st Sess. (1928–1935) [hereinafter FTC REPORT] (documenting the holding company abuses). In 1928, the Federal Trade Commission (FTC), began a study into the regulation and ownership of utilities and holding companies. *Id.* The documented abuses included: issuance of securities to the public that were based on unsound asset values or on-paper profits from intercompany transactions; mismanagement and exploitation of operating subsidiaries of holding companies through excessive service charges; excessive common stock dividends; upstream loans and an excessive portion of senior securities; and the use of the holding company to evade state regulation. *Id.* Additionally, the House Interstate and Foreign Commerce Committee conducted a second study from 1933–35, which supported the findings of the FTC study. See generally FOREIGN COMMERCE COMM. REPORT ON THE RELATION OF HOLDING COMPANY IN POWER AND GAS AFFECTING CONTROL, H.R. Rep. No. 827, 73d Cong., 2d Sess. (1933–35) (documenting holding company abuses).

34. See 5 LAW & SEC. REG. § 18.1 (5th ed. 2005) (discussing the use and abuse of holding companies).

35. See *id.* (discussing the methods of abuses).

36. See David I. Bloom & Samantha Hampshire, *What the PUHCA Repeal Means for U.S. Utilities*, INT'L FIN. L. REV., Sept. 2005, at 44, 45 (tracing the development of holding

made it almost impossible for an investor to ascertain pertinent information about the status of a holding company's operations.³⁷

The real danger of holding companies became apparent in 1929.³⁸ Holding companies used pyramiding, which allowed the controlling interests to domineer a larger amount of business than would have been possible otherwise with the capital at their disposal.³⁹ This structure allowed the holding company to operate with a high debt ratio.⁴⁰ The danger of this arrangement was a serious financial risk to investors if these securities collapsed in value.⁴¹ In 1929, securities values plummeted, and many holding companies collapsed because they could not service their high debt levels.⁴² The crash of 1929 exposed holding company abuses, caused investor confidence to plummet, and led to an earnest push for regulation.⁴³ The government studies concluded that, "the only practical control over public-utility holding companies will be one which can directly reach the holding company itself and supervise its security structure and its use of capital."⁴⁴ Congress responded by passing PUHCA to protect investors from further holding company abuses.⁴⁵

companies).

37. See HAWES, *supra* note 23, §§ 2-5-2-10 (providing a full history, description, and flow charts to illustrate the power and control exercised by The Electric Bond & Share Group, The Insull Group, and The United Corporation); Hon. Richard D. Cudahy, *From Insull to Enron*, 26 ENERGY L.J. 35, 39-72 (2005) (illustrating the rise, and subsequent fall, of Sam Insull, his company, and his legacy). Judge Cudahy notes that "the consolidation within the industry was undeniably being driven by the efficiencies of superior management and better (but costly) technology, the giant egos of these industry moguls no doubt played a part in stimulating the sprawling growth of utility holding companies that defied all economic logic." *Id.* at 51. The complex arrangements impeded an investor's ability to make informed investment choices. *Id.*

38. See Cudahy, *supra* note 37, at 39-72 (2005) (describing the spectacular crash of the Insull corporation and other holding companies when the values of securities dropped).

39. See MOSHER & CRAWFORD, *supra* note 29, at 323-24 (discussing pyramiding and the dangers inherent in the practice).

40. See *id.* (describing the "benefits" of pyramiding).

41. See JAMES C. BONBRIGHT & GARDINER C. MEANS, *THE HOLDING COMPANY: ITS PUBLIC SIGNIFICANCE AND ITS REGULATION* 1-54, 149-99 (1932) (providing a complete discussion of the holding company structure and its advantages); see also MOSHER & CRAWFORD, *supra* note 29, at 322-50 (same).

42. See FTC REPORT, *supra* note 33, at pt. 72-1, 496-515 (discussing holding company abuses).

43. See HAWES, *supra* note 23, § 2-14 (presenting the history of the pre-regulated environment).

44. See SEC REPORT, *supra* note 31, at 13-14 (describing the collective findings of all studies conducted on holding company abuses).

45. See *id.* at 11-20 (providing an overview of PUHCA history and the purpose and objectives of the Act).

B. The FERC Protects the Ratepayers

Congress created the FERC in 1920, through the FPA.⁴⁶ Most states had independent regulatory commissions that regulated the public utilities, and the 1920 FPA gave the FERC limited authority to regulate rates, services, and securities.⁴⁷ As electricity demand increased and the industry developed, new transmission facilities made it possible to engage in interstate sales of wholesale power.⁴⁸ State utility commissions attempted to regulate interstate wholesale sales of power, but the Supreme Court made it clear in *Public Utilities Commission of Rhode Island v. Attleboro Steam and Electric Company*⁴⁹ that state commissions could not regulate interstate transactions.⁵⁰ Congress designed Title II to supplement, not supplant, state regulation of public utility rates, services, and securities.⁵¹

The *Attleboro* case provides a clear example of a state regulatory commission attempting to regulate an interstate transaction.⁵² The Narragansett Electric Lighting Company, a Rhode Island corporation producing electric current at its plant in Providence, sold power to Attleboro Steam & Electric Company, a Massachusetts corporation supplying electricity for public and private use in Massachusetts.⁵³ In 1917, Attleboro entered into a twenty-year contract to buy power from Narragansett, with the power delivered at the state line.⁵⁴ In 1924, the Narragansett Company applied to the Rhode Island Commission to obtain a new rate schedule, which

46. See PHILLIPS, *supra* note 8, at 644–45 (discussing the birth of the Federal Power Commission); see *id.* at 655 (discussing the Department of Energy's reorganization).

47. See *id.* at 646 (discussing the FPC's early regulatory duties).

48. See Joseph T. Kelliher, *Market Manipulation, Market Power, and the Authority of the Federal Energy Regulatory Commission*, 26 ENERGY L.J. 1, 5 (2005) (providing the history of the FERC's regulatory duties).

49. See *Pub. Util. Comm'n of R.I. v. Attleboro Steam & Elec. Co.*, 273 U.S. 83, 83 (1927) (finding that state utility commissions do not have the power to regulate interstate commerce).

50. See *id.* at 83 ("The order . . . places a direct burden upon interstate commerce . . . from which the State is restrained by the force of the Commerce Clause, [and] it must necessarily fall, regardless of its purpose.").

51. See SEC REPORT, *supra* note 31, at 22 (stating that many of the provisions of the FPA are designed to supplement state jurisdiction). In the early years of electricity development, plants were relatively small and there was no economical way to transmit power over any great distance. See *id.* at 11 (describing energy utility expansion and PUHCA). State utility commissions performed all manner of regulation. See PHILLIPS, *supra* note 8, at 631 (discussing the creation of a system of federal oversight of the electric utility industry through the 1935 Public Utility Act).

52. See *Attleboro*, 273 U.S. at 84 (explaining that the interstate transaction was beyond the reach of the Rhode Island Utility Commission).

53. See *id.* (explaining the identity of the parties).

54. See *id.* (detailing the agreement for power delivery).

would have allowed it to increase the rate for power sold to Attleboro.⁵⁵ When the Rhode Island Commission approved the increased rate Attleboro appealed.⁵⁶ The Supreme Court explained that, "the rate is therefore not subject to regulation by either of the two States . . . but if such regulation is required it can only be attained by the exercise of the power vested in Congress."⁵⁷ This decision created what became known as the "Attleboro Gap."⁵⁸ Congress responded by amending the FPA to close the regulatory gap and to implement a system of federal regulation to protect ratepayers from the potential of excessive rates.⁵⁹

III. Two Regulatory Personalities

The two titles of the 1935 Act emerged after a fight one historian described as "the most bitter legislative battle of Roosevelt's first term."⁶⁰ Congress intended that the two titles would work in tandem to create a solid foundation for federal regulation and protect investors and ratepayers from further abuses.⁶¹ The 1935 Act gave both the SEC and the FERC a foundation on which to build a regulatory structure, and it has been the foundation of the regulatory regime for the past seventy years.⁶²

A. The SEC's Proactive and Comprehensive Approach

The first phase of PUHCA regulation began immediately after passage of the Act and continued until the mid 1950s.⁶³ The SEC's duty was to restructure the

55. See *id.* (explaining the initial spark for the controversy).

56. See *id.* (noting the procedural posture).

57. *Id.* at 90.

58. See Hon. Richard D. Cudahy, *70th Anniversary Celebration of the Federal Power Act*, 26 ENERGY L.J. 389, 389 (2005) (providing an entertaining explanation of the Attleboro Gap).

59. See SEC REPORT, *supra* note 31, at 20 (noting that Congress passed Title II as a response to the gap in state regulation created by *Attleboro*).

60. MICHAEL E. PARRISH, *SECURITIES REGULATION AND THE NEW DEAL* 145 (1970); see also SEC REPORT, *supra* note 31, at 15–16 (describing the issues and compromises made in the process of passing the Public Utility Act).

61. See SEC REPORT, *supra* note 31, at 40 ("Consumers were not protected because the states did not review the transactions, and the investors were harmed because they could not obtain the information necessary to make an informed investment decision.").

62. See *infra* Part IV (discussing EPACT's repeal of PUHCA).

63. See SEC REPORT, *supra* note 31, at 41 (describing the SEC's first phase of PUHCA regulation).

eighty-six existing electric utility holding companies that held aggregate assets in excess of fourteen billion dollars.⁶⁴ The SEC effectively accomplished its mission of restructuring by the early 1950s, and thus only a few holding companies were required to register.⁶⁵ The second phase of PUHCA regulation began in the 1950s, and the SEC shifted its focus from corporate reorganization to oversight and approval of registered holding companies' transactions.⁶⁶ The second phase continued until Congress repealed PUHCA in EPAAct 2005.⁶⁷ An analysis of the SEC's regulatory history will show that the SEC, in its PUHCA administration, was a responsive agency and produced a stable and efficient regulatory environment through its proactive and comprehensive regulatory approach.⁶⁸

1. *The SEC Simplifies and Restructures Holding Companies*

The 1935 Congress vested the newly established SEC with the duty of restructuring the complex corporate structures of utility holding companies because it was the agency most familiar with economic matters.⁶⁹ After passage of the Securities Act in 1933 and the Securities Exchange Act of 1934 it was a logical decision to vest economic regulations in the SEC.⁷⁰ In its first PUHCA decisions, the SEC established itself as a proactive, comprehensive, and responsive body.⁷¹ The SEC's initial decisions were shaped by its

64. See 5 LAW & SEC. REG., *supra* note 34, § 18.1 (providing statistics to illustrate the magnitude of the task the SEC was required to accomplish).

65. See *id.* (providing statistics which demonstrate the success of the Commission's reorganization actions).

66. See SEC REPORT, *supra* note 31, at 41–42 (describing PUHCA regulatory history as two distinct phases).

67. See *id.* (describing PUHCA regulatory history as two distinct phases).

68. See *infra* Part III.A (discussing actions that illustrate the SEC's proactive and comprehensive approach to regulation).

69. See SEC REPORT, *supra* note 31, at 16 ("Congress entrusted the SEC, the agency with expertise in financial transactions and corporate finance, with administration of the Holding Company Act.").

70. See SELIGMAN, *supra* note 28, at 249 (describing the role and identity of the early SEC).

71. See *supra* Part II.A (discussing the SEC's regulatory patterns that accounted for social, historical, and political factors). The SEC took a comprehensive approach to regulation by accounting for all influencing factors—political, social, and historical—and using that information to formulate rules and regulations that would guide the industry. As a proactive body the SEC responded to industry changes as soon as they arose and issued rules that would provide stability and guidance during times of change. See *supra* Part II.A (discussing how the SEC used rules and regulations to guide the industry through the new industry developments).

awareness of the strong and bitter opposition to PUHCA and by the Judiciary's general disapproval of New Deal legislation.⁷² The SEC's Section 11 decisions best illustrate the regulatory approach of the agency. Section 11 was the "very heart"⁷³ of PUHCA, and it vested the SEC with the duty to simplify and restructure the corporate organization of utility holding company systems.⁷⁴ The statute instructed the SEC to:

[E]xamine the corporate structure of every registered holding company and subsidiary company thereof, the relationships among the companies in the holding company system of every such company and the character of the interests thereof . . . to determine the extent to which the corporate structure of such holding-company system and the companies therein may be simplified, unnecessary complexities therein eliminated, voting power fairly and equitably distributed among the holders of securities thereof, and the properties and business thereof confined to those necessary or appropriate to the operations of an integrated public utility system.⁷⁵

To effectuate its duties, the statute provided the SEC with two potential avenues of enforcement. Section 11(d) allowed the SEC to design and institute a divestiture plan for the holding company, which could be enforced through a court order,⁷⁶ and Section 11(e) allowed the SEC to accept a holding company's voluntary divestiture proposal.⁷⁷

This proactive and comprehensive approach provided regulatory certainty tailored to the needs of a developing industry. See *supra* Part II.A (discussing the SEC's commitment to regulatory certainty).

