Misguided Energy: Why Recent Legislative, Regulatory, and Market Initiatives are Insufficient to Improve the U.S. Energy Infrastructure

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ARTICLE

MISGUIDED ENERGY: WHY RECENT LEGISLATIVE, REGULATORY, AND MARKET INITIATIVES ARE INSUFFICIENT TO IMPROVE THE U.S. ENERGY INFRASTRUCTURE

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This Article argues that recent legislative and regulatory attempts to address inadequate energy infrastructure in the United States are too limited in scope and rely too heavily on market-based initiatives to stimulate the urgent improvements that are necessary. The Article analyzes the likely effects of the Energy Policy Act of 2005, challenging the assumption that the provisions intended to remove potential impediments to investment—including those repealing the Public Utilities Holding Company Act and modifying the merger review authority of the Federal Energy Regulatory Commission (“FERC”)—are likely to result in significant new investment in energy infrastructure. In addition to identifying remaining impediments to FERC’s siting authority, the Article explains how FERC’s increased use of market-based rates is insufficient to attract the necessary capital for infrastructure construction, considering the long lead times involved and the potentially tragic effects that can befall consumers in the interim. As a model of a successful regulatory approach, the Article examines the limited success of small-scale emergency orders in improving the energy infrastructure in targeted areas during the aftermaths of the California Energy Crisis and Hurricanes Katrina and Rita. The author concludes by calling for similar targeted intervention, albeit on a larger scale, and specifically recommends the expansion of federal siting authority for new construction and the provision of financial incentives tied to realistic deadlines to attract new investment.

I. Introduction

Soaring energy prices, natural gas supply shortages, and blackouts in major areas of the United States have led to a flurry of legislative and regulatory activity. Through this activity, lawmakers and regulators purport to resolve problems regarding natural gas and electricity supplies and service reliability.¹ A major goal of these actions has been to address

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¹ Gasoline supply and prices are the most publicized of the U.S. energy issues; how-
the overall energy crisis by increasing investment in the U.S. energy infrastructure.\(^2\) However, as is often the case with political remedies for difficult problems, what is being done and what legislators and policymakers claim is being done are two entirely different things. Recent legislative and regulatory policies are simply ill-equipped to have any substantial impact on the nation’s energy infrastructure in the foreseeable future. Although some of the policies provide long-term hope for increasing the amount and sources of capital available for investment, they are not adequate solutions to a current, and progressing, energy crisis.

The goal of increasing investment in U.S. energy infrastructure is well-founded. The most notable recent infrastructure failure was the blackout of August 2003, which left more than fifty million people in Canada and the Great Lakes, New England, and mid-Atlantic regions without power and reportedly caused $10 billion in damage in the United States alone.\(^3\) More recently, an unexpected 101-degree April day in Texas led to rolling blackouts affecting approximately 210,000 homes.\(^4\) Such failures cause a “ripple effect of disruption and damage far beyond the energy industry’s own domain”\(^5\) because of the substantial economic investments that are based on electricity being available at predicted levels and costs.\(^6\)

And the crisis likely will only get worse. The current energy infrastructure is insufficient in light of current demand, and the demand for energy in the United States is projected to increase at an average annual rate of 1.5% per year.\(^7\) In 2005, the volume of electricity generation rose 2.1% and electricity sales increased by 3.2% from 2004 levels.\(^8\)

Unfortunately, such failures are not shocking. A dearth of investment in electricity transmission infrastructure is a significant part of the prob-

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\(^2\) Energy infrastructure includes all infrastructure related to the production, generation, transmission, or distribution of energy. See Critical Energy Infrastructure Information, 71 Fed. Reg. 58,273, 58,274 (Oct. 3, 2006) (providing the definition of Critical Energy Infrastructure Information). However, the most glaring infrastructure need, and thus the primary focus of this Article, relates to the interstate electric transmission lines.


