

SYMPOSIUM

THE CHANGING LANDSCAPE OF FEDERAL ENERGY LAW

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INTRODUCTION

I recognize that some readers may believe the title of this Article, *The Changing Landscape of Federal Energy Law*, is inapposite. Energy law may be perceived as static or ossified, resistant to change. To some, the pace of change in federal energy law may appear to be geologic, advancing at a crawl. A closer look shows that the changes to federal energy law have been very significant in recent years, that the pace of change has been increasing, and that there is the prospect of sweeping change in the near future. Energy law truly is a dynamic area of law.

Energy law, as discussed in this Article, does not encompass the full range of energy laws, but instead is limited to the laws administered by the Federal Energy Regulatory Commission (FERC). Energy industries have existed for more than 100 years, and many energy laws were enacted decades ago. FERC administers five principal statutes: Part I of the Federal Power Act,¹ governing the licensing and operation of nonfederal hydropower projects; Part II of the Federal Power Act,² regulating wholesale power sales, the transmission of electric energy in interstate commerce, and the review of public utility mergers and acquisitions and other public utility corporate transactions; the Natural Gas Act,³ providing a comprehensive scheme to regulate certain wholesale natural gas sales and interstate transportation of natural gas; the Natural Gas Policy Act of 1978,⁴ authorizing certain transactions by interstate and intrastate natural gas pipelines; and the Hepburn Act, providing for economic regulation of crude oil and petroleum product pipelines. The youngest of these statutes, the Natural Gas Policy Act of 1978, is thirty years old. The oldest of the other four laws is the Hepburn Act of 1906.⁵ Part I of the Federal Power Act was enacted nearly ninety years ago, while the others, Part II of the Federal Power Act and the Natural Gas Act, were enacted seventy years ago during the New Deal.

1. 16 U.S.C. §§ 792–823d (2006).

2. *Id.* §§ 824–824w.

3. 15 U.S.C. §§ 717–717w (2006).

4. *Id.* §§ 3301–3432.

5. Hepburn Act, ch. 3591, 34 Stat. 584 (1906) (codified as amended in scattered sections of 49 U.S.C.). Although the Hepburn Act is the oldest of these four statutes, it was only entrusted to FERC administration relatively recently, in 1977. 42 U.S.C. §§ 7155, 7172 (2006). Interestingly, FERC administers the Hepburn Act as it existed in 1977, not as it exists today, under the terms of the Department of Energy Reorganization Act of 1977.

However, some of these four older laws have changed more significantly in the past fifteen years than in the prior half century or more. Part II of the Federal Power Act and the Natural Gas Act have changed from a regulatory scheme that controlled market power exercise by utilities, pipelines, and producers through classic rate regulation to a regulatory regime that controls the exercise of market power through reliance on a mixture of competition and regulation. This change was accomplished by congressional amendments to Part II of the Federal Power Act and the National Gas Act and through reinterpretation of the laws by FERC and the courts. It could be argued that more dramatic change was accomplished through reinterpretation than through enactment of legislative amendments.

Energy law is poised for even greater change in the future. The United States has a carbon-based economy, and our energy sector is founded on fossil fuel use. The likelihood is growing that the United States will commit itself to some manner of mandatory reduction in carbon emissions. Any carbon-reduction scheme will have profound implications for energy policy and law, because climate-change policy is as much energy policy as environmental policy.

Part I of this Article reviews the factors that cause the need to change energy law over time. Part II discusses the manner in which energy law has changed and likely will continue to change, including enactment of new legislation, court decisions that change interpretations of existing law, and agency reinterpretations.

I. THE REASONS ENERGY LAW IS SUBJECT TO CHANGE

Although the principal federal energy laws were enacted many years ago, energy law is not a static area. There are certain factors that cause the need to change energy law over time, including the dynamic nature of energy markets, technological developments, convergence of energy markets with other markets, and the rising tension between energy and environmental law and policy.

A. *Dynamic Markets*

A principal factor that drives changes in federal energy law is the nature of energy markets themselves. Energy markets are not static; they are highly dynamic. Two of the markets FERC regulates are the wholesale electricity and natural gas markets. There have been striking changes in electricity and natural gas markets since the principal laws that govern these markets, the Federal Power Act and the Natural Gas Act, were enacted seventy years ago.

Electricity markets today are remarkably different from those that

existed in 1935, when Part II of the Federal Power Act was enacted. In 1935, electricity markets were local in nature, with power plants located in major cities selling power to nearby areas through local distribution systems. There was very little interstate commerce in electricity. Today, with the development of the interstate power grid, electricity markets are not only interstate, but they are also international. Wholesale power markets in the United States are entwined with Canadian electricity markets. The level and volume of wholesale power trades have risen sharply in recent years.

In the 1930s, there was no interstate power grid and electricity delivery was local in nature. Congress did not anticipate the development of an interstate and international bulk power grid because Part II of the Federal Power Act provided for siting of transmission facilities under state law. However, that assumption proved false, and the bulk power system developed in the decades following enactment. Today, the power grid is not only interstate but is also international, fully interconnected with Canada and part of Mexico.

There have been major changes in wholesale natural gas markets as well. The U.S. natural gas pipeline network, which was interstate even in the 1930s, has become international as well, fully integrated with Canada and part of Mexico. Gas trading has become highly sophisticated, with regional pricing hubs and a range of standard products. There has also been a level of convergence between physical natural gas markets and financial energy markets, which is discussed below.

The nature of wholesale gas markets is changing in another respect. The North American natural gas market is becoming more international, becoming integrated to some extent with gas markets in Europe and Asia. The reason for this development is increased imports of liquefied natural gas (LNG) into the United States. The United States is competing with Europe and Asia for LNG imports, a competition we are not predestined to win.

The nature of natural gas production has also changed. In 1938, when the Natural Gas Act was enacted, natural gas production was limited to onshore areas; there was virtually no offshore natural gas production. This began to change soon after enactment, and U.S. natural gas production now extends well into the Gulf of Mexico and other offshore areas. Since Congress did not anticipate the shift in production to offshore areas, it did not provide for jurisdiction over offshore gathering in federal waters in the Natural Gas Act.

Not only are the markets different, the industry structure itself is different. In the 1930s, it was assumed there was a natural monopoly in electricity generation. Technological change destroyed that assumption

twenty-five years ago; instead of relying on vertically integrated utilities for electricity supply additions, the United States increasingly turned to independent power producers—a class of market participant that did not exist in the 1930s. Many of these new participants also developed new or improved technologies such as wind power, solar power, and other power sources. Electricity traders and marketers did not exist in 1935, but now they are some of the largest power sellers. Large parts of the interstate power grid are operated by regional transmission organizations and independent system operators, some of which also operate centralized power auctions. These entities also did not exist in 1935, and nothing in Part II of the Federal Power Act belies any anticipation by Congress that these institutions would develop. Wholesale gas markets are no longer strictly limited to producers, pipelines, and local distribution companies, as was the case in the 1930s when the Natural Gas Act was enacted, and traders and marketers now play an increasingly important role in these markets.

Congress did not anticipate these market developments and changes in industry structure when it enacted Part II of the Federal Power Act and the Natural Gas Act. That is reflected in the siting provisions of Part II of the Federal Power Act and the Natural Gas Act with respect to electric transmission facilities and interstate natural gas pipelines. Part II of the Federal Power Act and the Natural Gas Act both provided for siting of these facilities under state law. That was probably sensible in 1935, when there was no interstate power grid. If electricity delivery were to remain local in nature, state siting was entirely appropriate. Congress can hardly be faulted for not anticipating the development of the transmission grid in the ensuing decades. But that interstate grid developed nonetheless, while the Federal Power Act remains rooted in an implicit, but now false, assumption that electricity markets are characterized by local delivery. Congress recognized its error with respect to interstate natural gas pipelines and corrected the law. Recognizing that state siting of an interstate natural gas pipeline network was failing, Congress amended the Natural Gas Act in 1947 to provide for exclusive and preemptive federal pipeline siting.⁶

The real surprise is that the laws, conceived and drafted during the 1930s to regulate wholesale power and natural gas markets that have changed so dramatically, still work effectively. At one level, that is a tribute to how well many of the New Deal statutes were written. New Deal laws reflect a certain attitude toward regulatory agencies and toward regulation itself. Laws written during the New Deal generally grant a higher level of discretion to federal regulatory agencies than laws enacted during the past

6. Natural Gas Amendments of 1947, 15 U.S.C. § 717f(h) (2006).

thirty years. As a case in point, compare the Federal Power Act or the Natural Gas Act with the Clean Air Act Amendments of 1990⁷ or the Telecommunications Act of 1996.⁸ The newer laws evince an entirely different attitude by Congress toward regulatory agencies. Law enacted during the New Deal manifests a fundamental trust in regulatory bodies; many laws of a more recent vintage convey a lesser degree of trust in the exercise of discretion by agencies.

B. Technology

Another factor fostering change in regulated industries is technology, because technological change can introduce dynamic change in markets. This Article has already noted how technology destroyed the perceived natural monopoly in electricity generation. That technological change made possible a fundamental shift in federal electricity policy, namely the advent of competition policy and the introduction of competition into wholesale power markets.

Technological change was the predicate for competition policy, which relies on competitive forces and entry and the threat of entry by nonutility generators to assure adequacy of U.S. electricity supply at a reasonable cost, instead of complete reliance on rate-based generation additions by vertically integrated utilities. Part II of the Federal Power Act clearly anticipated some level of competition even in 1935, since the Act uses the term *contract* in a number of places, recognizing there was some level of wholesale power sales at the time of enactment, and an anticipation that commerce would continue.⁹ Competition has been lawful in wholesale power markets since the 1930s, despite a number of legal challenges.¹⁰ The courts found there is no constitutional right to be free from competition in wholesale power sales.¹¹

However, until the development of improved gas-turbine technology, the level of competition in wholesale power markets was very low. In a very real sense, competition policy, the most important change in federal electricity policy over the past thirty years, was made possible by technological developments. In 1978, vertically integrated utilities

7. Clean Air Act Amendments of 1990, Pub. L. No. 101-549, 104 Stat. 2399 (1990) (codified as amended at 42 U.S.C. §§ 7401–7671 (2006)).

8. Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (codified at 47 U.S.C. §§ 151–161 (2000)).

9. Joseph T. Kelliher, *Market Manipulation, Market Power, and the Authority of the Federal Energy Regulatory Commission*, 26 ENERGY L.J. 1, 6 & n.27 (2005).

10. *Id.*

11. See, e.g., *Tenn. Elec. Power Co. v. Tenn. Valley Auth.*, 306 U.S. 118, 139 (1939) (“The franchise to exist as a corporation, and to function as a public utility . . . creates no right to be free of competition . . .”); see also Kelliher, *supra* note 9, at 6 & n.27.

controlled 97% of the electricity generation capacity in the United States.¹² Yet, over the last twenty-five years, independent power producers have accounted for most of the increase in the U.S. electricity supply. Competition policy in natural gas markets did not have the same technological spark, and the origins of competition policy as it relates to wholesale gas policy are rooted more in antitrust principles than technology development.

Competition policy was adopted as national policy for both wholesale power and natural gas markets thirty years ago. This policy was established through a series of federal laws enacted over that period, beginning with the Public Utility Regulatory Policies Act of 1978 and the Natural Gas Policy Act, then the Natural Gas Wellhead Decontrol Act of 1989 and the Energy Policy Act of 1992, and through the Energy Policy Act of 2005.

Future technological developments may also require changes in energy law. If the United States commits to a mandatory carbon-reduction regime, there will be vigorous efforts to develop a host of new technologies to achieve that end. These may include carbon capture and sequestration technologies. If the United States is successful in developing this technology, then in all likelihood there will be a need for a regulatory regime to site carbon dioxide pipelines and storage facilities, and to set rates governing operation of these facilities. No such regulatory regime currently exists in the United States. Congress has taken the first steps to discuss the possible framework for regulation of these technologies if they are developed.¹³

C. Market Convergence

As discussed above, markets change. However, markets can also converge, which in turn can drive changes in energy law. For example, it was not so many years ago that it could be said with confidence that energy and commodities markets were entirely separate domains¹⁴—with FERC

12. Kelliher, *supra* note 9, at 6.

13. See generally *Regulatory Aspects of Carbon Capture, Transportation, and Sequestration: Hearing Before the S. Comm. on Energy and Natural Resources*, 110th Cong. (2008) [hereinafter *Hearing*].