72. See SELIGMAN, *supra* note 28, at 249–51 (describing the political environment immediately after passage of PUHCA). During this era, the Court viewed New Deal business legislation unfavorably, and was not hesitant to strike down such legislation as an unnecessary interference in capitalist markets. *Id.*

73. See SEC REPORT, *supra* note 31, at 56 ("It is therefore the very heart of the title, the section most essential to the accomplishment of the purposes set forth in the President's message [recommending the legislation].").

74. See SELIGMAN, *supra* note 28, at 249 (describing the political situation surrounding PUHCA and the SEC). Section 11 was also the most controversial section of the legislation, and most in danger of being invalidated by the Court.

75. Public Utility Act of 1935, tit. I, § 11(a), 49 Stat. 803.

76. See *id.* at tit. I, § 11(d) ("The Commission may apply to a court . . . to enforce compliance with any order issued under subsection (b).").

77. See *id.* at tit. I, § 11(e) (explaining the option of voluntary divestiture plans). The statute reads:

In accordance with rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company . . . may . . . submit a plan to the Commission for the divestment of control, securities, or other assets or for other action . . . for the purpose of enabling such company . . . to comply with the provisions of subsection (b).

The SEC recognized the danger of provoking a potentially disastrous court battle should it utilize Section 11(d), and so the SEC began regulation through use of the "Fabian tactic,"⁷⁸ to avoid giving the judiciary an opportunity to strike down the legislation.⁷⁹ Rather than imposing mandatory divestiture plans under Section 11(d), the SEC instead accepted voluntary proposals under Section 11(e).⁸⁰ While Section 11(d) would have allowed for strict divestiture plans and immediate results, the danger of judicial invalidation, at the time, was real.⁸¹ The SEC's decision in *American Water Works and Electric Company*⁸² best illustrates the SEC's strategic approach.

American Water Works controlled an intermediate holding company organized under the laws of Maryland,⁸³ and owned stocks in public utility and holding companies whose electric operations extended over an area covering portions of Maryland, Ohio, Pennsylvania, Virginia, and West Virginia.⁸⁴ Additionally, American Water Works engaged in a number of other businesses that were not within the PUHCA definition of a public utility.⁸⁵ The SEC approved American Water Works's voluntary divestiture proposal, even though the proposal did not comport with the Section 11 simplification provisions.⁸⁶ This proposal allowed American Water Works to retain its combined gas and electric system,⁸⁷ continue its water and coal operations,⁸⁸ operate its

id.

78. See SELIGMAN, *supra* note 28, at 250 (quoting then Public Utilities Division attorney Roger Foster). The famous Roman general Quintus Fabius Maximus engaged Hannibal in a long war of attrition during the Second Punic War. See ALLEN M. WARD, FRITZ M. HEICHELHEIM & CEDRIC A. YEO, *A HISTORY OF THE ROMAN PEOPLE* 110 (4th ed. 2003) (detailing Fabius' strategy of attrition).

79. See SELIGMAN, *supra* note 28, at 250 (explaining the influence of the judiciary on the Commission's actions).

80. See *id.* (describing use of the Fabian tactic).

81. See *id.* ("[T]he SEC compromised enforcement of Section 11 in its early Section 11 cases to discourage appeals to the judiciary.").

82. See *Am. Water Works & Elec. Co.*, 2 S.E.C. 972 (1937) (allowing a very generous divestiture proposal).

83. See *id.* at 976 (providing a discussion of the origin of the American Water Works holding company system).

84. See *id.* at 975 (explaining the extent of the American Water Works holding company system).

85. See Public Utility Act of 1935, tit. I, § 2(a)(5), 49 Stat. 803 (defining public utility).

86. See *id.* at tit. I, § 11(b) (providing the divestiture and simplification requirements for public utilities).

87. See *Am. Water Works*, 2 S.E.C. at 975 (describing facilities that clearly should not be part of an integrated facility, but nonetheless allowing their retention).

88. See *id.* at 984 (allowing the retention of businesses that were neither reasonably incidental nor economically appropriate).

transportation businesses,⁸⁹ and retain its agricultural property for a reasonable time.⁹⁰

Once the Supreme Court was filled with a majority of pro-New Deal Justices, the SEC quickly informed parties that *American Water Works* was nothing more than an "advisory opinion" and that it certainly did not amount to a controlling principle.⁹¹ While the Judiciary shifted to a pro-New Deal stance, political support of PUHCA remained unstable.⁹² The 1940s saw bitter opposition to PUHCA, and the SEC was aware that if it imposed even a single divestiture plan that appeared to harm investors or consumers, it would risk Congressional reexamination.⁹³ Consequently, the SEC refined its regulatory approach to respond to the changing situation.

The SEC took a comprehensive and proactive approach to the precarious political situation and created the "Section 11(e) strategy."⁹⁴ The key to this strategy was doctrinal.⁹⁵ Section 11(b)(1) required that the operations of a holding company system be limited to a "single integrated public utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public utility system."⁹⁶ Section 11(b)(2) required that each holding company "shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding company system does not unduly or unnecessarily complicate the structure . . . of such

89. See *id.* (permitting retention of property, even though it was not necessary and appropriate to proper functioning).

90. See *id.* (allowing additional time to dispose of agricultural property).

91. See SELIGMAN, *supra* note 28, at 250–51 (describing the ideological framework of the Judiciary and the SEC's reaction to the shift to a pro-New Deal court); see also *Columbia Gas & Elec. Corp.*, 8 S.E.C. 460 (1941) (stating that *American Water Works* would be considered only as an advisory opinion).

92. See SELIGMAN, *supra* note 28, at 251–53 (explaining the political situation surrounding PUHCA).

93. See *id.* (explaining the precarious political circumstances surrounding PUHCA enforcement). The SEC knew that the controversial Section 11 had been approved by Congress by only a single vote. *Id.* at 214. "The strategy of attrition is a naturally double-edged sword and puts as hard a strain on the user as on the enemy." WARD, ET. AL., *supra* note 78, at 110. While the SEC was still active, its strategy caused it to be classified as a "nonessential agency," the headquarters physically were transferred from Pennsylvania Avenue to Philadelphia, and one third of its staff was furloughed for military service. SELIGMAN, *supra* note 28, at 214.

94. See SELIGMAN, *supra* note 28, at 252 (describing the commencement of the Section 11(e) strategy).

95. See *id.* (discussing the teeth of the Section 11(e) strategy).

96. See Public Utility Act of 1935, tit. I, § 11(b)(1), 49 Stat. 803 (providing geographical limitations).

holding company system."⁹⁷ In a series of decisions the SEC put holding companies that submitted inappropriate Section 11(e) proposals "through the wringer."⁹⁸ The SEC's Section 11(e) strategy strictly construed Sections 11(b)(1) and 11(b)(2) to encourage utilities to offer appropriate voluntary divestiture plans.⁹⁹ The SEC made it clear that if a utility required it to perform a Section 11(d) proceeding, the Commission would issue as comprehensive a divestiture order as was permissible under a reasonable interpretation of the Act.¹⁰⁰

The SEC's *North American Company* decision¹⁰¹ provides a clear example of the SEC's Section 11(e) strategy. The North American Company was a "pinnacle of a great pyramid of corporations . . . scattered throughout the United States."¹⁰² Its holding company system consisted of "some eighty corporations . . . with an aggregate capitalized value in excess of \$2,300,000,000."¹⁰³ The companies in the North American system performed "a variety of functions from electric and gas service to railroad transportation, warehousing and amusement park operations."¹⁰⁴ North American submitted a voluntary divestiture plan that contemplated retention of the majority of its non-integrated businesses.¹⁰⁵ The SEC construed Section 11(b)(1) as permitting the retention of an additional system only if it was located in the state in which the principal system operated or in an adjoining state or country.¹⁰⁶ The SEC then construed Section 11(b)(2) to require divestiture of holding or subholding companies "which serve no useful purpose."¹⁰⁷ The SEC then found that North American had not confined its operations to "those of a single integrated public

97. See *id.* at tit. I, § 11(b)(2) (providing geographical limitations).

98. See SEC REPORT, *supra* note 31, at 74 (noting the SEC's strict construction of the statutory requirements). For an example of a holding company that the SEC put through the wringer, see *American Power & Light Co. v. SEC*, 329 U.S. 90 (1946).

99. See SELIGMAN, *supra* note 28, at 252 (discussing the success of the SEC's Section 11 strategy).

100. See *id.* (describing the Commission's strategy to induce appropriate divestiture plans).

101. *N. Am. Co.*, 11 S.E.C. 194 (1942) (issuing a strict divestiture plan for the North American Company).

102. *N. Am. Co. v. SEC*, 327 U.S. 686, 690–91 (1946) (explaining the North American Company's holding company system).

103. *Id.* at 691.

104. See *id.* (describing the structure of the North American holding company).

105. See *N. Am. Co.*, 11 S.E.C. at 195 (providing the details of the North American voluntary divestiture proposal).

106. See *id.* at 206–08 (articulating the SEC's narrow interpretation of the geographical limitations of Section 11(b)).

107. See *id.* (explaining the SEC's narrow interpretations of the 11(b) provisions).

utility system within the meaning of the Act, and to such businesses as are reasonably incidental, economically necessary, or appropriate to the operations of such integrated public utility system."¹⁰⁸ Consequently, the SEC issued an extremely strict Section 11(d) divestiture plan, and the Court upheld the proposal.¹⁰⁹

The cumulative effect of the SEC's strict interpretation of Sections 11(b)(1) and 11(b)(2) motivated many holding companies to offer appropriate voluntary divestiture plans in hopes of avoiding such severe impositions under a Section 11(d) action.¹¹⁰ This Section 11(e) strategy demonstrates the proactive and comprehensive nature of the SEC's regulatory personality and shows how such an approach produces industry compliance. This effective and efficient regulatory approach was due largely to the enabling statute, which gave the SEC the appropriate tools to create a stable regulatory environment.¹¹¹ By issuing a general order of what should be done, but allowing the utilities to work out the details and methods of compliance, the SEC adhered to Congressional goals while still giving the industry room to develop.¹¹² In addition to the statutory influence, the success of the SEC is also attributable to its members who planned and implemented such innovative strategies.¹¹³ Most members of the SEC can be classified as regulatory economists, and most regulatory economists would agree that "regulation is like growing old: we would rather not do it, but consider the alternative."¹¹⁴ This combination of statutory and member influences created a principled SEC that produced a stable, effective, and efficient regulatory regime.¹¹⁵

108. See *id.* at 197 (explaining its assessment of the North American Company).

109. *N. Am. Co. v. SEC*, 327 U.S. 686, 687 (1946) (upholding the SEC's divestiture order).

110. See SELIGMAN, *supra* note 28, at 207 (describing the effects of the SEC's Section 11 approach).

111. See Public Utility Act of 1935, tit. I, 49 Stat. 803 (giving the SEC the tools necessary (1) to restructure the corporate functions of holding companies in Section 11 and (2) to provide further regulation once its simplification duties were complete).

112. See HAWES, *supra* note 23, § 2-19 (arguing that the SEC developed its overall approach during the initial phase of PUHCA regulation).

113. See generally SELIGMAN, *supra* note 28 (providing a full description and explanation of all the SEC Chairmen).

114. See JAMES C. BONBRIGHT, ALBERT L. DANIELSEN & DAVID R. KAMERSCHEN, PRINCIPLES OF PUBLIC UTILITY RATES 18 (1988) (giving an economist's view of regulation).