\(^6\) See id. at 830 (stating that the prices paid for ineffective deregulation are “momentous” for small businesses, consumers, and energy infrastructure and that there are numerous other indirect victims).


lem. Electric transmission investment, in real dollars, declined for the twenty-three years between 1975 and 1998. Investment increased after 1998 but remains below 1975 levels. In the same time period, demand for electricity has more than doubled. Perhaps more illustrative of the lack of infrastructure investment is that “the interstate transmission system expanded [merely] by a total of 0.6 percent in circuit miles” in 2004. There are indications that transmission investment has been growing considerably since 1999, but additional transmission investment remains necessary because current investment is not necessarily increasing efficiency.

Rather than establishing an effective transportation grid, developers currently tend to invest in electricity transmission only where it is clearly necessary for reliability or where it lowers local costs. Both of these are good reasons for investment, but new investment is also needed to create an effective nationwide transportation network that will facilitate long-distance electricity transportation. Such a network would provide economic benefit and improve reliability, and would facilitate a better energy market through increased energy source options.

The amount of capital needed for infrastructure investment is staggering: “Energy industry spokespeople have called for grid investments of $56 billion, $100 billion, and even as much as $450 billion in total electricity infrastructure investments.” And these infrastructure investments are needed now. Congress, regulators, and other leaders should address the problem directly because a failing infrastructure truly is a crisis. Yet, despite political rhetoric to the contrary, these actors are apparently reluctant to wage a more full-scale, direct attack on the problem, perhaps in

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10 Id. at 1.

11 Id.


14 See id. at 18.

15 See id.


17 See Claire Poole, High Voltage Capital, DAILY DEAL, Sept. 12, 2005 (stating that the energy “sector still needs capital, perhaps $100 billion over the next 10 years for upgrades and new generation and transmission so blackouts like the one in the Northeast in 2003 don’t happen again”).
part because it is not clear that appropriate short-term measures are readily available. Assertive measures, more expansive than the “emergency measures” taken by the Federal Energy Regulatory Commission (“FERC” or “Commission”)\(^{18}\) in response to the California energy crisis of 2000 to 2001 (“2000-2001 California Energy Crisis”) and Hurricanes Katrina and Rita,\(^{19}\) are necessary on a sustained, national scale.\(^{20}\)

There are strong indications that infrastructure investment is key to alleviating many of the energy issues affecting the United States.\(^{21}\) The 2003 blackout affecting much of the midwestern United States and the New York metropolitan area demonstrated that the current energy infrastructure cannot always satisfy peak demand\(^{22}\) and lacks important redundancies that would improve reliability.\(^{23}\) The chaos that accompanied these mass power outages\(^{24}\)—the result of both infrastructure and operational failures\(^{25}\)—indicates that the United States could be especially vulnerable to targeted and deliberate attacks on its power supplies.\(^{26}\) This risk is yet another reason to support improvements in the U.S. energy infrastructure.\(^{27}\)

\(\text{\textsuperscript{18}}\) Please note that citation of FERC orders and cases herein is consistent with FERC’s guidance for the citation of FERC orders. See 2 FERC, FERC Prac\(\text{\textsuperscript{tice}}\)ce & Procedure Manual ¶ 2003.05 (2007) (quoting Notice Regarding Paragraph Numbering in Commission Orders (Dec. 19, 2001) (unreported)). The manual provides one citation format for orders issued before June 26, 2002 and another for orders after that date. See id.

\(\text{\textsuperscript{19}}\) See infra Part III.B.

\(\text{\textsuperscript{20}}\) FERC regulates wholesale sales of electricity and natural gas, which is then sold via retailers to consumers under individual state regulatory schemes. See Schneidewind v. ANR Pipeline Co., 485 U.S. 293, 200–01 (1998). Such review of the activities at a federal level provides valuable insight regarding likely investment around the United States. Jim Rossi, Transmission Siting in Deregulated Wholesale Power Markets: Re-Imagining the Role of Courts in Resolving Federal-State Siting Impasses, 15 Duke Envtl. L. & Pol’y F. 315, 315–16 (2005) (arguing that “courts can play a positive role to facilitate the resolution of state-federal siting conflicts”). Of course, “[d]uring most of the twentieth century, state and local regulatory bodies coordinated the siting of power plants and transmission lines.” Id. However, because of the many variations among the states and the relatively low impact of other federal agencies on energy infrastructure investment, this Article focuses on federal legislation and FERC regulation.