14. See STAFF OF PERMANENT SUBCOMM. ON INVESTIGATIONS, S. COMM. ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS, 110TH CONG., EXCESSIVE SPECULATION IN THE NATURAL GAS MARKETS 24 (Comm. Print 2007) (“In recent years, instead of using a published monthly index price derived from reported prices, buyers and sellers are increasingly referencing the relevant NYMEX futures contract for delivery of natural gas and using the price that is finally settled on for delivery of gas under that standard monthly contract.”) (emphasis added); FERC, 2006 STATE OF THE MARKETS REPORT 48 (2006) (“As a practical matter, monthly cash physical and futures natural gas prices are and must be

regulating physical natural gas sales under the Natural Gas Act and the Commodity Futures Trading Commission (CFTC) regulating financial sales under the Commodity Exchange Act.¹⁵ However, there has been some convergence between these markets so that these distinctions have become blurred, resulting in some friction between the agencies.¹⁶

Convergence between energy markets and commodities markets can be demonstrated in part by examining transactions. Some wholesale natural gas transactions are capable of being settled either financially or through physical delivery, so a bright line between a physical natural gas sale and a financial energy product is difficult to identify. Moreover, certain commodity transactions establish or shape the price of physical natural gas sales, such as the monthly futures product traded at the New York Mercantile Exchange.¹⁷ If the pricing of physical and financial sales are linked, then some level of market convergence has occurred.

The level of convergence between physical and financial markets in natural gas markets is undoubtedly greater than in electricity markets at this point. But as wholesale power markets continue to develop, it is likely that there will be a steady increase in the level of power transactions that resemble other commodity markets, which, with increasingly liquid markets, will lead to a convergence similar to that which has already occurred in natural gas markets. The convergence of electricity and commodity markets will accelerate and grow much stronger if the United States adopts a cap-and-trade carbon-reduction regime, since wholesale electricity prices will be heavily influenced by the cost of carbon emissions allowances.

As long as these markets were entirely separate, it was tenable to regulate them by separate agencies operating under entirely different

closely related to one another [A]ny material differences will be arbitrated away. . . . [B]ig changes in cash physical market values naturally affect futures trading, and vice versa.”).

15. 7 U.S.C. §§ 1–25 (2006).

16. For example, in *Amaranth Advisors L.L.C.*, 120 F.E.R.C. ¶ 61,085 (2007), FERC required various entities to show cause why they had not violated a Commission regulation which prohibits the manipulation of natural gas prices. The Commission explained,

This case concerns the important nexus between the wholesale interstate natural gas markets subject to our jurisdiction and the New York Mercantile Exchange (NYMEX) Natural Gas Futures Contract (NG Futures Contract). In recent years, many market participants in the physical natural gas markets have used the NG Futures Contract as a significant benchmark for prices in physical natural gas. In this case, manipulation of Commission-jurisdictional prices resulted from manipulation of the NG Futures Contract.

Id. para. 2.

17. See, e.g., *id.* para. 108 (“First, the settlement price directly sets the price for any contracts that ultimately go to delivery at Henry Hub. Second, the settlement price is directly incorporated into the price for physical basis transactions.”).

statutory authority. These legal and regulatory regimes were seen as separate areas of law, one labeled “energy law” and another labeled “commodities law.” There was no reason for FERC and the CFTC to coordinate their actions when the markets were divergent and little reason for the agencies to understand each other’s regulatory regimes. However, as some level of convergence has occurred, these legal domains have moved closer, and it has become increasingly necessary for FERC and the CFTC to coordinate investigations and market oversight.¹⁸

The agencies took an important step to improve coordination of investigations with the adoption of the Memorandum of Understanding between FERC and the CFTC to facilitate sharing of information relating to market oversight and ongoing investigations between the two agencies.¹⁹ This memorandum recognized that the need for cooperation between the agencies was not temporary, but continuing, and that there was a benefit to formalizing arrangements for coordinating investigations. That has been borne out, since the number of joint and coordinated FERC–CFTC investigations has increased steadily in recent years.

This market convergence creates the prospect of market manipulation across product lines, manipulation of physical natural gas products to extract gains from transactions in financial products, or the reverse. FERC and CFTC investigations have identified possible manipulation across product lines.²⁰ This prospect is reflected in recent legislation amending energy law. For example, the Energy Policy Act of 2005 includes amendments to the Natural Gas Act that establish an express prohibition of the manipulation of wholesale power markets. Significantly, those provisions extend beyond the traditional universe regulated by FERC under the Act, namely “natural gas companies,” to a broader universe of market participants.²¹ That distinction recognizes the prospect of market

18. See MEMORANDUM OF UNDERSTANDING BETWEEN THE FEDERAL ENERGY REGULATORY COMMISSION (FERC) AND THE COMMODITY FUTURES TRADING COMMISSION (CFTC) REGARDING INFORMATION SHARING AND TREATMENT OF PROPRIETARY TRADING AND OTHER INFORMATION 3 (2005) (“[T]he CFTC and the FERC may from time to time engage in oversight or investigations of activity affecting both CFTC-jurisdictional and FERC-jurisdictional markets.”).

19. *Id.*

20. Amaranth Advisors L.L.C., 120 F.E.R.C. ¶ 61,085 (2007); Energy Transfer Partners, L.P., 120 F.E.R.C. ¶ 61,086 (2007); CFTC v. Amaranth Advisors L.L.C., 554 F. Supp. 2d 523 (S.D.N.Y. 2008).

21. Section 315 of the Energy Policy Act of 2005 added a new § 4A to the Natural Gas Act, prohibiting manipulation of wholesale natural gas markets. Energy Policy Act of 2005, Pub. L. No. 109-58, § 315, 119 Stat. 691 (2005) (codified as amended at 15 U.S.C. § 717c-1 (2006)). The prohibition on market manipulation applies to *any entity*, an undefined term, but a term broader than *natural gas company* as defined in the Natural Gas Act. Natural Gas Act § 2(6), 15 U.S.C. § 717a(6) (2006). FERC has defined *any entity* to include any person or form of organization regardless of its legal status, function, or activities.

manipulation across product lines and that to protect wholesale natural gas consumers from exploitation, it may be necessary to reach across product lines, in enforcement actions, without interfering with CFTC futures regulation.

Manipulation across product lines in turn creates the prospect of tension between FERC and the CFTC, each of which otherwise possesses exclusive jurisdiction to regulate wholesale natural gas markets and futures markets, respectively. That potential for tension has also been realized, unfortunately. At the same time as the number of joint and coordinated investigations has increased apace, FERC and the CFTC have been engaged in a jurisdictional dispute as to the extent of FERC's authority to sanction market manipulation of futures if it affects jurisdictional wholesale natural gas markets.

This market convergence is also reflected in the entry of financial-sector firms into energy markets. Over the past ten years, the financial sector has entered electricity and natural gas markets, and has become a significant market participant. In addition, the role of the financial sector in wholesale power and natural gas trading and marketing has grown considerably in recent years, and many of the largest power and gas trading and marketing firms are now financial-sector firms.²² This is a significant change from only a few years ago, when trading and marketing was dominated by traditional energy companies.²³

That has implications for FERC, given the recent turmoil in the financial sector. At the beginning of 2008, there were five large investment banks in the United States; today, there are none. Two of these banks have been acquired, one is in bankruptcy, and two converted to bank holding companies regulated by the Federal Reserve. The financial crisis has implications for FERC, and not just because it raises legitimate questions about the ability of electricity and natural gas companies regulated by FERC to raise capital to fund operations and necessary infrastructure development; it also may impair the participation of financial-sector firms in wholesale power and natural gas markets. Some of the former investment banks were large wholesale power and gas traders, and there are questions as to whether they can engage in the same level of FERC-regulated trading and marketing activity as bank holding companies as they

Prohibition of Energy Market Manipulation, 71 Fed. Reg. 4244, 4248 (Jan. 26, 2006) (to be codified at 18 C.F.R. pt. 1c).

22. *Economy Fails to Stem Rise in Marketing Volumes*, GAS DAILY, Dec. 16, 2008, at 1, 5–7; *Leading Power Traders on Borrowed Time: Constellation and Big Banks Keep Q2 Lively*, POWER MARKETS WK., Sept. 29, 2008, at 1, 18–26.

23. *Top-Heavy Marketer Rankings Reflect Volatility*, GAS DAILY, Feb. 9, 2001, at 1, 8; *Merrill Lynch Now Among Big Sellers, May Augur New Role for Financial Firms*, POWER MARKETS WK., June 5, 2000, at 1, 18–19.

did as investment banks. To better understand how the Federal Reserve and financial regulators will govern bank activity in wholesale power and natural gas markets, FERC may have to pursue periodic discussions with the Federal Reserve, something that could hardly have been imagined before the crisis.

There is another form of entry by the financial sector into the energy industry, through passive ownership of energy company securities. Increasingly, investment firms are purchasing significant ownership interests in energy companies subject to FERC jurisdiction, particularly power companies. This has led to a series of FERC orders authorizing such transactions, in some cases with certain conditions.²⁴ In the course of some of these decisions, FERC has had to weigh the requirements of financial services laws such as the Investment Advisers Act of 1940. There may be a need for improved coordination between FERC and financial regulators.

D. Energy and Environmental Law

There is another area where the distinction between two different legal domains has become increasingly artificial, if not entirely abstract, namely energy law and environmental law. However, the notion that these legal domains are separate is deeply ingrained. In most respects, the notion that energy policy and environmental policy are separate domains is a workable fiction. But it is completely untenable when it comes to climate change.

I must admit I persisted in the abstraction that energy policy and environmental policy were separate for some time, and I was slow to recognize that climate-change policy was as much energy policy as environmental policy. I would shy away from discussions and deliberations on climate-change policy on the basis that it was environmental policy, and that it was either bad manners or bad form for an energy regulator to intrude into deliberations on environmental policy.

But climate-change policy is not just environmental policy—it is also energy policy. Climate change involves critical decisions such as the future level of U.S. electricity supply, the future price of electricity, and the future electricity supply mix of the United States, namely the extent to which the United States should rely on coal, nuclear, natural gas, and renewable energy to meet our future electricity supply needs. In my mind,

24. See *Horizon Asset Mgmt., Inc.*, 125 F.E.R.C. ¶ 61,209 (2008); *Entegra Power Group L.L.C.*, 125 F.E.R.C. ¶ 61,143 (2008) (rehearing pending); *Legg Mason, Inc.*, 121 F.E.R.C. ¶ 61,061 (2007); *Morgan Stanley*, 121 F.E.R.C. ¶ 61,060 (2007), *clarified*, 122 F.E.R.C. ¶ 61,094 (2008); *Goldman Sachs Group Inc.*, 121 F.E.R.C. ¶ 61,059 (2007), *clarified*, 122 F.E.R.C. ¶ 61,005 (2008); *Capital Research & Mgmt. Co.*, 116 F.E.R.C. ¶ 61,267 (2006).

these are energy policy considerations, or at least as much energy policy as they are environmental policy.

Currently, there is uncertainty in the United States with respect to climate-change policy. That uncertainty has significant energy policy implications. The most direct effect relates to the U.S. electricity supply. Electricity generators in the United States have cancelled thousands of megawatts of planned coal-generating capacity. The total amount of cancelled coal-generating capacity exceeds 100,000 megawatts, more than the entire electricity supply of the United Kingdom. More importantly, these cancelled coal power plants have not been replaced by other planned electricity-generating facilities. The economic downturn associated with the financial and credit crisis has reduced demand and provided a respite.

President Barack Obama has called for a U.S. commitment to mandatory carbon reductions and endorsed the cap-and-trade approach. There is growing support in Congress for carbon-reduction legislation. U.S. climate-change policy will likely change. There are three avenues for change in U.S. climate-change policy: domestic legislation, rules and orders issued by the Environmental Protection Agency (EPA) under the Clean Air Act, and an international treaty entered into by the United States and ratified by the Senate. However, the timing of actions in these three areas remains uncertain.

In any event, when the United States does act, it is absolutely essential that U.S. climate-change policy reflect a balance between sound energy and environmental policy. Climate-change policy must work effectively on both levels. To illustrate, energy policymakers and environmental policymakers each have an interest in the future electricity supply of the United States. But their interests are different. Energy policy seeks to assure that the United States has an adequate electricity supply to meet the needs of consumers and a growing economy and that the price of that electricity is just and reasonable. Energy policy may also encourage fuel diversity in our electricity supply mix. Environmental policy, or more properly, climate-change policy, is interested largely in the future level of emissions from the electricity sector and other sectors.