115. See SELIGMAN, *supra* note 28, at 257 (noting that by 1948 holding companies had voluntarily divested themselves of approximately \$12 billion in assets and the number of subsidiaries controlled by holding companies was reduced from 1,983 to 303); see also HAWES, *supra* note 23, § 2-19 (noting that Congress did not intend utilities to remain permanent federal wards of the Act, and that the reduction in companies subject to the Act was intended and

2. A Stable and Efficient Regulatory Environment

By 1952, the SEC had completed over 90% of its restructuring mission,¹¹⁶ and only a few holding companies registered with the SEC.¹¹⁷ In the second phase of PUHCA regulation, the SEC shifted its focus to the duties of Sections 6¹¹⁸ and 7,¹¹⁹ which provided for SEC oversight of securities transactions by registered holding companies and their subsidiaries; Sections 9¹²⁰ and 10,¹²¹ which required the SEC to approve the acquisition of securities and utility assets and other interests by registered holding companies and their subsidiaries; and Sections 12¹²² and 13,¹²³ which authorized the SEC to approve affiliate transactions in a holding company system.¹²⁴ The SEC's regulatory behavior in this second phase shows a commission committed to guiding the industry into a new stage of development by issuing proactive rules and regulations.

In the 1950s the industry shifted focus to the development of technological advancements in engineering and power systems, and the SEC responded by formulating and enforcing a number of policies and practices that would serve as a guide in this new field.¹²⁵ The SEC's proactive regulations consisted of adopting statements of policy regarding first mortgage bonds and preferred

reflects attainment of the Act's purpose).

116. See SELIGMAN, *supra* note 28, at 257 (describing the accomplishments of the Commission); see also SEC REPORT, *supra* note 31, at 5 (noting that the task of restructuring was largely completed by 1952).

117. See James W. Moeller, *Toward an SEC-FERC Memorandum of Understanding*, 15 ENERGY L.J. 31, 69 n.30 (1993) (listing the remaining registered holding companies).

118. See Public Utility Act of 1935, tit. I, § 6, 49 Stat. 803 (describing unlawful registered holding company securities transactions).

119. See *id.* at tit. I, § 7 (listing mandatory declarations for registered holding companies in securities transactions).

120. See *id.* at tit. I, § 9 (stating the restrictions on a registered holding company's acquisitions of securities).

121. See *id.* at tit. I, § 10 (describing standards that guide the FERC in approving securities transactions of registered holding companies).

122. See *id.* at tit. I, § 12 (prohibiting certain intercompany transactions).

123. See *id.* at tit. I, § 13 (describing standards for service, sales and construction contracts of affiliated companies).

124. See SEC REPORT, *supra* note 31, at 59 (describing regulatory duties during the "transmission period" after Section 11 enforcement).

125. See *id.* at 41 (noting that "electric power consumption in the United States doubled every decade between 1935 and 1970, due to the increased development of household electric appliances and other devices that increased consumption"); see also *id.* at 24 (commenting that the increased electric power consumption required new technologies for its generation, transmission, and distribution).

stock,¹²⁶ creating general standards for debt and equity as a percentage of total capitalization,¹²⁷ and imposing limitations on the types of securities issued.¹²⁸ Further, the SEC issued comprehensive rules and regulations to account for industry needs, investor and consumer concerns, and PUHCA's goals. Instead of being shaped by the industry, the SEC's regulatory behavior effectively shaped the industry.¹²⁹

To accommodate the increased demand in electricity from 1965 to 1979 the industry shifted its focus to the construction of new facilities.¹³⁰ The SEC responded to the industry changes by allowing the industry to issue nontraditional securities, to depart from conventional financing rules, and to use sale-leaseback transactions.¹³¹ Additionally, the SEC responded to new industry developments by maintaining flexible regulations in new situations.¹³² The SEC noted that "the determination of whether to permit enlargement of a system by acquisition is to be made on the basis of all the circumstances, not on the basis of preconceived notions of size."¹³³ The SEC adjusted its regulatory decisions to account for the current changes in the industry, but also set forth general rules and regulations that would continue to guide all registered holding

126. *See id.* at 42 (describing policy statements that outlined the various terms required to be included in issues of such securities to satisfy the standards of Section 7(d)). These policy statements included redemption provisions, dividend limitations, sinking and improvement fund and renewal and replacement fund provisions, and other terms for bonds; and unsecured debt limitations, voting rights, redemption provisions, and other terms for preferred stock. *Id.*

127. *See id.* (explaining the SEC's established requirements for balanced capitalization ratios in order to maintain conservative capital structures that would tend to produce economies in the cost of new capital).

128. *See id.* (discussing rules and policies used to deal with securities financings). In general, electric-utility holding companies issued common stock, while their subsidiaries issued preferred stock and first mortgage bonds to the public, and common stock to the parent company. *Id.* Short-term borrowings were permitted as interim financing. *Id.*

129. *See id.* at 36-40 (explaining why the PUHCA provisions were redundant). Additionally, all registered holding companies were reporting companies under the Securities Exchange Act of 1934, and the SEC regulated the public utility holding companies by virtue of their status as issuers of securities. *Id.*

130. *See* SEC REPORT, *supra* note 31, at 85 (discussing the SEC's second phase of regulation).

131. *See id.* at 43-44 (describing in detail the flexible interpretations offered by the SEC).

132. *See id.* at 60 (noting that companies which sought SEC approval for joint ownership of large generating facilities met an accommodating commission); *see also* Am. Elec. Pwr. Co., 46 S.E.C. 1299 (1978) (approving an acquisition that, in 1946, the SEC would have judged to be too large).

133. *Am. Elec. Pwr. Co.*, 46 S.E.C. at 1309 (explaining the SEC's flexible interpretation of the PUHCA provisions, specifically regarding permissible holding company size).

companies in their future dealings, thus facilitating a consistent and stable regulatory environment.¹³⁴

The SEC's effective regulation of PUHCA, the Securities Act, and the Securities Exchange Act made many PUHCA provisions redundant and burdensome.¹³⁵ Beginning in the early 1980s, the SEC began advocating for the repeal of PUHCA.¹³⁶ Most of PUHCA's transactions were also under the SEC's jurisdiction in its role as securities regulator.¹³⁷ Securities statutes use disclosure to facilitate the dissemination of full and accurate information, but PUHCA required the SEC to conduct an additional merit review of the transaction.¹³⁸ In 1995 the SEC presented a clear and cogent proposal for PUHCA repeal in a comprehensive report.¹³⁹ This report illustrates, once again, the proactive and comprehensive regulatory approach of the SEC. Instead of revamping PUHCA through creative interpretation, the SEC called for Congressional action.¹⁴⁰ The 109th Congress finally acted on the recommendation and repealed PUHCA, divesting the SEC of its electric regulatory duties and establishing the FERC as the sole electric utility regulatory commission.¹⁴¹

The SEC's PUHCA regulatory history demonstrates that a proactive and comprehensive approach to regulation can shape and direct, rather than confine, industry development. Predictability favors investors and consumers by allowing regulated utilities to plan and price transactions on the front end, which can lead to efficient corporate functions, that can help encourage industry advancements. A volatile regulatory environment might have hindered

134. See, e.g., Transactions Limited to Cost, 17 C.F.R. § 250.90 (2005) (permitting transactions between and among affiliates so long as the holding company complied with the SEC's at-cost standard); Determinations of Cost, 17 C.F.R. § 250.91 (2005) (setting standards for use of the "at cost" pricing standard for affiliate transactions); Sales of Goods Produced by Seller, 17 C.F.R. § 250.92 (2005) (same).

135. See SEC REPORT, *supra* note 31, at 7 ("Since 1935, developments in other regulation have made the SEC's merit review increasingly redundant.").

136. See *Hearings on S. 1869, S. 1870, S. 1871 and S. 1977 to Amend or Repeal the Public Utility Holding Company Act of 1935: Before the Subcomm. on Securities of the S. Comm. on Banking, Hous., and Urban Affairs, 97th Cong.* 407 (1982) (discussing the repeal of PUHCA).

137. See SEC REPORT, *supra* note 31, at 107 (describing the redundant PUHCA provisions).

138. See *id.* at 115 ("While those statutes generally focus on disclosure . . . the Holding Company Act requires the SEC to evaluate the merits of securities issuances.").

139. See *id.* at 6 (suggesting that the best solution would be for Congress to issue a conditional repeal of PUHCA).

140. See *id.* (providing potential plans of action if Congress did not repeal PUHCA).

141. See Energy Policy Act of 2005, Pub. L. No. 109-58, §§ 1263-89, 119 Stat. 594 (providing for a new regulatory regime).

the companies' ability to seize opportunities for growth and development, ultimately harming investors and consumers in a manner that would have been antithetical to the goals of PUHCA. The SEC's regulatory personality and the resulting regulatory environment ensured that both investors and consumers received the benefits of a stable and efficient industry.

B. The FERC Produces an Unstable and Inefficient Regulatory Environment

For the past seventy years, the FERC and the SEC have continued on parallel tracks of regulation, each guided by distinct regulatory principles. Whereas the SEC was a predictable and proactive body, the FERC has been a reactive body with fragmented policies.¹⁴² President George W. Bush promised that EPACK 2005 would "help every American who drives to work, every family that pays a power bill, and every small business owner hoping to expand."¹⁴³ This promise presumes great developments in the energy industry, and a stable and effective regulatory environment is one step toward achieving such industry advancements.¹⁴⁴ The 109th Congress established the FERC as the sole electric utility regulatory commission, and if the goals of EPACK 2005 are to be achieved the FERC should aim to produce a stable and efficient regulatory environment reminiscent of the SEC's.

1. The FERC Conducts Individualized Examinations

The 74th Congress amended the FPA to give the FERC regulatory jurisdiction over a very small portion of the electric utility industry.¹⁴⁵ FERC's authority was

142. See, e.g., Kelliher, *supra* note 48, at 15 (discussing the role of the FERC). In the securities industry disclosure of material information is the key to informed decision-making and allows securities transactions to remain free from price regulation. See Reply Comments of Edison Electric Institute at 9–10, Docket No. RM06-3 (Fed. Energy Reg. Comm'n Nov. 17, 2005), http://elibrary.ferc.gov/idmws/File_list.asp?document_id=4360333 (last visited Nov. 13, 2006) (arguing for the repeal of PUHCA) (on file with the Washington and Lee Law Review). In contrast, the electricity industry has its foundation in, and critical infrastructure has been financed upon, the concept of extensive regulation based upon private contractual undertakings that must receive regulatory approval before they can become effective. See Kelliher, *supra* note 48, at 15 (giving the regulatory history).

143. Press Release, President George W. Bush, President Signs Energy Policy Act at the Sandia National Laboratory (Aug. 8, 2005), <http://www.whitehouse.gov/news/releases/2005/08/20050808-6.html> (last visited Nov. 13, 2006) (on file with the Washington and Lee Law Review).

144. See *supra* Part III.A (explaining how the SEC's stable and predictable regulatory environment facilitated industry growth during the phases of industry development).

145. See *supra* Part II.B (describing the "Attleboro gap").

limited to such actions as regulating rates and related terms and conditions for interstate wholesale transactions, establishing a uniform system of accounts, and approving mergers of electric utilities.¹⁴⁶ "Price regulation is the heart of public utility regulation,"¹⁴⁷ and the FERC's regulatory history shows that it is a results driven commission. A private operator who chooses to perform a function clothed in the public interest enters into the regulatory compact, which entitles him to receive a reasonable rate of return in exchange for providing reliable service.¹⁴⁸ Rate regulation ensures that the utilities make a profit but limits that profit to a reasonable amount.¹⁴⁹ In 1935, when the FERC began its regulation of electric utilities, the FERC was rightfully concerned that utilities were trying to pass through maximum rates.¹⁵⁰ Negative public perception, combined with the utilities' opposition to rate regulation, created an adversarial tension between the FERC and the industry. This tension formed the roots of the FERC's regulatory approach.

The FERC modeled its electric utility regulatory duties off of its prior experience regulating the water and gas industries. The 1935 Act instructed the FERC to ensure that rates were "just and reasonable."¹⁵¹ This vague delegation gave the FERC the discretion to set rates in the "zone of reasonableness," which is "bounded at one end by the investor interest against confiscation and at the other by the consumer interest against exorbitant rates."¹⁵² Not wanting

146. See *supra* Part II.B (describing the 1935 amendments to the FPA).

147. 1 ALFRED E. KAHN, *THE ECONOMICS OF REGULATION* 20 (1970). Traditionally, it was presumed that the primary purpose of regulation was, ostensibly at least, the promotion of the public interest through the protection of consumers against exploitation. See *Smyth v. Ames*, 169 U.S. 466 (1897) (noting that this proposition has been accepted without objection as an essential element in the law of property). This theory is more often assumed than articulated. See Richard Posner, *Economic Theories of Regulation*, *THE BELL J. OF ECON. & MGMT. SCI.* 336, 336–40 (1974) (discussing the public interest theory and potential reforms). The public interest theory of regulation starts from the uncontroversial normative proposition that regulation should occur when necessary to address a market failure such as a natural monopoly. See *id.* at 336 (discussing the roots of the public interest theory). The theory arose out of two assumptions: that economic markets are extremely fragile and prone to operate inefficiently or inequitably if left alone and that government regulation is virtually costless. *Id.*

148. See PHILLIPS, *supra* note 8, at 631 (describing the concept of regulatory compact).

149. *Id.* (explaining the meaning of the regulatory compact).