\(\text{\textsuperscript{21}}\) See, e.g., Neil J. Numark & Robert D. MacDougall, Nuclear Power in Deregulated Markets: Performance to Date and Prospects for the Future, 14 Tul. Envtl. L.J. 463, 464 (2001) (“Electricity deregulation in the United States is still in the first inning of play, and some worry the future will be darker if deregulation does not offer sufficient incentives for new power plant construction.”).

\(\text{\textsuperscript{22}}\) See id. (stating that “the final report of the U.S.-Canada Power System Outage Task Force . . . concluded that poor free maintenance along transmission lines in the First Energy (Ohio) service area, combined with inoperative computer software and operator errors, were the proximate cause of the blackout”).

\(\text{\textsuperscript{23}}\) See Matthew H. Brown & Richard P. Sedano, Electricity Transmission: A Primer 9 (2004), available at http://www.raponline.org/Pubs/ELECTRICITYTRANSMISSION.pdf (“If the transmission system is robust, with a certain amount of redundancy built in, it can withstand the failure of its most critical lines or other components.”).

\(\text{\textsuperscript{24}}\) See, e.g., Phillip Coorey & Larry McShane, Chaos Rocks Crisis Cities, Sunday Mail (Austl.), Aug. 17, 2003, at 38 (noting that millions were without power as a result of “America’s worst power failure”).

\(\text{\textsuperscript{25}}\) See Numark & MacDougall, supra note 21, at 464.

\(\text{\textsuperscript{26}}\) See Steven E. Roberts, Protect the Power Grid, 52 Miami Daily Bus. Rev. 6 (2005) (“Security experts have long warned that the electric grid is vulnerable to terrorism . . . .”).
infrastructure. Improved energy infrastructure would not, of course, prevent terrorist attacks. But an improved infrastructure would help mitigate the damages and difficulties stemming from power outages, regardless of the cause.

The most high-profile portion of the Energy Policy Act of 2005 ("EPAct 2005") represents a response to the complaints of business and corporate leaders that restrictions on corporate structures and other regulatory hurdles have limited the number of available sources of capital for investment in utilities. Prior to the enactment of EPAct 2005, business leaders continually argued that regulatory changes (that is, relaxed regulation) were essential to increase investment. In response to the current and continuing "energy crisis," Congress took action to remove several long-standing restrictions on the corporate structure and governance of U.S. utilities, and thereby improve, at least in theory, the U.S. energy infrastructure. Politicians, regulators, and corporate leaders have all lauded these recent activities as crucial steps that will increase capital investment and "help modernize our aging energy infrastructure.

Other less prominent portions of EPAct 2005 could increase investment more directly if the new or modified grants of power are actively and aggressively used. In one of the provisions providing the most promise, FERC was granted "backstop authority" for siting interstate electric