These goals are different although not necessarily inconsistent. The tension is obvious—climate-change policy would be advanced by a relatively high-cost mix of electricity supply, which would reduce total emissions by decreasing demand. Climate-change policy would also be advanced by an electricity supply mix that produces the lowest carbon emissions levels—even if that mix is the high-cost mix. Energy policy that delivers low electricity prices may produce relatively high demand from an electricity supply mix that produces high emissions levels.

It is possible to strike a balance between energy and environmental

policy that achieves these different goals, but it will not be easy. A balanced approach can achieve significant carbon reductions at a reasonable cost while assuring the adequacy of the U.S. electricity supply. Climate-change policy that is unbalanced may impair the ability of the United States to assure adequacy of electricity supply at a reasonable cost. An unbalanced approach may also fail to achieve necessary carbon reductions and may produce unreasonable energy costs and unreliable energy supplies. Climate-change policy that produces unreasonable energy costs and unreliable energy supplies may be unsustainable politically and subject to reversal. Laws can be enacted; those same laws can be repealed.

A U.S. commitment to mandatory carbon reductions will likely require changes in energy law. For example, in my view the United States must revise its transmission siting regime if it is to develop an interstate power grid capable of delivering both large-scale renewable energy and nuclear energy. It is unlikely that the bulk power grid can be developed to the point where we can achieve our maximum wind potential in the United States under the current state siting regime. That would entail amending Part II of the Federal Power Act to provide for exclusive and preemptive federal siting of electric transmission facilities, modeled on the pipeline siting provisions in the Natural Gas Act. Congress did provide for some federal transmission siting jurisdiction in the Energy Policy Act of 2005, but this authority is very limited, has some serious flaws, and compares unfavorably to the pipeline siting model.

To some extent, pressures on grid development exist already because FERC is confronted by a host of proposals to build high-voltage transmission projects to accommodate large-scale wind electricity development. These wind projects are driven by adoption of renewable portfolio standards by many states, which to some extent serve as a proxy for carbon reductions pending continued deliberations on climate policy. The force of wind electricity development has already led FERC to revise its interconnection cost allocation policy,²⁵ and has sparked discussion of changes in policy relating to merchant wind transmission projects, transmission-to-transmission interconnection rules, transmission planning, and other areas.²⁶

If the United States does change course on climate change, there will be a need to address a host of issues that are as much energy policy as environmental policy. There will be a need for a regulatory framework to regulate carbon trading in the United States and coordinate with regulators

25. Cal. Indep. Sys. Operator Corp., 119 F.E.R.C. ¶ 61,061 (2007).

26. See generally Transmission Barriers to Entry, 73 Fed. Reg. 61,854 (issued Oct. 17, 2008) (supplemental notice of technical conference).

of carbon-trading regimes elsewhere in the world. One leading legislative proposal would assign the task of regulating carbon markets and trading to FERC.²⁷ It will also be necessary to establish a regime to verify carbon offsets and to prevent or minimize leakage from a cap-and-trade system. Moreover, there will be a need for a U.S. regulatory regime for a carbon capture and sequestration network of pipelines and storage projects—siting, rates, liability, and safety—assuming the technology is developed. Congress has begun deliberations on a regulatory framework for this new infrastructure, and an expanded FERC regulatory role is being considered.²⁸

II. THE MANNER IN WHICH ENERGY LAW CHANGES

These factors—dynamic markets, technological developments, market convergence, and the tension between energy and environmental policy with respect to climate change—at best create the need for changes in energy law, perhaps a desperate need. These factors do not actually effect change in energy law. But sometimes the need rises to the point where the law is changed. There are three principal ways energy law can change: enactment of new legislation, judicial decisions, and agency reinterpretation of existing law.

A. *Enactment of New Legislation*

The first way to change energy law or any other body of law, obviously, is enactment of new legislation. However, this is probably the most difficult way to effect change in any area of law. The legislative process in practice is much different than “How a Bill Becomes a Law.”²⁹

I worked as a congressional aide and a committee counsel, and have great respect for the institution. I have even gone so far as to describe myself as a “creature of Congress.”³⁰ But it sometimes takes Congress a long time to enact legislation to address a problem, even a problem that is

27. American Clean Energy and Security Act of 2009, H.R. 2454, 111th Cong. § 341 (2009).

28. See generally *Hearing*, *supra* note 13.

29. See, e.g., Kids in the House, How Laws Are Made, <http://clerkkids.house.gov/laws/index.html> (last visited July 11, 2009). A far better description of the legislative process can be found in *The Dance of Legislation* by Eric Redman, tracing enactment of a minor law by a skilled legislator. ERIC REDMAN, *THE DANCE OF LEGISLATION* (1973).

30. *Joseph T. Kelliher Nomination: Hearing Before the S. Comm. on Energy and Natural Resources*, 108th Cong. 20–21 (2003) (statement of Joseph T. Kelliher) (“As I pointed out in my testimony, at one level I consider myself a creature of Congress. I have spent a lot of my career working for Congress, and I have a tremendous respect for Congress’s role in energy policy.”).

widely recognized. A case in point is enactment of legislation to establish mandatory electric grid reliability standards. A broad consensus developed around the need for legislation to provide for mandatory and enforceable reliability standards in 1998 after two regional blackouts in the summer of 1996. In 2000, the Senate passed mandatory reliability legislation by unanimous vote,³¹ but it still took Congress until 2005 to enact legislation. The August 2003 blackout, which affected 50 million Americans, probably helped push legislation to final enactment.

But the need for legislation in this area was demonstrated many years earlier. There is an expression: “third time is the charm.” Unfortunately, it took more than three major regional blackouts to convince Congress to pass mandatory reliability legislation. Altogether, it took eight large regional blackouts, all of which were caused in part by violation of voluntary reliability standards, over a period of thirty years, to convince Congress to pass mandatory reliability legislation.

As noted earlier, among the principal laws FERC administers are Part II of the Federal Power Act and the Natural Gas Act. While these laws remained largely unchanged for forty years, a series of important reforms took place over the subsequent thirty years, with the pace and degree of change increasing over that period.

The first significant changes to Part II of the Federal Power Act and Natural Gas Act occurred in 1978, when Congress enacted the Public Utility Regulatory Policies Act of 1978 and the Natural Gas Policy Act of 1978. The Public Utility Regulatory Policies Act added interconnection and wheeling provisions to the Federal Power Act, as well as provisions relating to continuance of service, while making revisions to ratemaking and interlocking directorate provisions.

The Natural Gas Policy Act took the first step toward decontrol of natural gas prices, a process that was completed with the enactment of the Natural Gas Wellhead Decontrol Act of 1989. The Natural Gas Policy Act also included significant provisions authorizing interstate natural gas pipelines to sell or transport natural gas on behalf of intrastate pipelines or local distribution companies without prior FERC approval.

The Energy Policy Act of 1992 made some important changes to the Federal Power Act, granting FERC effective authority to order “wheeling,” or third-party transmission service upon application,³² and providing FERC

31. 146 CONG. REC. 13,414 (2000).

32. Energy Policy Act of 1992, Pub. L. 102-486, §§ 721–722, 106 Stat. 2915, 2915–19 (1992) (codified as amended at 16 U.S.C. § 824j (2006)); see also Joseph T. Kelliher, Comment, *Pushing the Envelope: Development of Federal Electric Transmission Access Policy*, 42 AM. U. L. REV. 543, 589–91 (1993). Strictly speaking, the Energy Policy Act of 1992 did not grant wheeling authority to FERC; that authority had been granted by the

some civil penalty authority.³³ The law also amended § 3 of the Natural Gas Act to clarify regulation of certain natural gas imports and exports.³⁴

The most recent law, the Energy Policy Act of 2005, made very significant changes to both the Federal Power Act and the Natural Gas Act. In my view, the Energy Policy Act of 2005 brought about the most significant change in the laws FERC administers since the New Deal and represents the largest single grant of regulatory power to FERC in the past seventy years.

The revisions to Part II of the Federal Power Act were very significant. The Energy Policy Act of 2005 included a number of major changes to FERC's economic regulatory authority. Specifically, these changes proscribed market manipulation and granted FERC the authority to define manipulation by rule or order,³⁵ improved FERC's ability to prevent market power exercise by strengthening the agency's merger authority,³⁶ expanded the agency's authority to order open access to the transmission system,³⁷ provided for more-timely refunds,³⁸ and granted FERC discretionary authority to require dissemination of information that would improve the transparency of wholesale power markets.³⁹ The Act gave FERC a new mission to assure the reliability of the bulk power system, authorizing the agency to establish and enforce mandatory reliability standards.⁴⁰ Finally, the Energy Policy Act of 2005 sought to strengthen the interstate power grid by granting FERC limited transmission siting authority⁴¹ and encouraging transmission incentives to spur grid investment.⁴²

The Energy Policy Act of 2005 also made major changes to the Natural

Public Utility Regulatory Policies Act of 1978. But that law, which added § 211 to the Federal Power Act, was defective. Under § 211, as added by the Public Utility Regulatory Policies Act of 1978, FERC could not order wheeling if doing so would disturb "existing competitive relationships." 16 U.S.C. § 824j(c)(1) (1988). As a result of this provision, the wheeling provisions in the Public Utility Regulatory Policies Act of 1978 proved ineffective. Kelliher, *supra*, at 551. This subsection was deleted by § 721(4)(A) of the Energy Policy Act of 1992. If the Energy Policy Act of 1992 did not "grant" FERC wheeling authority, it is probably fair to say that it granted FERC "effective" wheeling authority.

33. Energy Policy Act of 1992 § 725(b). Curiously, the civil penalty provisions of the Energy Policy Act of 1992 were limited to violations of sections of the Federal Power Act added or substantially amended by the 1992 Act, namely §§ 211–214. *Id.*

34. *Id.* § 201.

35. Energy Policy Act of 2005, Pub. L. No. 109-58, § 1283, 119 Stat. 594, 979–80 (2005).

36. *Id.* § 1289.

37. *Id.* § 1231.

38. *Id.* § 1285.

39. *Id.* § 1281.

40. *Id.* § 1211(a).

41. *Id.* § 1221(a).

42. *Id.* § 1241.

Gas Act. These changes granted FERC express authority to police the manipulation of wholesale natural gas markets,⁴³ gave FERC discretionary authority to require dissemination of information that would improve the transparency of wholesale natural gas markets,⁴⁴ and clarified FERC's exclusive authority to site LNG import and export projects.⁴⁵ The revisions also gave the agency discretion to approve market-based rates for natural gas storage projects, even, under certain circumstances, if such projects had market power,⁴⁶ and granted FERC authority to coordinate federal and state agency review of natural gas projects.⁴⁷

However, perhaps the most significant changes to Part II of the Federal Power Act and the Natural Gas Act effected by the Energy Policy Act of 2005 were the anti-manipulation provisions and the enforcement provisions, notably the grant of authority to impose sizeable civil penalties, up to \$1 million per day per violation.⁴⁸ Interestingly, these anti-manipulation provisions were expressly modeled on the anti-manipulation provisions of the Securities Exchange Act of 1934.⁴⁹

The manipulation and enforcement provisions to a large extent can be viewed as a reaction to the California and western energy crisis of 2000–2001. In my view, that crisis resulted in part from the significant changes that had occurred in electricity markets since 1935, and the failure to ensure that FERC had the regulatory tools it needed to discharge its duty to guard the consumer from exploitation.⁵⁰ Congress recognized that FERC needed different regulatory tools to discharge its historic duty, given the changes in markets, and granted the agency the authority it requested to prevent and sanction market manipulation.⁵¹

B. Court Decisions

The second way to change energy law is through court decisions. Courts can change energy law and other areas of law through decisions that find those laws are unconstitutional. Constitutional challenges to energy laws

43. *Id.* § 315.

44. *Id.* § 316.

45. *Id.* § 311.

46. *Id.* § 312.

47. *Id.* § 313.

48. *Id.* §§ 314(b), 1284(e).

49. Compare § 222 of the Federal Power Act, 16 U.S.C. § 824v (2006), and § 4A of the Natural Gas Act, 15 U.S.C. § 717c-1 (2006), with § 10 of the Securities Exchange Act of 1934, 15 U.S.C. § 78j (2006).