150. See *supra* Part II.A (discussing documented holding company abuses).

151. See Public Utility Act of 1935, tit. II, §§ 205–06, 49 Stat. 803 (requiring the FERC to determine if the proposed rates were just and reasonable and giving it the power to set the rates if it determined the proposed rates were not just and reasonable). A court would overturn a rate order only if the FERC's determination was arbitrary. See *FPC v. Hope Natural Gas*, 320 U.S. 591, 628 (1944) (giving great deference to the FERC's findings).

152. See *Jersey Cent. Pwr. & Light v. FERC*, 810 F.2d 1168, 1177 (D.C. Cir. 1987) (explaining the zone of reasonableness).

to be a rubber stamp on industry proposed rates, the FERC inquired into the particularities of each rate application.¹⁵³ The early ratemaking decisions illustrate the FERC's driving principle, expressed throughout its water, gas, and electric utility regulatory decisions, that ratepayers are best protected when rates are as low as possible.

In *Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia*,¹⁵⁴ the Court presented a lengthy list of factors that the FERC should consider in determining the fair rate of return but left the particular methods of calculation to the FERC.¹⁵⁵ The factors included: comparisons with other companies having corresponding risks, the attraction of capital, current financial and economic conditions, the cost of capital, the risks of the enterprise, the financial policy, the capital structure of the utility, the competence of management, and the company's financial history.¹⁵⁶ After *Bluefield*, the FERC conducted individualized examinations that attributed varying weights to the above factors and found reasonable a 7% rate of return,¹⁵⁷ a 6.5% rate of return,¹⁵⁸ and a rate of return as low as 6%.¹⁵⁹ The ensuing years created a guessing game between the utility and the FERC as to what would be approved as a reasonable rate of return.¹⁶⁰

Dissatisfied with the FERC's varying determinations, and in hopes of requiring the FERC to set a clear standard for a reasonable rate of return, Hope Natural Gas filed suit against the FERC. In *Federal Power Commission v. Hope Natural Gas*,¹⁶¹ the Court noted that:

153. See KAHN, *supra* note 147, at 26 (describing the supervision and control of operating costs and capital outlays). To analyze rate applications, the FERC had to require the companies to keep uniform systems of accounts, according to Commission issued procedures and subject to the Commission's review. *Id.*

154. *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n of W.Va.*, 262 U.S. 679 (1923).

155. *Id.* at 679.

156. *Id.*; see also PHILLIPS, *supra* note 8, at 377 (describing the *Bluefield* factors).

157. See *McCardle v. Indianapolis Water*, 272 U.S. 400, 419 (1926) (finding that a 7% rate of return was reasonable).

158. See *Dayton Pwr. & Light v. Pub. Util. Comm'n of Ohio*, 393 U.S. 290, 311 (1934) (finding a 6.5% rate of return reasonable).

159. See *Driscoll v. Edison Pwr. & Light*, 307 U.S. 104, 120 (1939) (finding a 6% rate of return reasonable).

160. See KAHN, *supra* note 147, at 42-43 (discussing the issues involved in rate setting). The zone of reasonableness is a compromise, or bargain, between the investors' and consumers' interests. *Id.* Rate regulation "has to steer between Scylla and Charybdis." *Cedar Rapids Gas Light Co. v. Cedar Rapids*, 223 U.S. 655, 669 (1912).

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

The Commission [is] not bound to the use of any single formula . . . in determining rates And when the Commission's order is challenged in the courts, the question is whether the order "viewed in its entirety" meets the requirements of the Act. Under the statutory standard of "just and reasonable" it is the result reached and not the method employed which is controlling. It is not the theory, but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.¹⁶²

Justice Douglas went on to say that "[r]ates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return."¹⁶³ The Court's decision in *Hope* reaffirmed the FERC's broad discretion in its regulatory duties.¹⁶⁴ After *Hope*, the FERC continued its pattern of individual examination and scrutinization of all factors to ensure that each rate passed on only minimal costs to the ratepayer.¹⁶⁵

The FERC's early approach to rate regulation illustrates the roots of the FERC's regulatory personality. The tension between the FERC and the industry, combined with the FERC's commitment to ratepayer protection, spurred its use of in-depth, individualized examinations.¹⁶⁶ Prior to the early 1960s, the FERC's "function of regulating interstate wholesale electric rates [had] not received the attention it deserved."¹⁶⁷ The FERC's avoidance of guiding rules, and its emphasis on individual examination, produced an unstable and inefficient regulatory environment. The consequences of the

162. *Id.* at 602.

163. *Id.* at 605.

164. *See id.* (giving the FERC broad discretion in its methods used to calculate the rate base and a reasonable rate of return).

165. *See* KAHN, *supra* note 147, at 40–54 (discussing the difficulties in setting a standard rate of return).

166. Instead of adopting a presumptively reasonable rate of return, the Commission continually altered its methods of calculation and evaluation to account for new issues. *See, e.g.,* Driscoll v. Edison Pwr. & Light, 307 U.S. 104, 120 (1939) (setting the rate of return at 6%, after approving 6.5% for Dayton Power and Light). Adoption of a presumptively reasonable rate would have likely produced a stable and effective regulatory environment akin to that of the SEC under PUHCA. *See* discussion *supra* Part III.A.2 (discussing the power of standardized rules to produce a stable regulatory environment).

167. PHILLIPS, *supra* note 8, at 648. The effects of the FERC's approach were largely unrealized because a sophisticated transmission system had yet to develop. *Id.* With the power to regulate only a few interstate wholesale transactions, the FERC's influence on the electric field was relatively limited. *See id.* at 655 (describing the reorganization of the Department of Energy, and noting the FERC's increased involvement in the federal regulation of electricity).

FERC's reactive and fragmented approach were not felt until the FERC's role in electricity regulation increased.¹⁶⁸

2. *The FERC Shifts to Market Regulation*

The FERC's role and influence in electricity regulation greatly increased in the 1970s due to a reorganization in the Department of Energy, high energy prices, and new legislation.¹⁶⁹ The increased energy demands of the 1970s were met by the industry's construction of new facilities, strengthened interconnection of the transmission grid, and developments of new sources of energy.¹⁷⁰ The strengthened transmission grid increased the potential for interstate transactions, and the FERC experienced an increased role in electric utility regulation.¹⁷¹ Additionally, a competitive generation market began emerging after Congress passed the Public Utilities Regulatory Policies Act (PURPA).¹⁷² PURPA was the Congressional response to high energy prices due to the oil and natural gas shortage, and was intended to further the United States' energy self-sufficiency.¹⁷³ PURPA's ancillary result was the emergence of a competitive generation market.¹⁷⁴

Traditionally, the FERC used a cost-of-service standard to evaluate a utility's proposed rate.¹⁷⁵ This method was consistent with the FERC's role of protecting ratepayers by setting individual rates.¹⁷⁶ However, the development

168. *See id.* at 655 (discussing the significance of the FERC's increased role in electric utility regulation).

169. *See id.* (describing the reorganization of the Department of Energy and noting the FERC's increased involvement in the federal regulation of electricity).

170. *See* SEC REPORT, *supra* note 31, at 41 (describing the industry construction phase and the development of the transmission system).

171. *See id.* (describing the increased development of the transmission system and industry developments that resulted from the use of the transmission system).

172. *See* PHILLIPS, *supra* note 8, at 661 (describing the industry at a crossroads); *see also* Hon. Richard Cudahy, *PURPA: The Intersection of Competition and Regulatory Policy*, 16 ENERGY L.J. 419, 421 (1995) (describing the Congressional goals embodied in PURPA and the development of a competitive generation market).

173. *See* Cudahy, *supra* note 172, at 422 (describing the role and effects of PURPA).

174. *See id.* (discussing the emergence of a competitive generation market after the passage of PURPA). Additionally, PURPA helped to solve the problems created by the utilities' failed construction of generation plants. *See id.* (describing the benefits of PURPA). Transmission was still monopoly controlled, and a lack of open access transmission would have impeded the feasibility of purchases from the increased number of Qualifying Facilities (QF). *See* PHILLIPS, *supra* note 8, at 655-56 (summarizing PURPA).

175. *See* Kelliher, *supra* note 48, at 2 (describing traditional cost-of-service ratemaking).

176. *See id.* ("Under traditional cost-of-service rate regulation, the accumulation of

of a generation market shifted the FERC's role from rate regulation to market regulation, and a cost-of-service test was not well suited to the FERC's new role.¹⁷⁷ A competitive generation market allowed utilities to sell and buy electricity at market-based rates.¹⁷⁸ The FERC's reactions to industry changes, particularly its treatment of market-based rates, shows a reactive agency judging the needs of a new and developing industry under a rigid template formed by old standards.¹⁷⁹

Ocean State Power Company was the first utility to gain market-based rate approval.¹⁸⁰ Ocean State proposed four power sales at market-based rates—three to non-affiliates and one to an affiliate.¹⁸¹ The FERC approved the three non-affiliated proposed transactions based on the existence of a competitive market, but required Ocean State to pass further tests to transact with an affiliate at market-based rates.¹⁸² The FERC, expressing its commitment to ratepayer protection, noted that:

When a purchaser is affiliated with a seller, the purchaser might agree to pay a higher price than it would otherwise agree to pay because the purchaser would financially profit from the transaction. To prevent inflated rates that might result from the affiliate relationship, we must review the rates to the affiliated purchasers to evaluate whether there is any indication of abuse due to self-dealing.¹⁸³

generation market power is a lesser concern, since the exercise of market power can be controlled by setting individual rates.").

177. *See id.* at 1 ("As the industry has changed, the FERC's role has evolved from setting rates for individual sellers to setting rules of general application that govern electricity markets."); *see also id.* at 8 (discussing the FERC's development and treatment of market-based rates).

178. *See, e.g., Ocean State Pwr.*, 44 F.E.R.C. ¶ 61,261, 61,976 (1988) (applying to the FERC for market-based rates).

179. *See* PHILLIPS, *supra* note 8, at 861–98 (providing an appraisal of regulation). Equally applicable to FERC's history is the observation that "[r]egrettably one searches in vain for an unambiguous pronouncement of general policy with respect to the various measures . . . the reading of decisions creates the impression that the FERC selects whichever theory appears best to fit the case at hand." *See* C.H. FULDA, *COMPETITION IN THE REGULATED INDUSTRIES: TRANSPORTATION* 370 (1961) (comparing the unpredictable regulatory decisions of the FERC with the unpredictable nature of the Interstate Commerce Commission's).

180. *See Ocean State*, 44 F.E.R.C. at 61,985 (1988) (approving the first proposal for affiliates to transact at market-based rates).

181. *See id.* at 61,977 (describing the proposed transactions).

182. *See id.* at 61,978 (noting that proof of an arms length transaction would be sufficient to establish the existence of a competitive market for affiliate transactions).

183. *Id.* at 61,983.

The FERC employed a comparable market test to judge the affiliated transaction.¹⁸⁴ The FERC noted that it would:

Compare the rates paid by the affiliated purchasers to (1) the rates that the affiliated purchasers would pay to other suppliers for similar service, and (2) the rates that non-affiliated purchasers pay to the same source for similar service The FERC will also consider the terms and conditions of service to the affiliated purchasers when evaluating whether self-dealing resulted in the choice of a less favorable deal.¹⁸⁵

Ocean State was the only utility to gain approval so easily to transact at market-based rates.

The FERC's skepticism of the industry runs deep, and an increase in market-based rate applications spurred the FERC to reevaluate its standard.¹⁸⁶ In *Edgar Energy*,¹⁸⁷ the FERC noted that "it is essential that the ratepayers be protected and the transactions be above suspicion, and the critical first step is to ensure lack of abusive self dealing."¹⁸⁸ The FERC explained that "market-based rates for sales involving affiliates will be found to violate § 205(a) of the FPA unless there is a clear showing of lack of potential affiliate abuse."¹⁸⁹ To negate affiliate abuse, the utility should present:

(1) evidence of direct head-to-head competition between the affiliate and competing unaffiliated suppliers in a formal solicitation or informal negotiation process; (2) evidence of the prices non-affiliated buyers were willing to pay for similar services from the affiliate; or (3) benchmark evidence that shows the prices, terms, and conditions of sales made by non-affiliated sellers.¹⁹⁰

The FERC explained that the affiliate abuse test would ensure the solicitation negotiation was designed and implemented without undue preference for the affiliate, the analysis of the bids or responses did not favor the affiliate, and the affiliate was selected based on some reasonable combination of price and nonprice factors.¹⁹¹

184. *See id.* (explaining the comparable market test).