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28 See Markian M. W. Melnyk & William S. Lamb, PUHCA's Gone: What is Next for Holding Companies?, 27 ENERGY L.J. 1, 1 (2006) ("[The Public Utilities Holding Company Act of 1935 ("PUHCA")] was widely believed to have discouraged investment in electric and gas utility infrastructure by companies that could not restructure to satisfy PUHCA's prohibition on the ownership of diversified business;"); see also infra note 67 and accompanying text.
29 See, e.g., California ex rel. Lockyer v. FERC, 329 F.3d 700, 703, 711 (9th Cir. 2003) (denying petition seeking review of FERC's decision to expedite approval of a corporate reorganization and finding that FERC had acted properly "to mitigate the growing California energy crisis").
31 See infra Part II.A.
33 See EPAct 2005 § 1221, 16 U.S.C.S. § 824p (LexisNexis 2006); see also Roseman, supra note 13, at 18. This limited authority is called "backstop" because it is available only where states lack the authority or otherwise have failed to act. The term "backstop" has often been used to describe this type of federal authority in the energy industry. See, e.g., 149 CONG. REC. H11415 (2003) (statement of Rep. Joe Barton (R-Tex.)) (referring to the Energy Policy Act of 2003, S. 2095, 108th Cong. (2003), which was never passed, as "federal backstop authority for siting of new transmission lines"); 147 CONG. REC. S9158 (2001) (statement of Sen. Jeff Bingaman (D-N.M.)) (arguing that "what is needed is to use federal eminent domain as a backstop to a more cooperative, regionally based approach to transmission and siting issues" in discussing "legislativesolution[s]" to energy problems in 2001).
transmission facilities. This limited authority is available only in areas the Department of Energy ("DOE") identifies as a "national interest electric transmission corridor" ("NIETC"). DOE will issue a report in which it will "designate any geographic area experiencing electric energy transmission capacity constraints or congestion that adversely affects consumers as a [NIETC]." In addition, EPAct 2005 grants FERC exclusive jurisdiction over siting, construction, expansion, and operation of liquefied natural gas ("LNG") terminals. However, despite the promise of these provisions, similar past initiatives have failed to produce significant results.

EPAct 2005 was passed, in part, because the United States faces both short-term and long-term energy issues, and while the recent high-profile activities may provide some long-term benefit, they do not offer much promise for remediating the very real short-term problems. As a sponsor of EPAct 2005, Senator Pete Domenici (R-N.M.) admitted: "It's not a bill for today or necessarily tomorrow—it's for the future." The suggestion that EPAct 2005 may not be especially effective is not a unique proposition. It is, after all, the same bill that Senator John McCain (R-Ariz.), among others, dubbed "the No Lobbyist Left Behind Act of 2005.

Given the political rhetoric regarding both public safety issues and energy prices, it would seem that the nation’s leaders would be eager to incentivize significant and immediate infrastructure investment. However, recent legislative and regulatory actions provide, at best, long-term prom-

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35 Id.
36 Id.
37 LNG is natural gas that is condensed into a liquid after having being cooled to minus 260 degrees Fahrenheit or below. See Monica Berry, Liquefied Natural Gas Import Terminals: Jurisdiction over Siting, Construction, and Operation in the Context of Commerce Clause Jurisprudence, 26 Energy L.J. 135, 137 (2005).
38 EPAct 2005 § 311(c)(2), 15 U.S.C.S. § 717b(e)(1) (LexisNexis 2006) ("[FERC] shall have the exclusive authority to approve or deny an application for the siting, construction, expansion, or operation of an LNG terminal."). This power is limited by certain rights retained by the states pursuant to: (1) the Coastal Zone Management Act, 16 U.S.C. §§ 1451-1466 (2000); (2) the Clean Air Act, 42 U.S.C. §§ 7401-7431 (2000); and (3) the Federal Water Pollution Control Act, 33 U.S.C. §§ 1251–1274 (2000).
39 See infra Part III (discussing the limited success of FERC’s emergency orders designed to remedy infrastructure problems related to Hurricanes Rita and Katrina).
40 Jim VandeHei & Justin Blum, Energy Bill Unlikely to Lower Prices, CHARLOTTE OBSERVER, Aug. 9, 2005, at 1A, 7A.
41 See, e.g., Robert Westervelt, Dow CEO Urges Action on Natural Gas “Crisis,” CHEM. WEEK, Nov. 16, 2005, at 11 ("The Energy Policy Act of 2005 was a good start toward addressing the supply-demand problem that drives the U.S. natural gas crisis, and I commend [Congress] for it. But that is not enough. Congress must act now." (internal quotation marks omitted) (quoting Andrew Liveris, Chairman and CEO, Dow Chemical Co.)).
The political claims that EPAct 2005 comprehensively addresses the looming “energy crisis” simply do not accurately describe the actions taken. Certainly, it partly addresses the energy crisis, but for all the discussion about the major problems, the proposed fixes are either small in scope or do not address the infrastructure problems.