50. *NAACP v. FPC*, 520 F.2d 432, 438 (D.C. Cir. 1975) (“Of the Commission’s primary task there is no doubt, however, and that is to guard the consumer from exploitation by non-competitive electric power companies.”).

51. See generally Kelliher, *supra* note 9.

charged to the administration of FERC are unusual, but they have been leveled from time to time.⁵² In the context of this Article, when I describe the courts as changing energy law, I refer to court decisions that change a settled or long-standing interpretation of the law. By unsettling that interpretation, a court decision can change energy law in the same manner as if Congress enacted a law to the same end.

A regulatory body charged with administering certain laws is obligated to interpret those laws. A particular interpretation may remain settled for many years. In my experience, it is not unusual for an agency to refrain from fully exercising its legal authority, and I believe there is significant unexercised authority in the laws charged to FERC's administration, particularly the Federal Power Act. Interpretation of a statute can be more of an art than a science, resulting in different possible interpretations that involve more or less legal risk.⁵³ The first instinct of a regulatory body will not always be to seize upon the most aggressive interpretation, the interpretation that is most likely to be challenged in the courts and involve the greatest legal risk. A court may reinterpret statutes in a manner that is more aggressive than the administering agency. The net effect can be to grant an agency additional regulatory powers that it did not think it possessed based on its more conservative reading of the statute.

1. *Phillips Petroleum Co. v. Wisconsin*

Court decisions have certainly brought about major changes in energy law. The best example relevant to FERC would be *Phillips Petroleum Co. v. Wisconsin* in 1954, where the Supreme Court held that the Natural Gas Act charged FERC's predecessor, the Federal Power Commission, with the responsibility to set rates for wellhead natural gas sales, authority the Commission did not think it possessed.⁵⁴ Before *Phillips*, the Commission interpreted the Natural Gas Act as limiting its ratemaking jurisdiction to wholesale natural gas sales by interstate pipelines and exempting wellhead sales from its ratemaking jurisdiction, on the basis that such sales constituted the "production or gathering of natural gas," exempt from its jurisdiction.⁵⁵ However, in *Phillips* the Court narrowed the application of the "production" exemption, finding that natural gas producers were

52. See *Energy Transfer Partners, L.P.*, 121 F.E.R.C. ¶ 61,282, paras. 80–85 (2007) (respondent asserted that the procedural due process requirements of the Fifth Amendment dictate that enforcement litigation take place in federal district court).

53. See NORMAN J. SINGER & J.D. SHAMBIE SINGER, *SUTHERLAND STATUTES AND STATUTORY CONSTRUCTION* §§ 45.1, 45.8 (7th ed. 2007), available at Sutherland s 45:1 (Westlaw) (discussing the process of statutory interpretation and construction).

54. 347 U.S. 672 (1954).

55. *Id.* at 677–78.

“natural gas companies” subject to the ratemaking jurisdiction of the Commission.⁵⁶

By the standard discussed above, the Supreme Court did much more than clarify the law in *Phillips*; the Court changed the law in the sense that it completely overturned the interpretation of the Natural Gas Act that had guided regulation of natural gas production for nearly twenty years. That reinterpretation extended rate regulation well beyond wholesale gas sales to encompass a wide swath of natural gas production. Essentially, the Court’s decision in *Phillips* had the same effect as enactment of legislation amending the Natural Gas Act itself.

The *Phillips* decision imposed a tremendous regulatory burden both on the Commission and natural gas producers. At the time of *Phillips*, there were thousands of natural gas producers in the United States. Under the decision, the Commission was charged with setting wellhead rates for each of these producers. The agency struggled valiantly to honor the Supreme Court’s reading of the Natural Gas Act, but it ultimately proved to be a Sisyphean task.⁵⁷ Altogether, the agency developed three different regulatory approaches, each of which failed. First, the agency attempted to set rates for each producer through individual ratemaking proceedings. This approach quickly proved to be administratively infeasible and was abandoned in 1960. The agency then resorted to setting area-wide rates, dividing the country into five producing regions and setting rates for all producers in a particular region, setting interim ceiling rates based on average contract prices paid during 1959 and 1960. This approach also failed and was abandoned in 1974. Finally, the agency adopted national price ceilings for the sale of natural gas into interstate pipelines. This approach failed as well, contributing to natural gas shortages at the end of the 1970s.

In the end, it took Congress more than thirty years to reverse *Phillips* through enactment of natural gas decontrol legislation. The first step toward removing the regulatory regime mandated by the Supreme Court took place with the enactment of the Natural Gas Policy Act of 1978, which provided for partial decontrol of natural gas prices. The second and final step occurred through enactment of the Natural Gas Wellhead Decontrol Act of 1989. After enactment of these two laws, the *status quo ante* was restored, and wellhead production was no longer rate regulated.

56. *Id.* at 682–83 & n.10.

57. In Greek mythology, Sisyphus was cursed to roll a large boulder up a hill, only to watch it roll down again, repeating the process throughout eternity. EDITH HAMILTON, MYTHOLOGY 439–40 (Little, Brown and Company 1998) (1942).

2. California ex rel. Lockyer v. FERC

A more recent example of a court decision that changed energy law, in the sense that it overturned FERC's settled interpretation of one of its core statutes, was *California ex rel. Lockyer v. FERC*.⁵⁸ In that decision, the Ninth Circuit held that FERC had the authority to order retroactive refunds under § 205 of the Federal Power Act,⁵⁹ notwithstanding the plain language of §§ 205(e) and 206(b). It is not clear in *Lockyer* how far back FERC could conceivably order retroactive refunds. The agency could reach back months or perhaps even years.

The *Lockyer* court certainly changed FERC's settled interpretation of §§ 205 and 206 of the Federal Power Act. Under a strict reading of § 205(e), FERC has very limited power to order refunds. If a seller has a rate on file, FERC can only order refunds if a seller has filed a rate change, if the proposed rate went into effect before the completion of a FERC investigation, and if the agency ultimately determines the rate is unlawful. In that circumstance, FERC can order refunds of the difference between the filed rate change and the rate the agency found to be just and reasonable, but only for the period where the filed rate was effective, not for any period before the filed rate change. Before *Lockyer*, FERC did not read § 205(e) to allow it to order retroactive refunds in the absence of a filed rate change.

The *Lockyer* decision also appears inconsistent with the plain language of § 206(b) of the Federal Power Act, which otherwise governs refunds. Under § 206(b), as it existed at the time of *Lockyer*, in the event of a refund proceeding instituted on complaint, "the refund effective date shall not be earlier than the date 60 days after the filing of [a] complaint," and in the case of a proceeding instituted by FERC on its own motion, "the refund effective date shall not be earlier than the date 60 days after the publication by the Commission of notice of its intention to initiate such proceeding"⁶⁰ *Lockyer* involved a refund proceeding initiated on complaint, in which FERC set a refund effective date at the earliest date it believed was allowed by law, sixty days after notice of its initiation of a refund proceeding.

Admittedly, *Lockyer* was a surprising interpretation, at least to FERC. Leading up to *Lockyer*, Congress had been considering amending § 206(b) to change the refund effective date for a number of years, to eliminate the sixty-day notice period and to allow for a refund effective date coincident with the date of a complaint and the date FERC initiated a refund proceeding. Congress ultimately revised § 206(b) to that end in the Energy

58. 383 F.3d 1006 (9th Cir. 2004), *cert. denied*, 549 U.S. 882 (2006).

59. *Id.* at 1015–16.

60. 16 U.S.C. § 824e(b) (2000).

Policy Act of 2005.⁶¹ Arguably, this enactment was unnecessary if FERC had authority under § 205(e) to provide for retroactive refunds, let alone to waive the sixty-day waiting period.

Curiously, the court in *Lockyer* almost ignored the plain language of §§ 205(e) and 206(b) in reaching its conclusion, preferring to rely on “the underlying theory or regulatory structure established by the FPA”⁶² and “the fundamental purpose and structure of the FPA,”⁶³ rather than the plain words of §§ 205(e) or 206(b). Indeed, the court’s statutory construction does not even parse the words of §§ 205(e) or 206(b).⁶⁴ Unable to find any statutory language to support its interpretation, the court simply asserted that the authority to order retroactive refunds was “inherent” in the Federal Power Act.⁶⁵ In other words, retroactive refund authority lives somewhere between the lines of the Act.

Perhaps the heart of *Lockyer* is the imprecision of the court in distinguishing between “refunds” and “disgorgement of profits.” In the eyes of FERC, *refund* is a particular term, meaning returning the difference between a just and reasonable rate and an unjust and unreasonable rate. With respect to wholesale power sales, FERC believed it could order refunds only in the course of a § 206 proceeding, initiated by complaint or by FERC on its own motion. FERC also believed it could not order retroactive refunds.

Disgorgement of profits is a different remedy, namely the disgorgement of all proceeds above a cost level. FERC can order disgorgement of profits for violations of tariffs established under the Federal Power Act or Natural Gas Act. Disgorgement can be ordered without regard for whether rates are unjust and unreasonable in order to remedy a tariff violation. FERC has long held that it had a remedy of ordering disgorgement of profits for tariff violations. However, the statutory basis for ordering disgorgement of profits is not § 206(b) or its companion in the Natural Gas Act, § 5(a), but §§ 309 and 16 of the Federal Power Act and Natural Gas Act, respectively.

The confusion in *Lockyer* rests with the court’s use of the particular term *refund* when seeming to restate FERC’s long-standing authority to order disgorgement of profits for tariff violations. As noted above, refunds and disgorgement of profits can be distinguished. In a refund, FERC can order the return of the difference between a just and reasonable rate and an unjust and unreasonable rate. It can lower the rate charged by a seller while still

61. Energy Policy Act of 2005, Pub. L. No. 109-58, § 1285, 119 Stat. 594, 980 (2005) (codified as amended at 16 U.S.C. § 824e(b) (2006)) (revising refund effective date).

62. *Lockyer*, 383 F.3d at 1016.

63. *Id.* at 1017.

64. *Id.* at 1015–17.

65. *Id.* at 1016.

leaving the seller with the profit earned by charging a just and reasonable rate. Disgorgement of profits, by contrast, involves the return of profits; the seller merely recovers its costs, or costs plus a regulated profit level.

If *Lockyer* is read liberally to mean *disgorgement of profits* in places where it uses *refund*, it can be an accurate description of FERC remedial authority, effecting no change in the *status quo ante*. Otherwise, the decision can be read as significantly changing energy law and expanding FERC's remedial powers.

FERC did not seek rehearing of *Lockyer*. Power sellers sought rehearing in the Ninth Circuit and later filed a petition for a writ of certiorari with the Supreme Court, in part on the grounds that FERC might abuse this new authority to order retroactive refunds. That was a rationale FERC could hardly be expected to agree with. FERC opposed granting certiorari, largely on the grounds that if the court granted FERC greater remedial power than the agency believed it was due under the Federal Power Act, that only improved the ability of the agency to guard the consumer from exploitation.⁶⁶

3. Massachusetts v. EPA

As discussed above, the line between energy and environmental law may become more and more difficult to discern in the future, as the United States moves toward establishing a carbon-reduction regime. For that reason, FERC must be mindful of developments in environmental law relevant to climate change.

The Supreme Court's decision in *Massachusetts v. EPA*⁶⁷ changed energy and environmental law, in the sense used in this Article. It overturned EPA's interpretation of the Clean Air Act that had governed for many years and directed EPA to take the first steps in a new regulatory proceeding to consider whether the agency should regulate the greenhouse gas emissions of new motor vehicles under the Clean Air Act.

Previously, EPA had concluded that it lacked authority to regulate carbon dioxide and other greenhouse gases as *air pollutants* under the Clean Air Act. Under § 202(a)(1) of the Clean Air Act,

The [EPA] Administrator shall by regulation prescribe . . . standards

66. See Brief for the Federal Energy Regulatory Commission in Opposition at 25, *Coral Power, L.L.C. v. California ex rel. Brown*, 127 S. Ct. 2972 (2007) (Nos. 06-888, 06-1100), available at <http://www.usdoj.gov/osg/briefs/2006/0responses/2006-0888.resp.pdf> ("Those new statutory provisions and measures instituted by [FERC] since the California energy crisis in 2000–2001 also reinforce the conclusion that the remedial issue raised in the principal petition . . . does not warrant review by this Court, especially at this interlocutory stage of the proceedings.")