185. *Id.*

186. *See* discussion *supra* Part III.B.1 (discussing the FERC's regulatory roots and how early circumstances made the FERC skeptical of the industry).

187. *See* *Boston Edison Co. (Edgar Energy)*, 55 F.E.R.C. ¶ 61,382, 62,161(1991) (setting forth the requirements for the affiliate abuse test).

188. *Id.* at 62,167.

189. *Id.*

190. *Id.* at 62,168.

191. *See id.* (discussing the need for additional standards in proposed transactions between affiliates).

Skeptical of the industry, the FERC was also concerned that a seller with market power could manipulate the market and influence the market price by restricting supply or denying access to alternative sellers.¹⁹² In addition to negating the potential for affiliate abuse, a utility had to negate market power by showing that neither it nor any of its affiliates:

- (1) is a dominant firm in the sale of generation in the relevant market;
- (2) owns or controls transmission facilities through which the buyer could reach alternative sellers (or, if the seller or any of its affiliates does own such facilities, they have adequately mitigated their ability to block the buyer from reaching other sellers); and (3) can erect or control any other barrier to market entry.¹⁹³

Edgar required utilities to negate both market power and affiliate abuse in order to gain market-based rate approval.¹⁹⁴

The FERC utilized these tests to protect ratepayers from excessive pricing and to prevent abusive cross-subsidies. This pattern of regulation proves the FERC's propensity to regulate in the "interest of the public alone, and not the public utilities as well."¹⁹⁵ As an independent generation market continued to grow, power marketers emerged. These marketers sold at market-based rates either from merchant generation power plants or by buying power on the open market and reselling it.¹⁹⁶ When power marketers applied to the FERC for approval to sell power at market-based rates, the FERC reacted to the new situation by imposing a series of complex and cumbersome tests.¹⁹⁷

Driven by ratepayer protection, the FERC was concerned that excessive prices would be flowed through to the ratepayer.¹⁹⁸ To address this concern the FERC required power marketers to negate the existence of both generation and

192. See *Commonwealth Atlantic Ltd. P'ship*, 51 F.E.R.C. ¶ 61,368, 62,244 (discussing FERC's concerns about abusive self-dealing).

193. *Edgar Energy*, 55 F.E.R.C. ¶ 61,382, 62,167 (1991).

194. See *id.* at 62,170 (setting forth the standards the FERC would employ when evaluating a market-based rate application).

195. See *Moeller*, *supra* note 117, at 37 (discussing the different legal standards of the SEC and the FERC).

196. See *PHILLIPS*, *supra* note 8, at 657–61 (describing the provisions of the Energy Policy Act of 1992 and their effects). The FERC permitted utilities to own and operate EWG's, so long as the utility filed a sworn statement that it would comply with the statutory requirements. *Id.*

197. See *Heartland Energy Serv.*, 68 F.E.R.C. ¶ 61,223, 62,052 (1994) (establishing two separate tests, one for an unaffiliated power marketer, and a second higher standard that an affiliated power marketer must satisfy).

198. See *id.* at 62,062 (explaining the FERC's concerns about affiliate abuse).

transmission market power.¹⁹⁹ A number of non-affiliated power marketers easily passed the market power tests, but the FERC expressed additional concerns about the potential for cross-subsidization when a power marketer was affiliated with a public utility.²⁰⁰ For an affiliated power market to gain approval to sell at market-based rates to non-affiliated third party customers the marketer had to show that neither it, nor any of its affiliates, possessed market power.²⁰¹

Heartland Energy Services, a power marketer affiliated with Wisconsin Power & Light (WP&L), was the first affiliated power marketer to apply to the FERC for market-based rate approval.²⁰² Heartland was separate, both operationally and administratively, from WP&L, yet the FERC still focused on both the generation and transmission market power of WP&L.²⁰³ The FERC would not approve an affiliated power marketer's proposal for market-based rates unless the affiliated public utility also lacked generation and transmission market power.²⁰⁴ Lack of generation dominance is demonstrated by:

199. *See id.* at 62,063 (applying general standards to Heartland's proposal).

200. *See id.* at 62,064 (explaining additional standards to protect ratepayers from affiliate abuse). A number of utilities sought to develop a power marketing function which would combine a number of attributes. Interview with Al Carr, Adjunct Professor of Law, Wash. & Lee School of Law, in Lexington, Va. (Mar. 5, 2006) (discussing the history of power marketers and the FERC's treatment of power marketers transacting at market-based rates with their affiliated utilities). Those marketers could sell and purchase power at market-based rates, both from the market at large and independent generating plants; they could develop merchant power plants and sell from them at market-based rates; and they could sell to third parties and sell and trade power among themselves. *Id.*

201. *See Heartland*, 68 F.E.R.C. at 62,060 (explaining the tests an affiliated power marketer would have to satisfy).

202. *See id.* at 62,052 (describing the characteristics of Heartland). Heartland was a power broker, and did not itself own any generation or transmission facilities. *Id.* Heartland sought authority to make market-based sales, but pledged not to engage in any transactions with its affiliated utility. *See id.* at 62,056 (describing Heartland's proposal, which included a pledge not to transact with WP&L).

203. *See id.* at 62,052 (describing Heartland's proposal).

204. *See id.* at 62,062 (describing the steps necessary to mitigate transmission power). Market power in transmission arises when sellers can block the buyer from reaching competing suppliers. *See Ocean State Pwr. II*, 69 F.E.R.C. ¶ 61,035 (1994) (explaining the role of open access transmission). An open access transmission tariff that is not unduly discriminatory or anticompetitive should offer third parties access on the same or comparable basis, and under the same or comparable terms and conditions, as the transmission provider's uses of its system. *See Kansas City Pwr. & Light Co.*, 67 F.E.R.C. ¶ 61,557 (1994) (discussing open access transmission requirements). For a clear explanation of the value of an open access transmission tariff, see *Hermiston Generating Co.*, 69 F.E.R.C. ¶ 61,035 (1994). The FERC explained that the only way to be sure that PG&E could not exercise transmission market power over a Hermiston competitor is if PG&E had an open access tariff on file with the FERC to provide comparable transmission service under specific rates, terms, and conditions. *Id.* The FERC

- (1) Showing that the entire output of a generating unit is committed under long-term contract with non-affiliates; (2) showing that its affiliates already are authorized to sell at market-based rates; or
- (3) submitting a market analysis that indicates that its affiliates have no generation dominance in the relevant markets.²⁰⁵

An affiliated power marketer would not pass the FERC's market power tests unless its affiliated utility had on file an open access transmission tariff.²⁰⁶ The FERC also required affiliated power marketers to file a code of conduct to protect against cross-subsidization.²⁰⁷ The code of conduct prevented the power marketer from transacting with its affiliate, unless the marketer made a separate § 205 rate filing for the proposed affiliated transaction.²⁰⁸ The complexity of these tests, and the intricate nature of the individual examination, show how the FERC's regulatory behavior impeded industry functions.

The FERC feared that market conditions would subvert its commitment to protecting ratepayers. In order to prevent affiliates from exploiting market conditions the FERC imposed complex tests, as demonstrated by *Heartland*, that consequently impeded industry functions. *Heartland* made it clear that gaining approval for market-based rates would not be easy, and it was not until ten years later that a utility proposed a sale from a power marketer to its affiliated public utility.²⁰⁹ In *Southern*

stated that it would apply such a requirement in the future in any situation in which a seller seeking market-based rates was affiliated with an owner or controller of transmission facilities. *Id.*

205. *Heartland*, 68 F.E.R.C. ¶ 61,223, 62,063 (1994).

206. *See, e.g., Hermiston Generating*, 69 F.E.R.C. at 61,160 (stating that the seller's affiliate must have on file an open-access transmission tariff). Prior to Order 888, which standardized transmission tariffs, the FERC analyzed the tariff to assure that the affiliate did not possess transmission market power. *See id.* at 61,162 (explaining reasons for requiring open-access transmission).

207. *See Heartland*, 68 F.E.R.C. at 62,062 (describing the FERC's affiliate abuse concerns).

208. *See id.* (requiring separate § 205 filings for transactions between affiliates). The FERC also imposed stringent reporting requirements if the market-based contract was for more than one year. *See Intercoast Pwr. Mktg. Co.*, 68 F.E.R.C. ¶ 61,248 (1994) (explaining the reporting requirements). The FERC used the stringent reporting requirements "to evaluate the reasonableness of the charges and to provide for ongoing monitoring of the marketer's ability to exercise market power." *Id.* at 62,134.

209. *See S. Ca. Edison Co.*, 109 F.E.R.C. ¶ 61,086 (2004) (proposing power sale to an affiliate). It is important to note that it was not until after the California power crisis that utilities took the step to approach the FERC with the proposal for the affiliated transaction. For a salient discussion regarding the California energy crisis and the limits of state regulation, see Norman A. Pederson, *Power Play*, LOS ANGELES LAWYER (Apr. 2002). For a complete discussion of the market-regulatory issues raised by the California power crisis and the Enron

California Edison,²¹⁰ the FERC reacted by extending *Edgar* to all long-term (one year or more) power purchase agreements between affiliates, whether cost-based or market-based.²¹¹ The FERC noted that market factors made it possible to purchase power at a market-based rate that was lower than the cost of service.²¹² The FERC was skeptical, and expressed concern that a utility would purchase power from its affiliate at a cost-of-service price, that was higher than the market-based rate, and flow through the increased cost to the ratepayer.²¹³ The FERC noted that it was "concerned about recent trends in energy markets, and [would now] require additional scrutiny and a greater degree of certainty that affiliate transactions will not cause long-term harm to wholesale competitive markets."²¹⁴ The FERC continued its practice of using complex and individualized tests to guard against the potential of abusive self-dealing.

The FERC's rhetoric recognized its new role as market regulator, but the FERC failed to alter its behavior to comport with its new role. The inefficiency of the FERC's practice of using complex tests and in-depth examinations is demonstrated in the 2005 *Commonwealth Edison* decision.²¹⁵ Before Exelon Generation (ExGen) could sell power to its affiliated utility, Commonwealth Edison (ComEd), it first had to satisfy all of the FERC's market-based rate tests.²¹⁶ ComEd's § 205 proposal presented evidence to negate the presence of

scandal, see Jacqueline Lang Weaver, *Can Energy Markets be Trusted? The Effect of the Rise and Fall of Enron on Energy Markets*, 4 HOUS. BUS. & TAX. L.J. 1 (2004).

210. See S. Ca. Edison Co., 109 F.E.R.C. ¶ 61,086 (2004) (extending *Edgar* to all long-term power purchase agreements).

211. See *id.* at 61,350 (permitting a power marketer to transact at market-based rates with its affiliated public utility).

212. See *id.* (extending *Edgar* to protect against affiliate abuse of market conditions).

213. See *id.* at 61,355 (explaining the potential for ratepayer exploitation).

214. *Id.*; cf. Transactions Limited to Cost, 17 C.F.R. § 250.90 (2005) (setting standards for use of the "at cost" pricing standard for affiliate transactions); Determinations of Cost, 17 C.F.R. § 250.91 (2005) (same); Sales of Goods Produced by Seller, 17 C.F.R. § 250.92 (2005) (same). The SEC, in its market regulation role, utilized clear rules and regulations to facilitate efficient and effective regulations for affiliate transactions in registered holding companies.

215. See *Commonwealth Edison*, 113 F.E.R.C. ¶ 61,278 (2005) (permitting the affiliated transaction only after the utility and the power marketer passed a series of complex tests).