There are three primary ways in which legislators and regulators have attempted to increase investment in energy infrastructure. First, with the hope of increasing utilities’ access to capital, they have removed or relaxed several barriers to capital investment. Second, they have permitted incentive pricing policies, including market-based rates (as opposed to traditional, cost-based rates) and favorable tax treatment for new investments in certain circumstances for both natural gas and electricity. Third, the regulatory approval processes for mergers and acquisitions and for construction of new facilities have been streamlined, at least in theory.

The present programs designed to address major infrastructure are too vague and ill-defined to initiate major construction projects. Conversely, recent short-term efforts are so limited that vast infrastructure needs remain even in the targeted areas. To address a large-scale energy crisis, a coherent and comprehensive federal energy program is needed. A major program must be designed to identify energy infrastructure needs quickly and accurately, provide attractive financial incentives, and provide aggressive yet feasible deadlines to motivate investors. The authority of the fed-

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44 See, e.g., OilOnline, CEO Alliance Calls on Congress to Take Immediate Action to Increase Natural Gas Supplies, OilOnline Internet Inquirer, Mar. 28, 2006, http://www.oilonline.com/news/headlines/internet/20060328.CEO_Alli.20760.asp (“I believe we are facing an energy crisis of epic proportions and in order to solve it, policy makers must take immediate action.” (internal quotation marks omitted) (quoting Larry Downes, CEO, New Jersey Resources)).


46 See infra Part II.A.

47 See, e.g., In re Cal. Wholesale Elec. Antitrust Litig., 244 F.Supp. 2d 1072, 1076 (S.D. Cal. 2003) (“The key feature of California’s recently deregulated wholesale energy markets is the markets’ reliance on ‘market-based rates.’ These rates are still subject to FERC oversight, but to a much lesser extent than traditional ‘cost-based rates.’”); Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines and Regulation of Negotiated Transportation Services of Natural Gas Pipelines, 61 Fed. Reg. 4633, 4633 (Feb. 7, 1996) (stating that FERC had been “exploring the criteria it should use when evaluating rates established through methods other than the traditional cost-of-service ratemaking method” and was “now providing the industry with guidance by stating the criteria it will consider when evaluating proposals for market-based rates”). See generally infra Part II.B.


49 See infra Part II.C.
eral government must be expanded and exercised to ensure that regulatory delays do not impede the process.

This Article reviews recent federal legislative and regulatory activity seeking to improve energy infrastructure and analyzes the ability of each action to achieve this goal efficiently and effectively. In Part II, the Article reviews the current federal statutory scheme and related developments in market rates and pricing. Part II first briefly reviews EPAct 2005, which includes the historic repeal of the Public Utilities Holding Company Act of 1935 ("PUHCA"). 50 This discussion considers the events leading to the passage of PUHCA and its subsequent repeal and assesses the likely impact (both positive and negative) that the repeal of PUHCA will have on timely investment in energy infrastructure. Part II next describes the use of pricing incentives and the advent of market-based rates in wholesale energy markets, and elucidates the apparent economic and political rationales behind such incentives and rates. This Part then summarizes recent and expected developments related to these incentive pricing programs. Part II concludes by looking at recent legislation and the subsequent regulatory actions related to approval of mergers and acquisitions under the Federal Power Act ("FPA"). 51

Part III explains that while significant legislative and regulatory activities abound, the actions to date provide little reason to expect significant changes in the near future. This Part considers recent FERC action in response to certain "emergencies" related to the 2000–2001 California Energy Crisis and Hurricanes Rita and Katrina and argues that these emergency actions provide yet another example of plans that fail to effectively improve the nation's energy infrastructure in a timely way. This Part argues that more aggressive action is necessary to implement the programs effectively.

Finally, Part IV concludes that it is time for an aggressive and innovative plan that will lead to immediate and sustained energy infrastructure enhancements. Even with financial incentives tied to specific deadlines for putting new facilities in service, such as those used in FERC's emergency orders, improvements in energy infrastructure under current policies are insufficient to effectuate real change. A targeted and comprehensive program is needed to ensure new facilities are built in a timely and effective manner.