67. 549 U.S. 497 (2007).

applicable to the emission of any air pollutant from any class or classes of new motor vehicles or new motor vehicle engines, which in his judgment cause, or contribute to, air pollution which may reasonably be anticipated to endanger public health or welfare.⁶⁸

EPA had declined to regulate greenhouse gases under § 202(a)(1), concluding that it lacked authority under the Clean Air Act to issue mandatory regulations relating to greenhouse gas emissions.⁶⁹ EPA's conclusion was based largely on a complicated statutory interpretation of § 202(a)(1) of the Clean Air Act.⁷⁰ The Agency's conclusion was strengthened by questions about the strength of the scientific evidence relating to causation and the efficacy of new motor vehicle standards, as well as policy reasons concerning the President's ability to negotiate treaties.⁷¹

The Supreme Court, in a 5–4 decision, rejected this interpretation of § 202(a)(1) of the Clean Air Act, holding that EPA had authority to regulate carbon emissions and the emissions of other greenhouse gases, and that the Agency was obliged to conduct a proceeding to set new motor vehicle standards. According to the Supreme Court, if EPA makes a finding of endangerment, the Clean Air Act requires the Agency to regulate emissions from new motor vehicles, and EPA can only refrain from doing so if it determines that greenhouse gases do not contribute to climate change or offers some reasonable explanation of why the Agency cannot or will not exercise its discretion to make such a determination.⁷² Under *Massachusetts*, the only question is whether sufficient information exists to make an endangerment finding.⁷³

In the wake of *Massachusetts*, EPA initiated a rulemaking to determine whether it should regulate carbon emissions from new motor vehicles.⁷⁴ It remains to be seen whether EPA will issue final rules to regulate carbon emissions from new motor vehicles. The mere prospect may serve to

68. 42 U.S.C. § 7521(a)(1) (2000). In the Clean Air Act, *welfare* is defined to include “effects on . . . weather . . . and climate.” *Id.* § 7602(h).

69. *Massachusetts*, 549 U.S. at 511.

70. *See id.* at 511–12 (claiming that Congress “declined to adopt a proposed amendment establishing binding emissions limitations”).

71. *See id.* at 513 (implying that EPA relied heavily on a report suggesting that the causal link between tailpipe emissions and global warming could not be established).

72. *See id.* at 533 (“If EPA makes a finding of endangerment, the Clean Air Act requires the agency to regulate emissions of the deleterious pollutant from new motor vehicles.”).

73. *Id.* at 534. In April 2009, EPA issued a proposed endangerment finding. Proposed Endangerment and Cause or Contribute Findings for Greenhouse Gases Under Section 202(a) of the Clean Air Act, 74 Fed. Reg. 18,886 (proposed Apr. 24, 2009) (to be codified at 40 C.F.R. ch. 1).

74. Regulating Greenhouse Gas Emissions Under the Clean Air Act, 73 Fed. Reg. 44,354 (proposed July 30, 2008).

increase the likelihood of Congress enacting climate-change legislation, in part because the Clean Air Act is viewed as a very poor vehicle for reducing carbon emissions.⁷⁵

The Supreme Court changed environmental law in the sense that it overturned the settled and long-standing interpretation of the law by a regulatory agency, in this case EPA. *Massachusetts* had the same effect as an enactment of a new law that revised the Clean Air Act and required EPA to regulate carbon dioxide and other greenhouse gas emissions as air pollutants under the Act.

C. Agency Reinterpretation of Existing Law

Perhaps the most interesting manner of changing energy law, at least from the vantage of the head of a regulatory body, is through agency reinterpretation of existing law. Sometimes the most dramatic changes in energy law can be accomplished through reinterpreting existing law. As discussed earlier, interpretation of a statute can be more of an art than a science, resulting in different possible interpretations that involve more or less legal risk. It is not unusual for a statutory provision to have more than one possible interpretation. How an agency chooses among these interpretations, and interprets—and reinterprets—a statute involves a balance between a fair reading of the statute, an assessment of the legal risk involved in different interpretations, and policy considerations.

A rational balancing would accept an interpretation that entails a higher degree of legal risk, if necessary to advance important policy objectives. A regulatory body will not always elect the most aggressive interpretation—the interpretation that is most likely to be challenged in the courts and involve the greatest legal risk. But an agency may be willing to accept a degree of legal risk, depending on the importance of policy objectives. Statutes can incorporate a tremendous amount of unexercised authority available to regulatory bodies. As the need for changes in energy law rises, as discussed in Part I of this Article, it may become necessary to resort to this corpus of unexercised authority. Indeed, the legal risk involved in reinterpreting existing law is not a constant, and can be more fairly characterized as waxing and waning over time. A legal interpretation that involved extreme legal risk at one point may later entail only modest risk.

75. Former House Energy and Commerce Committee Chairman John Dingell predicted that regulating carbon emissions under the Clean Air Act would lead to a “glorious mess.” *Strengths and Weaknesses of Regulating Greenhouse Gas Emissions Using Existing Clean Air Act Authorities: Hearing Before the Subcomm. on Energy and Air Quality of the H. Comm. on Energy and Commerce*, 110th Cong. (2008), http://archives.energycommerce.house.gov/cmte_mtgs/110-eaq-hrg.041008.CleanAirAct.shtml (follow “Connect to the Archived Video Webcast of this Hearing” hyperlink).

Some may perceive that the choice by a regulatory body to reinterpret its legal authority more expansively is nothing more than a grasp for power. That is an uncharitable view and one I must disagree with. An alternative explanation lies with an appreciation of a regulator's sense of duty. Every agency is tasked with certain missions. FERC's missions are reasonably well established by its organic acts and have been reiterated by the courts. For example, the courts have declared that FERC's primary task is to "protect consumers against exploitation."⁷⁶ Sometimes a regulator is given a duty but not granted the necessary express authority to fulfill that responsibility. Sometimes the need for a change in energy law grows over time, for the reasons described in Part I, but the statute remains static. The statutory tools at the disposal of an agency that were once adequate may become insufficient over time. In those circumstances, it should be expected that a regulatory body may reexamine its legal authority and consider electing a more expansive interpretation. That reinterpretation may better enable an agency to discharge its historic duties. Of course, FERC remains an agency of limited powers, since reinterpretation must be rooted in a fair reading of a statute. FERC accepts those limits, even when there is a compelling public interest at stake.

A federal regulatory agency is quasi-judicial, not judicial. It has some similarities to a court as it is a body of limited powers, it must have legal authority to act, and it must have some factual or strong theoretical foundation for its actions. But a regulatory agency is different from a court in the sense that it is entrusted with certain duties by its organic acts. The central task of the Commission, to "guard the consumer from exploitation," is not a passive duty; it is an active responsibility. While a court can wait for a dispute to be brought before it, FERC must constantly search for ways to better discharge its duty. Sometimes that search will lead to reinterpretation of its legal authority.

The ability of federal regulatory agencies to reinterpret their statutes and adopt a more expansive reading is not a constant. To some extent, it will vary depending on the vintage of their organic acts. As a general matter, agencies endowed with authority through statutes enacted during the New Deal probably have a better ability to reinterpret their statutes more expansively, for reasons discussed above. FERC is fortunate to be one such agency.

Sometimes there is a perception that regulators introduce change into

76. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944); *see also* *NAACP v. FPC*, 520 F.2d 432, 438 (D.C. Cir. 1975), *aff'd*, *NAACP v. FPC*, 425 U.S. 662 (1976) ("Congress's central concern with exploitation is of course reflected in the statute's emphasis on just and reasonable prices . . .").

areas where there is repose. Certainly, that is a perception within the regulated community. In my view, this is a misperception. In most cases, regulators are forced to react to change that occurs within regulated industries as a result of dynamic market change and other factors discussed in Part I. Regulators may, of course, seek to channel policy change in a certain direction, but the need to change energy law is driven largely by external factors, not by a whim of the regulator.

Reinterpretation of existing statutes by regulatory bodies need not offend lawmakers in Congress. Indeed, the extent to which a more aggressive interpretation of an existing statute is welcomed by Congress is remarkable. Congress has frequently ratified FERC reinterpretations of its existing legal authority, even urging the agency to go further.⁷⁷

1. Natural Gas Pipeline Unbundling

The first step toward rolling back *Phillips* and decontrol of natural gas prices was enactment of the Natural Gas Policy Act of 1978. This law only partially decontrolled natural gas prices, however. Under the partially regulated system, many natural gas pipelines entered into long-term contractual obligations, known as “take-or-pay” contracts, to purchase minimum quantities of natural gas from producers at prices that proved to be well above market levels.⁷⁸ To some extent, this problem was collateral damage from the success of gas decontrol.

The surge in pipeline take-or-pay obligations forced the Commission to react to events and develop new approaches to pipeline regulation.⁷⁹ The

77. The wheeling provisions of the Energy Policy Act of 1992 ratified FERC’s policy of promoting transmission open access through its merger and market-based rate conditioning authority in the late 1980s. See Kelliher, *supra* note 32, at 589–97. At least three provisions of the Energy Policy Act of 2005 ratified FERC interpretations of its preexisting authority under the Federal Power Act and Natural Gas Act. Section 311(c) of the Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594, 685–86 (2005), ratified FERC’s interpretation of its authority to site LNG import terminals under § 3 of the Natural Gas Act. Initial Decision of the Presiding Examiner on a Pipeline Certificate Application, 47 F.P.C. 567, 572 (1970); *Distrigas Corp. v. FPC*, 495 F.2d 1057, 1064 (D.C. Cir. 1974). Section 1241 of the Energy Policy Act of 2005 ratified the FERC policy of granting rate incentives to members of regional transmission organizations. Section 1242 of the Energy Policy Act of 2005 ratified FERC’s discretion to approve certain participant funding schemes. The Energy Policy Act of 2005 urged FERC to go even further than it had on its earlier reinterpretation of its existing legal authority. For example, § 211A of the Energy Policy Act of 2005 followed the Supreme Court’s affirmation of Order No. 888, the open transmission access rule. Since the rule was affirmed by the Supreme Court in a unanimous decision, there was no need for Congress to ratify the rule *per se*. Instead, Congress enacted § 211A, which granted FERC authority to go further than Order No. 888, by authorizing the agency to require open access by unregulated transmitting utilities not subject to Order No. 888.

78. *United Distribution Cos. v. FERC*, 88 F.3d 1105, 1123 (D.C. Cir. 1996).

79. See Order No. 436, 50 Fed. Reg. 42,408, 42,411 (Oct. 18, 1985) (codified in

initial attempts by the agency were struck down by the courts because FERC “ha[d] not adequately attended to the agency’s prime constituency,” captive shippers vulnerable to the exercise of market power by pipelines.⁸⁰ In Order No. 436, FERC began “the transition toward removing pipelines from the gas-sales business and confining them to a more limited role as gas transporters.”⁸¹ Previously, pipelines accounted for most wholesale sales of natural gas. This process of removing pipelines from the gas-sales business is known as “unbundling.” For the first time, FERC imposed the duties of common carriers upon interstate pipelines.⁸² The courts largely upheld the rule but faulted FERC for declining to resolve the problem of pipeline take-or-pay obligations, remanding on that basis.⁸³

The Commission found that the open-access requirements in Order No. 436 were a partial success, and that pipelines’ remaining bundled gas sales were unduly discriminatory or preferential, violating §§ 4 and 5 of the Natural Gas Act. FERC’s solution was mandatory unbundling of pipelines’ gas sales and transportation services, as established in Order No. 636.⁸⁴ This final unbundling rule was also affirmed by the courts.⁸⁵

The open-access policies of the Commission with respect to the natural gas pipeline network were rooted in §§ 4 and 5 of the Natural Gas Act. These provisions, like their counterparts in the Federal Power Act, charge FERC with assuring that all natural gas rates and practices subject to the jurisdiction of the Commission shall be just and reasonable, and grants the agency the power to determine the just and reasonable rate or practice and fix the same by order. Section 7(e) of the Natural Gas Act authorizes FERC to condition certificates for services and facilities in such a manner as the public convenience and necessity may require. Such certificate and conditioning authority are the means by which FERC effectuates the purpose of the Natural Gas Act to assure just and reasonable rates.

As was the case with electric transmission open-access policy, the Commission interpreted legal authority it had possessed for nearly fifty

scattered sections of 18 C.F.R.) (“The Commission’s overriding goal in this docket is to adapt our regulations to these fundamental legal and technical changes so that we may continue to fulfill our statutory mandates under the NGA and the NGPA.”).