216. See *Commonwealth Edison*, 113 F.E.R.C. at 62,117 (discussing the factors the utility and power market had to satisfy in order to gain the Commission's approval). In *Allegheny*, the FERC redefined *Edgar* once more. See *Allegheny Energy Supply Co.*, 108 F.E.R.C. ¶ 61,082 (2004) (articulating further tests a utility must satisfy to earn the privilege of transacting at market-based rates). The FERC set forth four guidelines it would use to evaluate the competitive solicitation process in a proposed affiliate transaction. *Id.* at 61,417. The competitive solicitation process must be transparent, precisely defined, negotiated by standardized evaluation criteria, and the FERC will also consider whether the applicant employed a third party to oversee the transaction. *Id.*

market, generation, and transmission power, and also presented evidence to show that there was no potential for affiliate abuse in its proposed bid solicitation plan.²¹⁷ The FERC conducted a thorough examination of all factors and procedures in the ComEd and ExGen proposal, and only after closely scrutinizing the proposed bid solicitation did the FERC approve ExGen's participation.²¹⁸ This regulatory approach required ComEd to do significant amounts of work on the front end, without any assurance that its proposal would comport with the FERC's broad principles.²¹⁹ Had the FERC denied ComEd's proposal, all the legal and corporate work to set up the proposed power purchase would have been for naught. The vague and subjective nature of the tests, combined with intricate individual examinations, show an inefficient regulatory style that does not facilitate industry development.²²⁰

The FERC's market-based rate decisions illustrate the unpredictable and unstable regulatory environment. An unpredictable regulatory environment is antithetical to efficient regulation. Deep seeded industry skepticism and fear of affiliates exploiting market conditions are the roots of the FERC's regulatory personality. The FERC's practice of regulating through individualized decisions and utilizing vague standards has prevented any degree of regulatory certainty.

IV. EPAct 2005 Reformulates the Regulatory Regime

EPAct 2005 vests the FERC with complete regulatory jurisdiction over the electric utility industry and presents the opportunity for the birth of a new agency

217. See *Commonwealth Edison*, 113 F.E.R.C. at 62,118–62,119 (supplying evidence that the utility's bidding process is in accord with the FERC's tests). The FERC found that the competitive solicitation process was transparent and did not give an undue preference or discriminate in favor of ExGen. *Id.* at 62,118. ComEd employed a third party to oversee the bid process and set forth detailed requirements for bid qualification to ensure that bids were evaluated on a price basis only. *Id.* at 62,119.

218. See *id.* at 62,120 (approving ComEd's proposal to solicit bids from its affiliate, ExGen, in its upcoming auction).

219. See discussion *supra* note 216 (explaining the *Allegheny* factors). ComEd had to set up the bidding process, employ a third party overseer, and then operationalize all of the steps to meet the FERC's tests. See *Commonwealth Edison*, 113 F.E.R.C. at 62,118–62,119 (describing ComEd's proposed power purchase agreement).

220. This approach does not facilitate efficiency for the utility because of the inherent uncertainty of the process. The utility's planning on the front end does not ensure that its proposal will be approved, and if a proposal is denied, the legal and corporate work is all for naught. Additionally, this in-depth analysis is inefficient for a Commission which could set a general guide, and approve all utilities that comport with its promulgated standards. Such an approach would provide a degree of regulatory certainty and facilitate efficient regulation by only scrutinizing utilities that fall outside the safe harbor.

personality.²²¹ As agencies interpret their statutory mandates, they tend to internalize a particular mission, develop an agency culture, and cultivate a unique expertise.²²² EPACK 2005 gives the FERC the chance to redevelop its agency culture in keeping with its new regulatory duties, and it appears that the FERC is seizing this opportunity.

A. Will Things Be Different This Time?

While the FERC's recent developments are promising, it is important to remember that the FERC has been practicing reactive and fragmented regulation for more than seventy years.²²³ In 1988, the FERC aimed to produce a predictable regulatory environment by issuing a rule providing a generic determination of rate of return on common equity.²²⁴ The rule addressed complex and contentious issues regarding the appropriate methodologies to determine a "fair" rate of return.²²⁵ In the years that the FERC calculated and published a generic rate of return, the agency "never adopted the generic rate of

221. See Energy Policy Act of 2005, Pub. L. No. 109-58, tit. 12, 119 Stat. 594 (giving the FERC new regulatory responsibilities). EPACK 2005 gives the FERC the tools necessary to promulgate rules and regulations that will guide the industry into the next phase of development. *Id.* The FPA gave the FERC discretion that is so broad that it could offer a more or less plausible explanation for any conclusion it chose to reach on the matters coming before it. See PHILLIPS, *supra* note 8, at 875 (discussing the issues with broad delegations of power). The sparse FPA provisions were the equivalent of instructing the Commission: "Here is the problem. Deal with it." See 1 KENNETH DAVIS, ADMINISTRATIVE LAW TREATISE 82 (West 2002) (discussing inherent problems with broad congressional delegations of power).

222. See DeShazo & Freeman, *supra* note 12, at 2239 (2005) (discussing the culture and expertise of the FERC).

223. See discussion *supra* Part III.B (discussing the FERC's reactive regulatory roots and its preference for individualized decisions which each contain a fragment of the FERC's developing policy).

224. See Generic Determination of Rate of Return on Common Equity for Public Utilities, 53 Fed. Reg. 3342 (proposed Feb. 5, 1988) (codified at 18 C.F.R. pt. 37). The FERC passed the Rule in order to make more accurate and consistent determinations by focusing on a single generic proceeding. See Generic Determination of Rate of Return on Common Equity for Public Utilities, 18 C.F.R. pt. 37 (1992) (abolishing generic benchmark determinations, but discussing the original reasons for the rule's inception). The rate of return is the amount of money earned by a public utility, over and above operating costs, expressed as a percentage of the rate bases. See PHILLIPS, *supra* note 8, at 375-76 (discussing the concepts of a rate of return).

225. See Generic Determination of Rate of Return on Common Equity for Public Utilities, 18 C.F.R. pt. 37 (1988) (adopting a procedure for determining and updating the benchmark rate of return and discussing the FERC's mission to provide a fair rate of return).

return in any proceeding."²²⁶ Four years after issuing the rule, the FERC repealed it, noting that:

The Commission thus balanced hopes that creation of an annual proceeding to establish a benchmark rate of return would result in improved analysis of industry trends, [and] resources savings . . . against warnings by others that this proceeding would waste resources and create problems. Despite this disagreement, the Commission [passed the rule] based on hopes that the anticipated benefits of the benchmark proceedings would in fact materialize and outweigh the objections While the benchmark has produced some benefits, it has not produced many of the benefits envisioned for it.²²⁷

Bonbright and Means said it best: "Those familiar with the actual practice of American rate regulation need no reminder about the uncertain relationship between the supposed 'principles' of rate-of-return determination . . . and the considerations that actually lead commissions to allow whatever rates of return they do allow in specific cases."²²⁸ What began as a rule focused on accuracy and consistency became yet another example of the FERC's instability.²²⁹

The generic rate of return rule shows that true regulatory change requires more than the use of a new process; it requires reexamination and reformation of an agency's approach. EPAct 2005 imposed a drastic change in the regulatory regime, and recent developments suggest that the FERC is taking the opportunity to reexamine and reformulate its regulatory approach.

B. Recent FERC Actions Indicate Change Is Occurring

The FERC's regulatory personality is a result of the 1935 Act and the then-present political situation,²³⁰ but EPAct 2005 gives the FERC the

226. See NOPR and Request for Comments on Whether the Commission Should Continue, Abolish, or Alter the Generic Determination of the Rate of Return, 56 F.E.R.C. ¶ 61,276, 62,088 (1991) (concurring comments by Commissioner Trabandt).

227. Generic Determination of Rate of Return on Common Equity for Public Utilities, 18 C.F.R. pt. 37 (1992).

228. BONBRIGHT, ET AL. *supra* note 114, at 281. Prior decisions regarding the benchmark show that "the benchmark has been a contested and controversial issue since its inception." *Id.*; see Generic Determination of Rate of Return on Common Equity for Public Utilities, 18 C.F.R. pt. 37 (1992) (discussing the justification for the rule's repeal).

229. See Generic Determination of Rate of Return on Common Equity for Public Utilities, 18 C.F.R. pt. 37 (1992) (discussing reasons for repeal of the original rule).

230. See discussion *supra* Part III.B (discussing the regulatory roots and regulatory

opportunity to form new regulatory roots and a new regulatory approach.²³¹ Recent FERC actions indicate that the FERC is forming a regulatory personality similar to that embodied by the SEC in its PUHCA 1935 enforcement.²³² The new FERC remains committed to protecting ratepayers, but now aims to also provide regulatory certainty.²³³ Through a rules and regulations approach, the FERC is building the foundation for a stable regulatory environment that has the potential to guide the industry into the next phase of development. The recent issuance of a Policy Statement regarding enforcement,²³⁴ a rulemaking promulgating anti-manipulation standards,²³⁵ and adoption of the "No-Action" letter process, illustrate the FERC's new commitment to regulatory certainty and stability.²³⁶ The FERC should make this personality change permanent to help achieve the goals of EPACK 2005.

personality of the FERC prior to EPACK 2005).

231. See discussion *infra* Part IV.B.2 (discussing FERC's new power to prevent market manipulation).

232. See discussion *supra* Part III.A (discussing the regulatory personality and regulatory behavior of the SEC in its administration of PUHCA 1935). The FERC has chosen to refer to its new regulation as "PUHCA 2005." Press Release, Fed. Energy Reg. Comm'n, Comm'n Proposes Rule on Holding Co. Reform (Sept. 15, 2005), <http://www.ferc.gov/press-room/press-releases/2005/2005-3/09-15-05-M-1.asp#skipnavsub> (last visited Nov. 13, 2006) (on file with the Washington and Lee Law Review). For clarity, Title I of the 1935 Act will, henceforth, be referred to as "PUHCA 1935."

233. See Press Release, Fed. Energy Reg. Comm'n, Comm'n Rescinds Mkt. Behavioral Rules 2 and 6, Codifies Other Behavioral Rules in Regulations (Feb. 16, 2006) <http://elibrary.ferc.gov/idmws/nvcommon/NVViewer.asp?Doc=10955826:0> (last visited Nov. 13, 2006) (announcing the FERC's adoption and subsequent rescission of the Market Behavioral Rules) (on file with the Washington and Lee Law Review). The new regulatory personality of the FERC will "go a long way toward protecting consumers from unscrupulous behavior while providing clarity to the industry as to what is expected from them . . . [thus avoiding] confusion and [providing] greater regulatory certainty." *Id.*

234. See Policy Statement, 113 F.E.R.C. ¶ 61,068 (2005) (noting that the FERC will employ many of the considerations used by the SEC).

235. See Prohibition of Energy Market Manipulation, 71 Fed. Reg. 4244 (Jan. 26, 2006) (to be codified at 18 C.F.R. § 1c) (discussing the SEC's interpretation of similar provisions and voicing support of adopting a similar strategy).

236. See No-Action Letter Process, 13 F.E.R.C. ¶ 61,174 (2005) (basing the FERC's new approach on the SEC's no-action letter process); see also Reply Comments of Edison Electric Institute at 17, Docket No. RM06-3 (Fed. Energy Reg. Comm'n Nov. 17, 2005), http://elibrary.ferc.gov/idmws/File_list.asp?document_id=4360333 (last visited Nov. 13, 2006) (noting that the industry values, and needs, certainty) (on file with the Washington and Lee Law Review). EEI believes that these provisions will both educate the industry and provide guidance with regard to specific actions that market participants can take to protect themselves, to structure effective compliance programs, and to avoid severe penalties in the unfortunate event that an act of manipulation actually occurs. *Id.*

1. Proactive Policy Statement on Enforcement

EPA 2005 provides the FERC with the enforcement tools necessary to ensure industry compliance.²³⁷ The FERC now has the authority to impose civil penalties for any violation of Part II of the FPA, as well as of any rule or order issued thereunder,²³⁸ and may assess fines of \$1,000,000 per violation per day.²³⁹ The FERC issued the Policy Statement to "provide guidance and regulatory certainty regarding [the] enforcement of the statutes, orders, rules, and regulations."²⁴⁰ The issuance of the Policy Statement illustrates the FERC's new proactive approach to regulation.