II. INDIRECT MARKET-BASED ENERGY POLICIES: HIGH HOPES, UNREALISTIC EXPECTATIONS

A. The Impact of PUHCA Repeal: New Investment or Just New Investors?

Of all the laws regulating utilities today, PUHCA may well be the most antiquated. Its detailed provisions continue to inhibit the market discovery process and to ward off hobgoblins that have long ceased to exist.

—R. Richard Geddes

Closing the barn door after the horses have fled is a futile act. Public-utility holding companies and their subsidiary companies are affected with a national public interest, and consumers and investors are harmed by the lack of effective public regulation to prevent abuses similar to those that gave rise to the enactment of PUHCA.


When President Bush signed EPAct 2005 on August 8, 2005, it signaled the removal of one of the longest standing and most significant regulatory hurdles facing investors in the U.S. energy industry: PUHCA. Enacted in 1935, PUHCA was passed as part of President Franklin Delano Roosevelt’s New Deal. The goal of PUHCA was to regulate “for the equal benefit of the consumer and the investor.” PUHCA was created to protect investors and consumers—who had lost billions of dollars in the crash of Samuel Insull’s utility holding company empire—“by au-

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56 See Pub. L. No. 74-333, 49 Stat. 803 (1935); see also Richard D. Cudahy, 70th Anniversary Celebration of the Federal Power Act, 26 ENERGY L.J. 389, 390 (2005) (“PUHCA has, for better or for worse, become the black sheep of New Deal regulatory legislation.”).
horizing the SEC to regulate the financial and corporate transactions of registered holding companies that owned utility subsidiaries in more than one state.”

As of 1930, Insull controlled nearly ten percent of the electricity in the United States, and was a monopoly service provider in the Chicago area. Insull built his conglomerate, Commonwealth Edison, through a series of holding companies in a sort of a pyramid scheme, which created enormous profits until just after the market crashed following the Great Depression. The collapse of the “Insull monstrosity” led to the passage of PUHCA and the resulting restrictions on the corporate structures of public utility holding companies would last for more than seventy years.

PUHCA allowed utility holding companies to own electricity distribution systems in only a single state or region and prevented them from owning businesses that were not functionally or otherwise related to their energy business. Each utility was to operate as a solitary, integrated system, and thus, PUHCA significantly discouraged ownership of U.S. electric and natural gas utilities by domestic industrial and financial institutions and by foreign institutions.

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59 Richardson & Kelly, supra note 57, at 55.

60 See David B. Spence, The Politics of Electricity Restructuring: Theory v. Practice, 40 Wake Forest L. Rev. 417, 419 n.7 (2005) (“As founder of Commonwealth Edison in Chicago, Insull was the first to secure a charter to provide monopoly service in Commonwealth Edison’s service area.”).

61 See Richard D. Cudahy & William D. Henderson, From Insull to Enron: Corporate (Re)Regulation After the Rise and Fall of Two Energy Icons, 26 Energy L.J. 35, 58 (2005) (“[I]nvestors near the top of the pyramid . . . bear the bulk of the risk that is typically associated with leverage—in good times, rapidly burgeoning profits; in bad times, the danger of losses . . . . Insull’s highly leveraged empire was obviously highly dependent on the continued growth of the electric industry.”).

62 See Sidney A. Shapiro & Joseph P. Tomain, Rethinking Reform of Electricity Markets, 40 Wake Forest L. Rev. 497, 505 (2005). Although he was eventually acquitted, Insull was accused of fraud and there were claims of stock manipulation. See Cudahy & Henderson, supra note 61, at 39.

63 Richardson & Kelly, supra note 57, at 55.

64 Note that some commentators believe that the Securities and Exchange Commission (“SEC”) was not enforcing PUHCA anyway. See, e.g., Weaver, supra note 58, at 116–17 (“[I]t appears that the SEC has not been actively enforcing PUHCA.”). However, the courts served as a check on this apparent lack of oversight. See, e.g., Nat’l Rural Elec. Coop. Ass’n v. SEC, 276 F.3d 609, 617 (D.C. Cir. 2002) (finding that SEC approval of a proposed acquisition by American Electric Power Company did not comply with PUHCA and stating that the SEC’s determination could not “withstand even the most deferential review because the SEC had failed to make any evidentiary findings”).