80. *Md. People’s Counsel v. FERC*, 761 F.2d 780, 781 (D.C. Cir. 1985); *see also* *Md. People’s Counsel v. FERC*, 761 F.2d 768, 776 (D.C. Cir. 1985).

81. *United Distribution Cos.*, 88 F.3d at 1123.

82. *Associated Gas Distribs. v. FERC*, 824 F.2d 981, 997 (D.C. Cir. 1987).

83. *United Distribution Cos.*, 88 F.3d at 1124.

84. *See id.* at 1126 (“[T]he principal innovation of Order No. 636[] was mandatory unbundling of pipelines’ sales and transportation services.”); *see also* Order No. 636, 57 Fed. Reg. 13,267, 13,269 (Apr. 16, 1992) (codified at 18 C.F.R. pt. 284) (discussing the necessity of functional unbundling when transitioning to a competitive market).

85. *United Distribution Cos.*, 88 F.3d at 1127–30; *see also* *New York v. FERC*, 535 U.S. 1, 28 (2002) (finding that FERC made a “statutorily permissible policy choice”).

years to impose common carrier duties upon interstate pipelines and provide open access to the pipeline network. Its decision to do so was certainly related to an overall policy direction in favor of decontrol and increased competition in wholesale natural gas markets. The Natural Gas Policy Act of 1978 did not significantly enhance FERC authority to require unbundling and open access. But, just like the changes to § 211 of the Federal Power Act discussed later, it sent a policy signal to the agency in favor of open access that emboldened FERC to rely on other, much older statutory authority to move in the same policy direction.

But the Commission was not merely reacting to events; FERC was channeling policy in a certain direction, namely in favor of promoting competition in wholesale natural gas markets.⁸⁶ The development of competition policy with respect to natural gas markets also demonstrated a certain synergism between Congress and the Commission. FERC's natural gas unbundling policy was both a consequence and a companion to natural gas decontrol.⁸⁷ The legislative history of the Natural Gas Wellhead Decontrol Act of 1989 suggests Congress understood the relationship between decontrol and unbundling, and that unbundling was "essential" to the decision to enact total decontrol.⁸⁸ Enactment of full decontrol in turn encouraged FERC to impose mandatory unbundling on interstate pipelines.

2. *Transmission Open Access*

In 1996, FERC issued Order No. 888, a landmark final rule requiring public utilities to offer open access to their transmission systems.⁸⁹ This rule aimed to reduce the potential for these utilities to engage in undue discrimination and preference in transmission service in order to protect the consumer from exploitation. It also sought to promote more effective competition in wholesale power markets.

The legal foundations for this rule were §§ 205 and 206 of the Federal

86. See Order No. 636, 57 Fed. Reg. at 13,268 ("[Order No. 636] will therefore reflect and finally complete the evolution to competition in the natural gas industry. . . . [T]his promotion of competition among gas suppliers will benefit all gas consumers . . ."); Order No. 436, 50 Fed. Reg. at 42,411 ("[Order No. 436] adjusts, within the scope of the authority delegated by the Congress, those aspects of our current regulations that now appear to hinder the development of competition in those areas where competition will better protect the public interest than will traditional public utility regulatory rules.").

87. See Order No. 636, 57 Fed. Reg. at 13,269 (discussing the consistency of the goals of Order No. 636 and the Wellhead Decontrol Act); Order No. 436, 50 Fed. Reg. at 42,411 ("[Order No. 436] also secures to consumers the benefits of competition in natural gas markets consistent with both the NGA and the NGPA.").

88. H.R. REP. NO. 101-29, at 6 (1989), *reprinted in* 1989 U.S.C.C.A.N. 51, 56.

89. Order No. 888, 61 Fed. Reg. 21,540, 21,541-43 (May 10, 1996) (codified at 18 C.F.R. pts. 35 and 385 (2008)).

Power Act, which authorize FERC to act to prevent undue discrimination and preference in transmission of electric energy in interstate commerce.⁹⁰ Essentially, FERC argued that it was inherently unduly discriminatory for a vertically integrated utility to fail to provide open access to its transmission system.

To accomplish this end, it was necessary for FERC to reinterpret §§ 205 and 206 to require open access by all public utilities by rule. Interestingly, these sections had remained largely unchanged since 1935,⁹¹ and it was not until sixty years later that FERC discovered it had the legal authority to require open access, an action that the agency could presumably have taken any time between 1935 and 1996. However, that view would ignore the developments that occurred in the electricity industry, particularly the advent of wholesale competition.

Accepting *arguendo* that FERC had authority in 1935 to require transmission open access, it is by no means obvious that this policy would have been in the public interest. The independent power sector did not exist at the time, and there was little competition in wholesale power markets. The policy benefit of requiring transmission open access would have been elusive and the legal risk likely much greater than was the case sixty years later.

One reason that FERC was emboldened to take this action was that it had reason to believe Congress was comfortable with a policy direction favoring transmission open access. Just a few years earlier, Congress had enacted the Energy Policy Act of 1992, which enhanced FERC's authority to order wheeling as a means of assuring transmission open access.⁹²

90. Section 205 broadly precludes public utilities, in making any transmission or sale subject to FERC's jurisdiction, from "mak[ing] or grant[ing] any undue preference or advantage to any person or subject[ing] any person to any undue prejudice or disadvantage." 16 U.S.C. § 824d(b) (2006). Section 206 provides,

Whenever the Commission, after a hearing held upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.

Id. § 824e(a).

91. The sections were largely unchanged with the exception of the change to the refund effective date in § 206 effected through enactment of the Regulatory Fairness Act in 1988. *Id.* § 824e(b).

92. *See id.* § 824j (requiring that an entity or person generating power may request from FERC an order requiring transmission of the generated power over a utility's transmission lines); *see also* Kelliher, *supra* note 32, at 589–91 ("The bill's sponsors shared FERC's view that transmission access may be a barrier to enhanced competition in wholesale power markets and removed many of the restrictions on FERC's wheeling

FERC diligently exercised this new authority but found that individual wheeling orders, which could be issued only upon application and not on the Commission's own motion, were an unsatisfactory means of providing open access.⁹³ Even though the legislative solution adopted by Congress proved inadequate, FERC could reasonably conclude that the legal risk, or at least the political risk, of relying on its §§ 205 and 206 authority to require open access was lower than it would have been previously.

FERC was also encouraged by its experience with natural gas pipeline unbundling, specifically satisfaction with the policy itself and its success in the courts. The reaction of both Congress and the courts to FERC natural gas pipeline unbundling policy indicated that adoption of similar policies with respect to the transmission grid might enjoy comparable success. The natural gas unbundling experience demonstrates how the legal risk of reinterpretation is not a constant, and that risk may rise and fall over time. In this case, the legal risk of reinterpretation of §§ 205 and 206 of the Federal Power Act to require transmission open access declined in the course of judicial review of natural gas unbundling policy.

Faced with the inadequate remedy of § 211 orders issued under new authority, FERC examined its preexisting legal authority to determine if there was another way to achieve transmission open access. The agency settled on reinterpretation of its long-standing authority under §§ 205 and 206. FERC's exercise of its §§ 205 and 206 authority to require transmission open access was not based on a factual record of abuse but on the potential for undue discrimination and preference.⁹⁴ Theory can be a sufficient basis for FERC regulatory action.⁹⁵

The FERC open-access order was challenged in court and upheld by both the U.S. Court of Appeals for the District of Columbia Circuit and the Supreme Court.⁹⁶ The Supreme Court was unanimous in holding that the

authority . . .").

93. Order No. 888, 61 Fed. Reg. at 21,541.

94. *Id.*

95. *Associated Gas Distribs. v. FERC*, 824 F.2d 981, 1008–09 (D.C. Cir. 1987) (“Agencies do not need to conduct experiments in order to rely on the prediction that an unsupported stone will fall; nor need they do so for predictions that competition will normally lead to lower prices.”). Even in the decision vacating the FERC Standards of Conduct final rule, the court invited the Commission to attempt to justify the rule on theoretical grounds alone. *See Nat'l Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 844 (D.C. Cir. 2006) (“In the absence of factual evidence . . . FERC may try to support the Standards by setting out its best case for relying *solely* on a theoretical threat of abuse.”). However, FERC decided against making the attempt.

96. *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002). FERC's authority to impose open-access requirements was upheld by the D.C. Circuit and not raised before the Supreme Court. The Supreme Court decision focused on FERC's authority over unbundled retail transmission. *New York*, 535 U.S. at 4–5.

Commission could have gone further and required retail unbundling. Interestingly, the only division on the Court was related not to whether FERC went too far, but whether the agency failed to go far enough. Three members of the Court wrote separately to state their view that FERC not only had authority to require transmission open access over transmission facilities unbundled from retail sales, but that FERC must go further and assert jurisdiction over all transmission facilities, including those associated with bundled retail sales.⁹⁷

The court decisions upholding Order No. 888 strongly suggest that FERC has not necessarily reached the limits of its authority under §§ 205 and 206 of the Federal Power Act. Essentially, these decisions held that the Commission could impose transmission open-access rules on all public utilities that owned transmission facilities in order to promote competition and reduce the potential for undue discrimination and preference, based on limited factual findings and relying heavily on theory.⁹⁸ The courts reaffirmed that FERC is at its zenith of authority when it acts to prevent undue discrimination and preference. Usually when an agency acts at its zenith of authority, it receives a zenith of deference from the courts on judicial review. There is no reason to conclude that FERC cannot rely on §§ 205 and 206 to impose additional requirements on public utilities if such requirements are designed to promote competition and reduce the potential for undue discrimination and preference, again relying largely on theory.

The policy objective sought by FERC in its transmission open-access rules was very important, namely promoting effective competition in wholesale power markets. The agency recognized that transmission open access was a necessary element of effective competition. Open access was the next major step in FERC's wholesale competition policy, a step that FERC concluded was essential. Reinterpretation of existing law was necessary to achieve that end. FERC's reinterpretation changed energy law because it fundamentally altered the long-standing interpretation of §§ 205

97. *New York*, 535 U.S. at 25, 29.

98. *See Transmission Access Policy Study Group*, 225 F.3d at 667, 683 (“[T]he open access requirement of Order 888 is premised not on individualized findings of discrimination by specific transmission providers, but on FERC’s identification of a fundamental systemic problem in the industry.”). One of the challenges to Order No. 888 was based on the Commission’s reliance on economic theory, namely the incentive for transmission-owning utilities to use their ownership of transmission facilities to exercise vertical market power and discriminate against competing wholesale power sellers. The court dismissed this line of attack, distinguishing *Electricity Consumers Resource Council v. FERC*, 747 F.2d 1511 (D.C. Cir. 1984), where the court reversed a FERC order because it “was persuaded that the Commission had distorted the economic theory it claimed to apply.” *Transmission Access Policy Group*, 225 F.3d at 688. The rule seems to be that to the extent broad FERC regulatory requirements are based on economic theory, they must rest on sound economic theory.

and 206 of the Federal Power Act. Yet, both the District of Columbia Circuit and the Supreme Court affirmed FERC's reinterpretation. Congress later amended the Federal Power Act without attempting to reverse the FERC transmission open-access rules. Based on these actions, one can conclude that Congress ratified FERC's interpretation of §§ 205 and 206. In fact, Congress went further and granted FERC additional authority to require open access by nonjurisdictional transmitting utilities.⁹⁹

The development of transmission open-access policy reflected a certain synergism between Congress and the Commission. Congress took the first step with enactment of the wheeling provisions of the Public Utility Regulatory Policies Act of 1978. Then, beginning in the 1980s, FERC took the next step by conditioning mergers and market-based rate cases on open-access requirements.¹⁰⁰ Congress largely ratified the Commission's open-access policy with the wheeling amendments in the Energy Policy Act of 1992. The biggest step toward open access was taken with adoption of Order No. 888 four years later. Congress took no action to disturb Order No. 888 after it was affirmed by the Supreme Court.

3. *Electric Market-Based Rates*

As discussed earlier, federal electricity law has recognized competition since the 1930s. However, the level of wholesale competition was very low until technological change destroyed the natural monopoly in generation and spurred the development of a new class of competitors, independent power producers. But federal policymakers consciously encouraged these developments.