In the Policy Statement, the FERC exhibits a commitment to comprehensive regulation by considering its own past enforcement actions,²⁴¹ as well as the enforcement behavior of other agencies similarly situated.²⁴² The FERC expresses a commitment to the original FPA, but also promises to use a flexible analysis similar to that of the SEC, Commodities Future Trade Commission (CFTC), and the Federal Sentencing Guidelines (FSG).²⁴³ The first touchstone in determining the amount of the proposed penalty is the seriousness of the violation.²⁴⁴ However, to provide "firm, but fair enforcement,"²⁴⁵ the FERC also includes a list of questions and issues it will consider when tailoring penalties for violations.²⁴⁶ The FERC has thus adopted the individual balancing approach used by the SEC, the CFTC, and the FSG.²⁴⁷ The FERC promises to assess the degree of the violator's internal compliance

237. See Energy Policy Act of 2005, Pub. L. No. 109-58, § 1294(e)(1), 119 Stat. 594 (amending FPA § 316A).

238. See *id.* (amending FPA § 316A(a)).

239. See *id.* at § 1284(e)(2) (amending FPA § 316A(b)).

240. Policy Statement on Enforcement, 113 F.E.R.C. ¶ 61,068 (2005).

241. See *id.* at 61,244 (explaining the FERC's treatment of companies that did not comply with its standards).

242. See *id.* at 61,245 (discussing the SEC and the CFTC patterns of assessing penalties); *cf.* discussion *supra* Part II.B. (discussing the FERC's acquisition of its new duties in 1935 and its reliance on its own gas and water methods of regulation).

243. See *id.* at 61,244–61,245 (explaining that the seriousness of the violation is the first touchstone, but stating the FERC's intent to adopt enforcement procedures similar to the SEC, CFTC, and FSG).

244. See *id.* at 61,247 (listing the factors the FERC will consider when evaluating the severity of the situation).

245. Policy Statement on Enforcement, 113 F.E.R.C. at 61,243.

246. See *id.* at 61,247–61,249 (presenting the questions the FERC will consider).

247. See *id.* at 61,246 (discussing the approach used by the SEC, the CFTC, and Federal Sentencing Guidelines, and promising to use a similar approach when assessing penalties for violations).

programs,²⁴⁸ the existence of self-reporting,²⁴⁹ and the degree of the violator's cooperation.²⁵⁰ The FERC states that its decisions will "place a high value on internal compliance, self-reporting, and cooperation . . . [and] where many positive factors of internal compliance, self-reporting, and cooperation are present, [it] will take those factors into account in determining the appropriate penalties for violations."²⁵¹

The FERC's new comprehensive approach is illustrated by the extent and variation of the factors it promises to consider in its analysis. Regulatory standards should be flexible enough to adapt to changing economic conditions and technological developments, but clear and specific enough to provide guidance and predictability.²⁵² While the Policy Statement does not contain an exclusive list of the FERC's considerations, it provides a comprehensive guide for the industry.²⁵³ By enumerating certain factors, but leaving the potential for consideration of other issues as they arise, the Policy Statement appears to strike the appropriate balance between broad and vague policies and guidelines that are too tight and specific.²⁵⁴ This clear and comprehensive Policy Statement is one building block in the FERC's new regulatory foundation that will help to produce a stable and efficient regulatory environment.

2. Anti-Manipulation Rule

Throughout the maze of the FERC's market-based rate decisions, there exists a recurring theme of concern about the potential exploitation of market conditions.²⁵⁵ Prior to EPACK 2005, the rate proceeding was the main tool the FERC used to protect ratepayers from potential market manipulation and affiliate abuse.²⁵⁶ Utilizing complex tests like *Edgar* and *Allegheny* the FERC

248. See *id.* at 61,247 (listing the factors it will consider in assessing internal compliance).

249. See *id.* at 61,248 (listing the factors it will consider in assessing self-reporting).

250. See Policy Statement on Enforcement, 113 F.E.R.C. ¶ 61,068, 61,248 (2005) (listing the high standards of cooperation a company must meet to receive favorable treatment).

251. See PHILLIPS, *supra* note 8, at 874–77 (providing an appraisal of how regulations should be).

252. See Policy Statement on Enforcement, 113 F.E.R.C. ¶ 61,068, 61,249 (2005) (providing potential considerations, but reserving the right to reexamine its planned approach).

253. See *id.* at 61,246 (explaining the factors guiding the FERC's Enforcement Remedies).

254. See PHILLIPS, *supra* note 8, at 877 (discussing the compromise effective regulation should strive to achieve).

255. See discussion *supra* Part III.B (discussing the FERC's skeptical view of the industry and its concerns that an affiliate would exploit market conditions).

256. The FERC also required utilities to include a code of conduct in a market-based rate application, and required the utilities to adhere to the Commission's Market Behavior Rules.

prohibited utilities from exploiting market conditions,²⁵⁷ and it seems that fear was the driving force behind these tests.²⁵⁸ EAct 2005 solves this fundamental deficiency, and "provides the FERC with effective tools to assure that market prices are not skewed by manipulative and/or fraudulent behavior to the detriment of consumers."²⁵⁹

EAct 2005 amended the FPA to prohibit the use or employment of manipulative or deceptive devices or contrivances in connection with the purchase or sale of electric energy, or transmission services subject to the jurisdiction of the FERC.²⁶⁰ Rather than building its anti-manipulation approach through individualized decisions, the FERC engaged in a notice and comment rulemaking.²⁶¹ After soliciting and evaluating comments, the FERC issued a Final Rule, Order 670, to prohibit market manipulation.²⁶² Order 670 constitutes the second building block in the FERC's new regulatory foundation.²⁶³

See Prohibition of Energy Market Manipulation, 71 Fed. Reg. 4244, 4254 (Jan. 26, 2006) (to be codified at 18 C.F.R. § 1c) (discussing the Market Behavior Rules and their function).

257. *See* discussion *supra* Part III.B.2 (discussing the FERC's emphasis on tests which prevented affiliates from abusing market conditions).

258. *See* Hon. Joseph T. Kelliher, Chairman Fed. Energy Regulatory Comm'n, Statement on Anti-Manipulation Final Rule (Jan. 19, 2006), <http://www.ferc.gov/press-room/statements/kelliher/2006/01-19-06-kelliher-C-1.asp> (last visited Nov. 13, 2006) ("Congress gave us this [anti-manipulation] authority out of recognition that wholesale power and gas markets had changed dramatically since the 1930s. While our legal duty remains the same—protecting wholesale power and gas consumers—we needed different regulatory tools to discharge this duty.") (on file with the Washington and Lee Law Review).

259. Chair and Immediate Staff, Response to United States Senator Jeff Bingaman, Docket No. RM06-2 (Fed. Energy Reg. Comm'n Oct. 20, 2005), http://elibrary.ferc.gov/idmws/File_list.asp?document_id=4350785 (last visited Nov. 13, 2006) (on file with the Washington and Lee Law Review).

260. *See* Energy Policy Act of 2005, Pub. L. No. 109-58, § 1283, 119 Stat. 594 (giving the FERC the authority to prevent market manipulation).

261. Prohibition of Energy Market Manipulation, 113 F.E.R.C. ¶ 61,067 (proposed Oct. 20, 2005) (to be codified at 18 C.F.R. § 1c).

262. Prohibition of Energy Market Manipulation, 71 Fed. Reg. 4244 (Jan. 26, 2006) (to be codified at 18 C.F.R. § 1c).

263. *See* Prohibition of Energy Market Manipulation, 113 F.E.R.C. ¶ 61,067, 61,243 (proposed Oct. 20, 2005) (to be codified at 18 C.F.R. § 1c) ("The Commission's new EAct 2005 authority under the anti-manipulation provisions coupled with expanded civil penalty authority, provides us with more effective tools to assure workably competitive markets."). The timing of the issuance of the proposed rule is indicative of the Commission's new comprehensive regulatory approach. In a press release, the Commission stated that:

The Commission is of the view that the persistent high energy prices in the wake of severe damage to the United States' energy infrastructure from the hurricanes of 2005, together with the potential for severe price events in the event of cold winter weather during the winter months of 2006, may present opportunity for energy

The anti-manipulation provisions of EPACK 2005 closely track the prohibited conduct language in Section 10(b) of the Securities Exchange Act of 1934.²⁶⁴ The FERC recognized that the provisions are "patterned after SEC's Rule 10b-5, and are intended to be interpreted consistent with analogous SEC precedent that is appropriate under the circumstances."²⁶⁵ Order 670 makes it unlawful for:

Any entity, directly or indirectly . . . in connection with the purchase or sale of electric energy or the purchase or sale of transmission services subject to the jurisdiction of the Commission, (1) to use or employ any device, scheme, or artifice to defraud, (2) to make any untrue statement or a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (3) to engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity.²⁶⁶

Although the FERC did not vary its position from the NOPR, it did provide adequate consideration and evaluation of the issues raised by commentators.²⁶⁷

The FERC's consideration of the issues raised by the commentators illustrates its new, responsive behavior.²⁶⁸ In Order 670, the FERC considered

price manipulation Immediate adoption of the Final Rule will protect natural gas and electricity markets from manipulative conduct.

Press Release, Fed. Energy Reg. Comm'n, Comm'n. Finalizes Rule Barring Mkt. Manipulation (Jan. 19, 2006), http://elibrary.ferc.gov/idmws/File_list.asp?document_id=4371695 (last visited Nov. 13, 2006) (on file with the Washington and Lee Law Review).

264. See *Prohibition of Energy Market Manipulation*, 71 Fed. Reg. at 4249–55 (explaining the similarity between the two sections).

265. See *id.* (discussing 10b-5). The SEC's Rule 10b-5 states that:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Employment of Manipulative and Deceptive Devices, 17 C.F.R. § 240.10b-5 (2005).

266. *Prohibition of Energy Market Manipulation*, 71 Fed. Reg. at 4244.

267. See *id.* (addressing the issues presented in the comments). The comments identify a number of issues, including the Final Rule's scope, the usefulness of securities precedents to the energy industry, disclosure implications, elements of a violation, the interaction with market behavior rules, and a variety of procedural matters. See generally Public Comments, Docket No. RM06-3 (Fed. Energy Reg. Comm'n), http://elibrary.ferc.gov/idmws/docket_search.asp (last visited Nov. 13, 2006) (on file with the Washington and Lee Law Review).

268. See *Prohibition of Energy Market Manipulation*, 71 Fed. Reg. at 4249–55 (finding

Congressional intent,²⁶⁹ SEC precedent,²⁷⁰ and the particularities of the energy industry.²⁷¹ The FERC's reasoned and logical responses show the FERC's new practice of considering and responding to the industry's issues and concerns.²⁷² The FERC's clear and comprehensive rule prohibiting market manipulation is the second foundational building block that will facilitate production of a stable and efficient regulatory environment.²⁷³

3. *No-Action Letter Process*

The final building block of the FERC's new regulatory foundation is the adoption of the no-action letter policy. The no-action letter process will make available informal, advance advice by staff on transactions that could otherwise lead to an enforcement action later.²⁷⁴ The new FERC recognizes that "[c]ompliance should not be elusive, it should not be subjective; it should be objective to the greatest extent possible."²⁷⁵ The FERC's adoption of the no-action letter process illustrates the FERC's shift from a reactive to a proactive

that it is appropriate to model the Final Rule on SEC Rule 10b-5 in an effort to prevent fraud and manipulation affecting the markets the Commission is entrusted to protect).

269. *See id.* at 4248 ("Had Congress intended to expand the Commission's jurisdiction so significantly as to give it anti-manipulation authority over such transactions as . . . intrastate sales of electric energy, retail sales of electric energy or energy sales by governmental entities, we believe it would have done so explicitly."); *Id.* (deciding whether the limiting phrase "subject to the jurisdiction of the Commission" applies to only one or both the purchase or sale of electric energy and the purchase or sale of transmission services).

270. *See id.* at 4259–55 (analyzing the elements necessary for a SEC enforcement claim under 10b-5 and the history of interpretation of those elements).

271. *See id.* (giving consideration about which SEC precedents were applicable to the energy industry).

272. *See id.* at 4248–55 (responding in a clear and concise manner to all major issues raised in the public comments).

273. *See* Joseph T. Kelliher, Chairman, Fed. Energy Regulatory Comm'n, Statement on Market Behavioral Rules (Feb. 16, 2006), <http://elibrary.ferc.gov/idmws/nvcommon/NVViewer.asp?Doc=10955844:0> (last visited Nov. 13, 2006) ("[W]e take this action to reduce regulatory uncertainty, to assure that all market participants are held to the same standard, and to provide clarity to persons subject to our rules and regulations.") (on file with the Washington and Lee Law Review).

274. *See* Interpretative Order Regarding No-Action Process, 113 F.E.R.C. ¶ 61,174 (2005) (describing the no-action letter process).