PUHCA also required that any holding company register with the Securities and Exchange Commission ("SEC") if it owned subsidiaries that operated utilities in more than one U.S. state.\(^6^8\) The business structures and operations of these registered holding companies were severely restricted. Such companies were required to maintain a specified capital structure, their relationships with affiliates were limited, and potential diversification activities were constrained.\(^6^9\) Furthermore, registered holding companies faced additional potential liabilities that could be imposed by federal and state rate regulators.\(^7^0\)

Without PUHCA's restrictions, widely dispersed utility companies can now be owned without regard to where each utility is located or whether the resulting entity can be operated as a single system following a merger or acquisition. This change will likely accelerate consolidation in the energy sector and presents increasing opportunities for foreign investors interested in acquiring U.S. utilities.\(^7^1\) Prior to passage of EPAct 2005, some acquisitions were apparently negotiated and proposed with the full expectation that PUHCA repeal was imminent. For example, MidAmerican-Paciﬁc-Corp, approved by FERC in December 2005,\(^7^2\) would not have been permitted under PUHCA because of restrictions on "cross-country" transactions—transactions that would merge geographically remote electric utilities.\(^7^3\)

The repeal of PUHCA provides diverse and ample investment opportunities for non-U.S. investors because it allows new kinds of nonutility inves-

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\(^6^9\) See Seth A. Kaplan & Gregory N. Racz, It Seemed Like a Good Idea at the Time: Recent Trends in Mergers and Acquisitions in the Electric and Gas Utility Industries, in TELECOMMUNICATIONS Mergers & Acquisitions: Financing, Regulatory and Business Issues 491, 497 (PLI Corp. Law & Practice, Course Handbook Series No. B0-0079, 1998) ("PUHCA imposes limits on mergers and acquisitions and regulates capital structures, equity and debt ﬁnancings, internal restructurings, the formation of subsidiaries, transactions between afﬁliates, the composition of boards of directors and other matters.").

\(^7^0\) See Alabama Elec. Coop. v. SEC, 353 F.2d 905, 907 (D.C. Cir. 1965) ("The purpose of the [PUHCA], as shown by its legislative history, was to supplement state regulation—not to supplant it.").

\(^7^1\) See Foster Assoc., supra note 55, at 7; Robert Robinson & Branko Terzic, New Energy Law to Inﬂuence Mergers, ENERGYBIZ MAG., Nov.-Dec. 2005, at 14, 14 ("One of the most important aspects of the [EPAct 2005] is the repeal of this Depression-era law, which unleashes a new set of M&A possibilities and facilitates the attraction of much-needed investment capital into the industry.").


\(^7^3\) Cf. Nat'l Rural Elec. Coop. Ass'n v. SEC, 276 F.3d 609, 610 (2002) (vacating an SEC order approving American Electric Power Company's acquisition of four wholly owned operating subsidiaries of Central and South West Corporation because the SEC did not justify its conclusions that the proposed acquisition would "satisfy the single-area-or-region requirement" or "the interconnection requirement" mandated at that time by PUHCA).
tors to enter the market without these restrictions. Additionally, PUHCA’s repeal could significantly impact the overall business structure of utilities in the United States, potentially leading to additional consolidation among U.S. utilities and diversification by utility companies and their affiliates, especially in light of the removal of the structural and geographic restrictions PUHCA imposed.74

However, PUHCA’s repeal75 does not eliminate all regulatory obstacles to utility-related mergers and acquisitions. FERC and state regulatory commissions will continue to review mergers and acquisitions in the energy industry. EPAct 2005 requires that public utility holding companies and their affiliates and subsidiaries maintain “books and records” and make them available to FERC to ensure that consumers are protected with respect to jurisdictional rates (that is, the rates over which FERC already has jurisdiction under the FPA and the Natural Gas Act).76 EPAct 2005 also extended FERC’s merger approval authority over electric utilities to mergers and acquisitions, including stock acquisitions, by holding companies.77

In particular, now that PUHCA no longer serves as an initial defense in preserving local control over utility operations, state regulators are expected to scrutinize acquisitions of electric and gas distribution utilities by geographically distant companies, whether such companies are utility or nonutility in nature.78 Under EPAct 2005, to the extent necessary to discharge their duties, state commissions have access to books and records comparable to those possessed by FERC.79 It is not clear whether these changes will lead to additional (or reduced) investment by current utility owners; additional mergers or acquisitions being attempted and completed; or a rise in the number of new investors.