Electricity competition policy was born in the United States in 1978 with enactment of the Public Utility Regulatory Policies Act.¹⁰¹ The birth was somewhat of an accident, since Congress did not obviously intend to promote competition in the Act. However, the birth occurred nonetheless as the Public Utility Regulatory Policies Act promoted competition in wholesale power markets by establishing a mandatory purchase requirement.¹⁰² The requirement obliged utilities to purchase generation from qualifying facilities that met certain requirements.¹⁰³ Because utilities

99. See *supra* note 75.

100. See Kelliher, *supra* note 32, at 553–70 (noting that an increased level of merger applications provided FERC an opportunity to condition the mergers on open-access requirements).

101. Public Utility Regulatory Policies Act of 1978, 16 U.S.C. §§ 1601–2645 (2006).

102. See *id.* § 824a-3 (2006) (requiring FERC to establish rules encouraging cogeneration and mandating that utilities offer to “purchase electric energy from such facilities”).

103. See Federal Power Act, 16 U.S.C. § 796(17)–(18) (2006) (defining relevant terms).

were barred from owning qualifying facilities, this new class of generation was reserved for nonutilities.¹⁰⁴

Beginning in the early 1980s, FERC “began to rely increasingly on market forces to lower wholesale power prices” and assure just and reasonable rates.¹⁰⁵ “To this end, the Commission began to authorize public utilities to charge market-based rates for wholesale power sales, rather than cost-based rates. This marked a fundamental change in FERC policy. The objective of this new policy was clearly to lower wholesale power prices.”¹⁰⁶

Authorization of market-based rates for wholesale power sales was a pillar of electric competition policy.¹⁰⁷ This was a departure from traditional cost-based ratemaking, which was focused on preventing the exercise of market power by controlling profits rather than by fostering efficiency.¹⁰⁸ FERC policy was intended to create competitive pressures that would improve efficiency, reduce costs, and lower wholesale power prices.¹⁰⁹

It is important to recognize that market-based pricing of wholesale power sales is not deregulation for the simple reason that wholesale sales have continued to remain regulated since FERC took the first steps toward development of its market-based rate policies. The nature of that regulation has changed significantly, to be sure, but wholesale power sales were never deregulated. FERC has steadily strengthened its regulation of wholesale power sales as it continues to authorize and review the validity of the grant of market-based rates.¹¹⁰

The foundation for market-based rate pricing is interpreting § 205 of the Federal Power Act to find that a market-based rate is “just and reasonable,” as required by § 205, if the seller lacks market power or has adequately mitigated its market power. The central duty of the Commission is to “guard the consumer from exploitation,” which is achieved by preventing

104. See 16 U.S.C. § 796(17)(C)(ii), (18)(B)(ii) (2000) (limiting “qualifying small power production facility” and “qualifying cogeneration facility” to facilities that are “owned by a person not primarily engaged in the generation or sale of electric power” other than from qualifying facilities).

105. Kelliher, *supra* note 9, at 8.

106. *Id.*

107. *Id.* at 8–9.

108. *Id.*; see *California ex rel. Lockyer v. FERC*, 383 F.3d 1006, 1012 (9th Cir. 2004) (“[A]pproximately a decade ago, companies began to file market-based tariffs that did not specify the precise rate to be charged. As a result, FERC then departed from its historical policy of basing rates upon the cost of providing service plus a fair return on invested capital, and began approving market-based tariffs.”).

109. Kelliher, *supra* note 9, at 9.

110. See Kelliher, *supra* note 9, at 13–14 (noting that FERC required additional filing requirements in 2002 for utilities engaged in wholesale cost and market rate sales).

market power exercise. That duty is equally fulfilled when market power exercise is prevented through robust competition as it is through classic rate regulation.

Essentially, FERC reinterpreted the 1935 Act after a half century to allow it to authorize market-based rates in addition to cost-of-service rates. The Commission was careful in its application of this new interpretation, approving market-based rates for individual sellers on an interim basis in a number of pricing experiments beginning in the 1980s.¹¹¹ These experiments led to a general policy that was applied through case-by-case adjudications.¹¹² It was many years after the inception of the market-based rate program that the Commission issued final regulations.¹¹³

The courts have upheld the Commission's reinterpretation, holding that the authorization of market-based rates is consistent with the agency's legal duty to assure just and reasonable rates.¹¹⁴ *Lockyer* upheld the FERC market-based rate program, distinguishing it from market-based programs developed by the Federal Communications Commission and Interstate Commerce Commission that were previously overturned because those agencies were deemed to have relied solely on market forces to assure just and reasonable rates.¹¹⁵ By contrast, the *Lockyer* court found FERC did not

111. Entergy Servs., Inc., 58 F.E.R.C. ¶ 61,234, at 61,753 (1992) (approving market-based rates for wholesale power sales in order to provide greater efficiencies than traditional cost-based rate regulation); Pub. Serv. Co. of Ind., 51 F.E.R.C. ¶ 61,367, at 62,225 (1990) (“[I]mproved supply options should allow the purchasing utilities to reduce their costs, which will benefit their ratepayers when these cost reductions are passed through in their bills.”), *modified sub nom.* PSI Energy, Inc., 52 F.E.R.C. ¶ 61,260, *clarified*, 53 F.E.R.C. ¶ 61,131, *petition dismissed sub nom.* N. Ind. Pub. Serv. Co. v. FERC, 954 F.2d 736 (D.C. Cir. 1992); Pac. Gas & Elec. Co., 38 F.E.R.C. ¶ 61,242, at 61,790 (1987) (allowing experimental competitive rates for wholesale power sales because “competition . . . encourages utilities to make efficient decisions with a minimum of regulatory intervention. Ultimately, consumers should benefit from lower prices as competition improves efficiency”), *modified*, 47 F.E.R.C. ¶ 61,121 (1989), *modified*, 50 F.E.R.C. ¶ 61,339 (1990), *modified sub nom.* W. Sys. Power Pool, 55 F.E.R.C. ¶ 61,099, at 61,319 (1991) (rejecting flexible pricing for bulk power sales because applicant had failed to eliminate anticompetitive effects by mitigating market power in generation and transmission), *granting stay*, 55 F.E.R.C. ¶ 61,154 (1991), *reh’g granted in part*, 55 F.E.R.C. ¶ 61,495 (1991), *modified*, 59 F.E.R.C. ¶ 61,249 (1992); Pub. Serv. Co. of N.M., 25 F.E.R.C. ¶ 61,469, at 62,059–60 (1983) (approving experiment to promote efficiency in wholesale power markets through market-based pricing of sales).

112. Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities, 72 Fed. Reg. 39,904 (July 20, 2007) (to be codified at 18 C.F.R. pt. 35); 73 Fed. Reg. 25,832 (May 7, 2008) (order on rehearing).

113. *Id.*

114. See California *ex rel.* Lockyer v. FERC, 383 F.3d 1006, 1013 (9th Cir. 2004) (determining that market-based tariffs do not, per se, violate the Federal Power Act); see also La. Energy & Power Auth. v. FERC, 141 F.3d 364, 365 (D.C. Cir. 1998) (rejecting that FERC acted arbitrarily and capriciously by approving market-based rates without a hearing); see also Kelliher, *supra* note 9, at 12.

115. *Lockyer*, 383 F.3d at 1013. The court also found FERC did not adequately enforce

rely solely on an *ex ante* finding that an applicant for market-based rates lacks market power, but that it also relied on continuing reporting requirements to assure that rates were just and reasonable and not subject to market manipulation.¹¹⁶ The Supreme Court has not ruled on the legality of the FERC market-based rate program, denying two petitions for certiorari.¹¹⁷

Since *Lockyer*, Congress enacted the Energy Policy Act of 2005 without seeking to reverse FERC's interpretation of its authority to approve market-based rates. Not only were no provisions enacted to that end, there were no amendments offered or even introduced to curtail market-based rates. That is significant, since the Energy Policy Act of 2005 was enacted in the wake of the California and western power crisis of 2000–2001, and it would have been a simple matter to draft legislation to reverse FERC's interpretation. It would have been a matter of adding a simple sentence to § 205, or perhaps only a few words. It can be concluded that Congress ratified FERC's interpretation of the Federal Power Act to authorize market-based rates.

4. *Hydrokinetics*

A more recent example of where FERC has reinterpreted existing law in a manner that changed energy law is in the area of licensing hydrokinetics projects by reinterpreting the Federal Water Power Act of 1920 to establish a pilot license for new hydrokinetic projects.¹¹⁸ Hydrokinetics is the use of waves, tides, and currents from oceans and free-flowing rivers to generate electricity. The potential for these technologies is tremendous.¹¹⁹

In the wake of a technical conference held by FERC in December 2006 on barriers to the development of hydrokinetics technology, the agency concluded the greatest need was exhibition of these technologies through demonstration or pilot projects. There is virtually no operating history for

the *ex post* reporting requirement. *Id.* at 1014.

116. *Id.*

117. *Id.* at 1006, *cert. denied*, 127 S. Ct. 2972 (2007); Colo. Office of Consumer Counsel v. FERC, 490 F.3d 954 (D.C. Cir. 2007), *cert. denied*, 128 S. Ct. 1872 (2008). In *Morgan Stanley*, the Supreme Court specifically noted it had not ruled on the legality of the FERC market-based rate program. *Morgan Stanley Capital Group, Inc. v. Pub. Util. Dist. No. 1*, 128 S. Ct. 2733, 2741 (2008) (“Both the Ninth Circuit and D.C. Circuit have generally approved FERC’s scheme of market-based tariffs. We have not hitherto approved, and express no opinion today, on the lawfulness of the market-based-tariff system, which is not one of the issues before us.”) (citations omitted).

118. The Federal Water Power Act of 1920 became Part I of the Federal Power Act upon enactment of the Public Utility Act of 1935, Pub. L. 74-333, 49 Stat. 803, 838, 839 (codified as amended at 16 U.S.C. §§ 791, 791a (2006)).

119. See generally FERC, HYDROELECTRIC INFRASTRUCTURE TECHNICAL CONFERENCE, (2006), <http://elibrary.ferc.gov/idmws/nvcommon/NVViewer.asp?Doc=11217148:0>.

the various hydrokinetics technologies, so demonstration projects are necessary to prove these technologies to the point where they can obtain financial support.

To authorize demonstration projects, a licensing process suitable for pilot projects to test these technologies is needed. The licensing process used by FERC for conventional hydropower projects since 1920 is not suitable for demonstration projects. A conventional hydropower license has a fifty-year term and requires the submission of a license application containing significant environmental data. This process is not suitable for hydrokinetics demonstration projects since these projects have no operating history and cannot submit measurable environmental data in a license application. Also, a fifty-year term is far too long for a pilot project.

For these reasons, as Chairman, I directed FERC staff to consider whether the agency could establish a new licensing process suitable for demonstration projects. FERC staff responded with a very creative pilot license proposal drawn from a reinterpretation of the 1920 Act. Under this pilot license, an applicant would be required to submit minimal environmental data upfront. But a pilot license would require monitoring to identify any harm to fish or the environment and would authorize FERC to order suspension of operation or removal of such a project. The term of the pilot license would run five years, much shorter than the fifty-year term for conventional projects under existing law. The new hydrokinetics pilot license has not been tested in the courts yet, but there has been broad enthusiasm for the new approach developed by the Commission.

The key to development of the pilot license was the observation that § 6 of the Federal Power Act sets a maximum limit of fifty years for an original license, but no minimum limit.¹²⁰ The result has been a surge of applications for pilot licenses.¹²¹ What is interesting is that a licensing process designed nearly ninety years ago for conventional hydropower projects has been adapted to meet the needs of hydrokinetics technologies that were not contemplated at that time. That is a tribute to how well the Federal Water Power Act of 1920 was drafted, as well as to the creativity of the FERC staff when presented with a challenge.