275. Press Release, Hon. Joseph T. Kelliher, Chairman, Fed. Energy Regulatory Comm'n, Establishing a Clearer "No-Action" Letter Process (Nov. 17, 2005), <http://www.ferc.gov/press-room/statements/kelliher/11-17-05-kelliher-action.asp> (last visited Nov. 13, 2006) (on file with the Washington and Lee Law Review).

stance, and reaffirms the agency's express commitment to provide clarity and regulatory certainty.²⁷⁶

The SEC recognizes the relationship between proactive measures and industry compliance, and utilizes no-action letters regularly to respond to proposed transactions.²⁷⁷ This allows the SEC to quickly and effectively respond to new industry issues and proposals.²⁷⁸ While non-binding, the no-action letter still provides valuable guidance to the industry.²⁷⁹ The use of the no-action letter process is one part of the SEC's proactive and comprehensive regulatory approach, and its use has helped to produce a stable and effective regulatory environment.²⁸⁰ If the FERC continues to model its behavior off of the SEC, it will likely produce a similar regulatory environment.

The use of the no-action letter process also indicates a new relationship between the FERC and the industry. In its rule, the FERC noted that:

A number of industry participants have expressed concerns about the perceived ambiguity and vagueness of the Standards of Conduct and Market Behavior Rules and uncertainty about how they apply to the varied corporate structures, business operations and trading strategies of companies subject to the Commission's jurisdiction. There have been several suggestions that the Commission consider implementing a no-action letter process similar to those made available by the staffs of the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) to provide, in advance, increased certainty on whether particular transactions, practices or situations would be subject to agency enforcement action.²⁸¹

Promising guidance in advance reflects a shift in the FERC's regulatory behavior.²⁸² Contrasted with the FERC's prior skepticism, this statement shows that the agency recognizes the value of a quick and guiding response.²⁸³ The

276. See Press Release, Commission Implements "No-Action" Letter Process Designed to Help Clarify its Rules (Nov. 17, 2005), http://elibrary.ferc.gov/idmws/File_list.asp?document_id=4355750 (last visited Nov. 13, 2006) (explaining the reasons behind the FERC's adoption of the no-action letter process) (on file with the Washington and Lee Law Review).

277. See LARRY D. SODERQUIST & THERESA A. GABALDON, *SECURITIES REGULATION* 12-13 (5th ed. 2003) (discussing the SEC's use of no-action letters).

278. See *id.* (discussing the SEC's no-action letter process).

279. See *id.* (discussing the non-binding nature of the SEC's releases and no-action letters).

280. See discussion *supra* Part III.A (discussing the SEC's regulatory approach and the resulting regulatory environment).

281. Interpretive Order Regarding No-Action Process, 113 F.E.R.C. ¶ 61,174, 61,707 (2005).

282. See discussion *supra* Part III.B (discussing the FERC's reactive approach which did not focus on providing industry guidance).

283. See discussion *supra* Part III (discussing the FERC's skeptical view of the industry

FERC's responsiveness to the industry, and recognition of the values of regulatory certainty, indicate that the FERC's regulatory approach is changing.

C. Will the FERC Remain Committed to Its New Regulatory Approach?

The FERC has recently built a foundation for a new regulatory environment, but only time will tell if the FERC will remain committed to its new approach. While a Chairman can have a significant impact on the development of a commission, the staff performs the majority of the regulatory functions.²⁸⁴ These recent FERC actions have been initiated and directed by the Chairman, with the help and assistance of the staff. The next few years will determine if the Commission as a whole is committed to changing FERC's regulatory approach.²⁸⁵ Without a regulator of the regulators, it becomes the role of practitioners to ensure that the FERC remains committed to its new regulatory character.²⁸⁶

The first signal of the FERC's true regulatory personality will be the FERC's future use of the no-action letter. The no-action order only allows a utility to seek a no-action letter if the matter relates to the "Standards of Conduct for Transmission Providers, Market Behavior Rules, and the Prohibition of Energy Market Manipulation Rules."²⁸⁷ The FERC classifies this as an initial limitation.²⁸⁸ The FERC claims that its mission is to produce a firm, but fair, regulatory environment, and notes that this can only be achieved if the regulated utilities have notice of the factors the FERC will consider.²⁸⁹ The FERC also recognizes that "the no-action letter process can yield significant benefits to the entities subject to the statutes, regulations, rules, and

and explaining how the FERC's skepticism led to close scrutiny).

284. See PHILLIPS, *supra* note 8, at 877 (discussing the FERC's workload and the role of the staff in performing many duties with the Commissioners oversight).

285. See No-Action Process, 113 F.E.R.C. at 61,708 (noting that the ability of the staff to provide informal advice on matters pertaining to regulatory requirements is valuable and that the FERC fully intends the staff continue its present efforts).

286. For a complete discussion of the need for regulatory oversight, see generally JAMES R. BOWERS, *REGULATING THE REGULATORS: AN INTRODUCTION TO THE LEGISLATIVE OVERSIGHT OF ADMINISTRATIVE RULEMAKING* (1990).

287. See No Action Process, 113 F.E.R.C. at 61,707 (discussing the initial limitations on the use of the no-action letter).

288. See *id.* at 61,709 (stating that, as the Commission gains experience with the no-action letter process it may, in the future, change the matters that may be subject to requests for no-action letters).

289. See Policy Statement on Enforcement, 113 F.E.R.C. ¶ 61,068, 61,247 (2005) (discussing the need to inform the industry of the factors when assessing penalties).

orders administered by the Commission."²⁹⁰ As the FERC gains experience with the no-action letter process, the extensions or further limitations on its use will indicate the FERC's evolving nature. If the FERC is truly a proactive and comprehensive agency committed to regulatory certainty, it will extend the availability of its no-action letter process to maximize regulatory certainty and promote industry development.²⁹¹

In addition, the consistency of the no-action letters will help to evaluate changes in the FERC's regulatory behavior. The first area to look to will be the staff's consistency.²⁹² To achieve the FERC's promised firm, but fair, regulatory environment, and to provide regulatory certainty, the staff will need to be consistent in the answers given in the no-action letters. All no-action letter requests are to be submitted to the General Counsel, and the issue will be examined by staff who are familiar with the regulations on which the no-action letter process is focused.²⁹³ The consistency of both the delegations and the answers will help to judge whether the FERC's regulatory actions comport with its rhetoric. The second area to look to will be the FERC's consistency in deferring to the staff's judgment.²⁹⁴ The FERC has promised regulatory certainty, and it is the duty of the commissioners to ensure certainty in the no-action letter process. The FERC's consistent deference to the staff's determinations, the degree that the commissioners scrutinize the staff's findings, or the extent the commissioners remedy inconsistencies in the no-action letters will help to illuminate the FERC's true regulatory approach. To provide regulatory certainty, the treatment of no-action letters by the staff and the commissioners must be consistent.

The second signal of the FERC's true regulatory personality will be its adherence to the factors and considerations set forth in the Policy Statement. The FERC declined to "prescribe specific penalties or develop formulas for different violations," and chose to "retain the discretion and flexibility to address each case on its merits, and to fashion remedies appropriate to the facts presented."²⁹⁵ In adopting such an individualized approach, there is the danger that the FERC will regress to reactionary regulation, and consistency and certainty will be lost. The FERC has promised to "develop a consistent

290. No Action Process, 113 F.E.R.C. at 61,708.

291. See discussion *supra* Part IV.B.3 (discussing the value of the no-action letter process).

292. See PHILLIPS, *supra* note 8, at 877 (discussing the role and influence of the staff).

293. See Policy Statement on Enforcement, 113 F.E.R.C. ¶ 61,068, 61,709 (2005) (discussing the procedures for submitting questions).

294. See PHILLIPS, *supra* note 8, at 877 (noting that effective regulation requires that the commissioners take responsibility for all phases of opinions).

295. See Policy Statement on Enforcement, 113 F.E.R.C. ¶ 61,068, 61,246 (2005).

approach to the amount of penalties for misconduct so that the penalties are similar in analogous cases, and are evenhanded for similar conduct."²⁹⁶ The degree of consistency, and the depth of the explanations for inconsistencies, will help to judge the FERC's true regulatory approach. Inconsistency and a lack of guiding standards will indicate a regression to old regulatory patterns, while consistent applications and thorough explanations will indicate adoption of the new proactive and comprehensive regulatory approach.

The final signal of the FERC's true regulatory personality will be the degree of consistency in market manipulation enforcement actions. In developing standards of market-manipulation, the FERC is in a situation similar to its initial market-based rate decisions.²⁹⁷ In adjusting to its market rate regulation, the FERC started off on solid ground, but quickly entered into a quagmire of complex tests and seemingly inconsistent analyses.²⁹⁸ The similarity of situations makes the FERC's market-based rate decisions an appropriate juxtaposition to its new market manipulation enforcement duties. The similarities and differences between the two will fully illustrate the degree of change in the FERC's regulatory behavior.

V. Conclusion

Through the Policy Statement, Order 670, and adoption of the no-action letter process, the FERC has laid the foundation necessary to produce an efficient and stable regulatory environment.²⁹⁹ To achieve the goals of EPAct 2005, the FERC regulatory environment needs to encourage industry developments.³⁰⁰ PUHCA 2005 was intended to be a books and records statute, not a "massive new regulatory regime."³⁰¹ The purpose of PUHCA 2005 is to "help attract needed investment in the nation's electric utility infrastructure by

296. *Id.*

297. See discussion *supra* Part III.B.2 (discussing the FERC's new role as a market regulator, and the development of an unstable regulatory environment when the FERC could not come up with clear rules to guide the industry).

298. See discussion *supra* Part III.B.2 (discussing the FERC's new role as a market regulator and the complex and fragmented policies it used to perform its new duties).

299. See discussion *supra* Part IV.B (discussing the recent actions that illustrate the FERC's new regulatory foundation).

300. See PHILLIPS, *supra* note 8, at 878 (discussing problems that arise from a slow and inefficient regulatory commission).

301. See Reply Comments of Congressman Joe Barton at 1, Docket No. RM05-32 (Fed. Energy Reg. Comm'n Oct. 21, 2005), http://elibrary.ferc.gov/idmws/File_list.asp?document_id=4349284 (last visited Nov. 13, 2006) (on file with the Washington and Lee Law Review).

eliminating arcane, duplicative, and burdensome regulations that have hindered investment."³⁰² A proactive and comprehensive rules and regulations approach will help to achieve the goals of EPACK 2005.³⁰³

The FERC has been a reactive agency characterized by fragmented policies, and its regulatory behavior has produced an unstable and inefficient regulatory environment.³⁰⁴ In administering a parallel track of regulation, the SEC produced a stable and efficient regulatory environment by adopting a proactive and comprehensive approach to regulation.³⁰⁵ Fortunately, recent FERC actions indicate that the FERC is undergoing a personality transformation. The FERC has met every one of the ambitious deadlines of EPACK 2005,³⁰⁶ and it appears that the FERC is embracing a proactive and comprehensive rules and regulations approach.³⁰⁷ The FERC's new approach to regulation mirrors the SEC's approach in administering PUHCA 1935, and it is likely that if the FERC continues to follow the example of the SEC, it will produce a stable and efficient electric utility regulatory environment.

However, old habits die hard. The FERC has taken steps that indicated a personality change before, but it failed to provide regulatory decisions that were in line with its stated policy approach.³⁰⁸ EPACK 2005 decisions are in their early stages, and there is the possibility that the FERC will revert to its reactive and fragmented approach. Only time will tell which regulatory personality the FERC will embrace. EPACK 2005 anticipates great developments in the energy industry, and a stable and efficient regulatory environment will likely support and facilitate industry advancements. If the FERC continues on this path of change, the goals of EPACK 2005 will be more readily achievable. It will be the role of practitioners to ensure the FERC remains committed its new regulatory approach.

302. *Id.* at 3.

303. See discussion *supra* Part III.A (discussing how the SEC achieved the goals of PUHCA 1935 through its creation of a stable and efficient regulatory environment).

304. See discussion *supra* Part III.B (discussing the FERC's reactive decisions, fragmented policy development, and the resulting uncertainty for the regulated utilities).

305. See discussion *supra* Part III.A (discussing the SEC's successful administration of PUHCA 1935).

306. For full details of the Commission's EPACK 2005 actions and progress, explore the FERC's designated EPACK 2005 webpage at <http://www.ferc.gov/legal/maj-ord-reg/fed-sta/enepol-act.asp>.

307. See discussion *supra* Part IV.B (discussing recent FERC actions and the FERC's new regulatory foundation).

308. See discussion *supra* Part IV.A (discussing the FERC's failed generic rate of return rule).