5. *Gas Gathering*

Not all agency reinterpretations of existing law are successful, however, and some are even reversed by the courts. One of the areas where FERC has been most persistent and creative in interpreting its legal authority is in

120. Federal Power Act § 6, 16 U.S.C. § 799 (2006).

121. As of January 5, 2009, FERC had issued 138 preliminary permits for hydrokinetic licenses under the pilot program, with 68 applications for preliminary permits pending.

the area of jurisdiction over offshore natural gas gathering facilities. This is also an area where FERC has suffered a long series of defeats in court.¹²²

Under the Natural Gas Act, FERC does not have jurisdiction over gathering facilities.¹²³ *Gathering* has been defined as “the collecting of gas from various wells and bringing it by separate and several individual lines to a central point where it is delivered into a single line.”¹²⁴ Under the Natural Gas Act, gathering facilities are left to the jurisdiction of the states.¹²⁵

FERC uses a “primary function” test to determine whether a facility is devoted to jurisdictional interstate transportation or nonjurisdictional gathering of natural gas.¹²⁶ Under that test, FERC relies on various physical characteristics of the facilities to determine their jurisdictional status. The line between gathering and transportation facilities is reasonably easy to draw onshore. But in the decades since enactment of the Natural Gas Act in 1938, natural gas production has increasingly moved offshore, both to state and federal waters. The movement of gathering offshore into federal waters creates a regulatory gap, where neither federal nor state regulators have authority over gathering.

This regulatory gap has arisen in part due to natural gas pipeline unbundling. Before Order No. 436, “interstate natural gas pipelines generally did not perform transportation-only or gathering-only services.”¹²⁷ Instead, they “used all their facilities, including any gathering facilities they owned, to provide a bundled transportation and sale for resale service, for which they charged a single bundled rate.”¹²⁸ As part of Order No. 436, FERC required that rates for open-access transportation service separately identify cost components attributable to transportation, storage, and gathering.¹²⁹ Upon implementation of Order No. 436, pipelines “generally continued to bundle gathering service within their stand-alone open-access transportation service.”¹³⁰ The Commission

122. *See, e.g.*, *EP Operating Co. v. FERC*, 876 F.2d 46, 48 (5th Cir. 1989); *Sea Robin Pipeline Co. v. FERC*, 127 F.3d 365, 368 (5th Cir. 1997).

123. Natural Gas Act § 1(b), 15 U.S.C. § 717(b) (2006).

124. *Barnes Transp. Co.*, 18 F.P.C. 369, 372 (1957); *see also ExxonMobil Gas Mktg. Co. v. FERC*, 297 F.3d 1071, 1076 (D.C. Cir. 2002).

125. Natural Gas Act § 1(c), 15 U.S.C. § 717(c) (2006).

126. FERC first articulated the primary function test in *Farmland Indus., Inc.*, 23 F.E.R.C. ¶ 61,083 (1983). The Commission later modified the test in *Amerada Hess Corp.*, 52 F.E.R.C. ¶ 61,268 (1990).

127. *Criteria for Reassertion of Jurisdiction over the Gathering Services of Natural Gas Company Affiliates*, 118 F.E.R.C. ¶ 61,114, para. 4 (2007) [hereinafter *Gathering Clarification Order*].

128. *Id.*

129. 18 C.F.R. § 284.10(c)(1) (2006).

130. *Gathering Clarification Order*, 118 F.E.R.C. at para. 8.

repeatedly urged pipelines to fully unbundle gathering from transportation service,¹³¹ and ultimately most pipelines did so.¹³² In the wake of Order No. 636, pipelines began to “spin down” their gathering facilities to corporate affiliates or to “spin off” the facilities to unrelated third parties.¹³³

It is in the nature of economic regulatory bodies to deplore unregulated monopolies. They are viewed as an evil, and something that cannot be tolerated. That instinct, and it truly is an instinct, has likely been the impetus for some of the persistence by FERC in seeking a means to regulate offshore gathering. Over the past fourteen years, FERC has advanced a variety of legal theories to justify some assertion of rate regulation over offshore natural gas gathering facilities. The courts have rejected each of these legal theories.¹³⁴

The first attempt was in *Arkla Gathering Services Co.*, where FERC attempted to regulate gathering performed by affiliates of interstate natural gas pipelines.¹³⁵ The Commission held that it could regulate gathering by affiliates of natural gas companies, even if those affiliates were not jurisdictional “natural gas companies” according to its “in connection with” jurisdiction under Natural Gas Act §§ 4 and 5, if exerting control is “necessary to accomplish the Commission’s policies for the transportation of natural gas in interstate commerce.”¹³⁶ FERC held that if a gathering affiliate acted in concert with a jurisdictional pipeline in a manner that frustrated effective regulation of the pipeline, the agency could look through or disregard corporate form and treat the pipeline and affiliate as a single entity, and regulate the gathering facilities as if they were owned by the interstate pipeline.¹³⁷ In *Conoco Inc.*, the court reversed the Commission’s requirement that a pipeline file a default gathering contract continuing existing rates in a spin down on the grounds that the agency had

131. FERC stated its preference for full unbundling of gathering service from transportation in its 1989 Rate Design Policy Statement, Interstate Natural Gas Pipeline Rate Design, 47 F.E.R.C. ¶ 61,295, at 62,059 (1989), restating its strong preference for fully unbundling gathering service in Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation, and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 57 Fed. Reg. 36,128 (Aug. 12, 1992).

132. Gathering Clarification Order, 118 F.E.R.C. at para. 8.

133. *Id.* paras. 17–20.

134. *Williams Cos. v. FERC*, 345 F.3d 910 (D.C. Cir. 2003); *Sea Robin Pipeline Co. v. FERC*, 127 F.3d 365 (5th Cir. 1997); *Nw. Pipeline Corp. v. FERC*, 905 F.2d 1403 (10th Cir. 1990); *EP Operating Co. v. FERC*, 876 F.2d 46 (5th Cir. 1989).

135. *Arkla Gathering Servs. Co.*, 67 F.E.R.C. ¶ 61,257, *order on reh’g*, 69 F.E.R.C. ¶ 61,280 (1994), *reh’g denied*, 70 F.E.R.C. ¶ 61,079 (1995), *reconsideration denied*, 71 F.E.R.C. ¶ 61,297 (1995), *aff’d in part and rev’d in part*, *Conoco Inc. v. FERC*, 90 F.3d 536 (D.C. Cir. 1996).

136. *Arkla Gathering Servs. Co.*, 67 F.E.R.C. at 61,871.

137. *Id.*

not identified any authority for that condition.¹³⁸ But the court did not rule on FERC's reservation of the right to reassert jurisdiction, preferring to wait until an exercise of authority.¹³⁹

Partially rebuffed, FERC turned to § 5(e) of the Outer Continental Shelf Lands Act as the basis to assert jurisdiction over offshore gathering facilities. The agency issued rules requiring companies providing natural gas transportation services, including gathering, on the Outer Continental Shelf to file information concerning pricing and service structures, including information gathering.¹⁴⁰ This attempt was also frustrated, as the courts vacated the FERC rules.¹⁴¹

The Commission next turned back to the Natural Gas Act, seeking to apply the reservation of authority in *Arkla* to a particular case. Acting on a complaint from Shell against Transco and its gathering affiliate, the Commission found that the pipeline and affiliate had acted in concert to frustrate FERC regulation by requiring Shell to pay exorbitant gathering rates and to agree to anticompetitive conditions.¹⁴² The Commission imposed a just and reasonable gathering rate.¹⁴³

On judicial review, *Williams Gas Processing-Gulf Coast Co. v. FERC* vacated and remanded the Commission's orders.¹⁴⁴ At the heart of the court's ruling was its conclusion that the agency misapplied the *Arkla* test. In particular, the court suggested that closing a regulatory gap with respect to offshore gathering was not a legitimate purpose, holding that the rationale for regulation under *Arkla* was preventing frustration of regulation of the *pipeline*, not the gatherer.¹⁴⁵ Thus, the *Williams* court placed strict limits on the scope of the *Arkla* test.¹⁴⁶

In the wake of *Williams*, the Commission issued a notice of inquiry to evaluate possible changes to the *Arkla* test and invited suggestions based on other legal theories to justify regulation of offshore gathering.¹⁴⁷ In response, FERC clarified the *Arkla* test but concluded that a gathering

138. *Conoco Inc.*, 90 F.3d at 553.

139. *Id.*

140. Regulations Under the Outer Continental Shelf Lands Act Governing the Movement of Natural Gas on Facilities on the Outer Continental Shelf, Order No. 639, 65 Fed. Reg. 20,354 (Apr. 17, 2000); 65 Fed. Reg. 47,294 (Aug. 2, 2000) (order on rehearing); 93 F.E.R.C. ¶ 61,274 (2000) (order denying clarification).

141. *Williams Cos. v. FERC*, 345 F.3d 910, 916 (D.C. Cir. 2003).

142. *Transcon. Gas Pipe Line Corp.*, 96 F.E.R.C. ¶ 61,115 (2001).

143. *Transcon. Gas Pipe Line Corp.*, 103 F.E.R.C. ¶ 61,177, para. 41 (2003).

144. *Williams Gas Processing-Gulf Coast Co. v. FERC*, 373 F.3d 1335, 1345 (D.C. Cir. 2004).

145. *Id.* at 1343.

146. *Id.* at 1342–43.

147. Criteria for Reassertion of Jurisdiction over the Gathering Services of Natural Gas Company Affiliates, 70 Fed. Reg. 55,819 (issued Sept. 23, 2005) (notice of inquiry).

affiliate charging a monopoly rent for gathering is an insufficient basis to reassert jurisdiction.¹⁴⁸

In the end, the Commission ran out of legal theories, accepted the limits on its Natural Gas Act jurisdiction over gathering, and reluctantly acquiesced in the reality that offshore gathering is an unregulated monopoly.¹⁴⁹ The Natural Gas Act provides for unregulated monopolies in offshore gathering, and FERC recognizes legislation is necessary for it to obtain jurisdiction over offshore gathering.¹⁵⁰

CONCLUSION

Federal regulatory agencies are agencies with limited powers, the powers specified in the statutes charged to their administration. I recognize those limits, and my record of decisions as Chairman and Commissioner of FERC demonstrates that I respect those limits. But frequently those statutes lend themselves to more than one interpretation. As discussed earlier, the question of which interpretation to choose depends to a large extent on a balancing of the need for the agency to take a particular action, the discretion afforded by existing law, and the level of legal risk.

With respect to assessing the need to act, a governing factor is the nature of the duties entrusted to an agency. The courts have held that the primary task of the Commission is to guard the consumer from exploitation. In my view, that is not a passive duty. All things being equal, in my experience, an agency is more likely than not to choose a conservative interpretation of its legal authority. However, when presented with new challenges, springing from the dynamic nature of energy markets, technological developments, the convergence of energy markets with other markets, the tension between energy and environmental law, and other factors, an agency may elect a more expansive interpretation.

The pace of change in energy law has increased in recent years, and signal change has come equally from enactment of new legislation, court decisions, and agency interpretations. I see no reason to expect that the

148. Gathering Clarification Order, 118 F.E.R.C. at para. 35.

149. See Press Release, FERC, Commission Clarifies Policy on Jurisdiction over Natural Gas Gathering Facilities (Feb. 15, 2007), <http://www.ferc.gov/news/news-releases/2007/2007-1/02-15-07-G-1.asp>. FERC Chairman Joseph T. Kelliher has observed that

[t]he Commission has tried a number of times to assert jurisdiction over offshore gathering facilities to protect against undue preference and the exercise of monopoly power, but has been repeatedly rebuffed by the courts. We must accept the judgment of the courts. Under current law, offshore gathering is an unregulated monopoly. That will remain the case unless and until the law changes.

Id.

150. *Id.*

pace of change will slow, since the factors that have led to changes in energy law in recent years have not dissipated. If anything, the pressure for continued change is rising.

Although energy law can be expected to continue to change, the manner in which that change is accomplished is uncertain. It is possible that Congress will enact significant energy or environmental legislation that effects significant change. I hope the Obama Administration and Congress will have the wisdom to pursue an approach that achieves a balance between sound energy and environmental policy. It is also possible that Congress will attempt to enact legislation but fail in the process. My hope is that enactment of climate-change legislation will not prove to be a Sisyphean task. If so, the path that change in energy law takes to achieve carbon reductions may be agency reinterpretation of existing law, principally reinterpretation of the Clean Air Act by EPA. That may require FERC and other agencies in turn to reinterpret other laws to fulfill their respective legal duties.

But there are limits on the extent of change that can be accomplished through the reinterpretation of existing law. Certain changes in energy and environmental law can only be achieved through enactment of new legislation.

In my view, FERC has not reached the full limits of its statutory authority, and there remains nascent authority in the Federal Power Act and Natural Gas Act. Whether there is a need for the agency to reinterpret its statutory authority more expansively in the future depends on the circumstances, on both the need to act and the willingness of Congress to enact sound energy legislation.