In addition to this change in the regulation of mergers and acquisitions, the repeal of PUHCA might increase the amount of capital available for investment by increasing the number of potential investors. Upon signing EPAct 2005, President Bush stated “[t]he bill removes outdated obstacles to investment in electricity transmission lines in generating facilities”80 and that it would “modernize the electricity grid.”81 How-

74 See, e.g., Poole, supra note 17 (“Repeal of the [PUHCA] opens the switches for $100 billion in investments the utility industry urgently needs . . . .”).


77 See infra Part II.C.

78 See Robinson & Terzic, supra note 71, at 14.


81 White House Press Release I, supra note 32.
ever, it is not clear that removing barriers to investment will actually increase investment in new facilities. Given the relaxed regulation of consolidation, PUHCA’s repeal could simply trigger a wave of consolidation through mergers and acquisitions, particularly in the near term. This might result in mere change in the ownership of current facilities rather than the planning and construction of new facilities by new investors.

Ultimately, to the extent industry consolidation is furthered by the repeal of PUHCA, the resulting mergers could conceivably lead to the exercise of market power and, thus, to increased prices. The repeal of PUHCA may lead to this power shift because, at least to some degree, PUHCA protected consumers from anticompetitive behavior by large utilities. Without PUHCA, merged utilities can inappropriately maintain and use increased market power largely because competitors are unable to enter the market following a merger-induced price spike. If competitors could easily enter the market they would (relatively) quickly drive prices back down, but the long timeline for most energy projects makes this an impossible outcome. Furthermore, a merged utility would be less inclined to invest in new infrastructure because, without PUHCA’s restrictions on nonutility investment, it may pursue higher-risk, higher reward investments first, because utility mergers themselves can be risky investments, and “in turn both stockholders and customers feel the pinch as the utility seeks to compensate for its overvalued investment.”86

83 See Herbert Hovenkamp, Federal Antitrust Policy § 1.6 (3d ed. 2005) (“[A] barrier to entry is some factor in a market that permits firms already in the market to earn monopoly profits, while deterring outsiders from coming in.”).  
84 U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, HORIZONTAL MERGER GUIDELINES § 3.0 (rev. ed. 1997), available at http://www.usdoj.gov/atr/public/guidelines/horiz_book/30.html (“A merger is not likely to create or enhance market power or to facilitate its exercise, if entry into the market is so easy that market participants, after the merger, either collectively or unilaterally could not profitably maintain a price increase above premerger levels.”); see also Geoffrey A. Manne & E. Marcellus Williamson, Hot Docs vs. Cold Economics: The Use and Misuse of Business Documents in Antitrust Enforcement and Adjudication, 47 Ariz. L. Rev. 609, 632 n.91 (2005) (“Entry is important in antitrust analysis because the threat of post-merger entry, exacerbated by the attractiveness of putative monopoly pricing, may ameliorate the negative price effect of a merger . . . .”).  
85 See Am. Pub. Power Ass’n, supra note 82, at 16 (stating that, following the repeal of PUHCA, restrictions that prevent utilities from being used as a “cash cow” to support unregulated investments should be maintained).  
86 See Am. Pub. Power Ass’n, supra note 82, The Post-Merger Experience 1 (2005), available at http://appanet.org/files/PDFs/APPAreportPost-MergerExperience.pdf (stating that although it is often assumed that larger companies “will have more capital to invest in infrastructure development . . . [p]ost-merger analysis . . . does not confirm these optimistic expectations”).
Several legislators believe that consolidated market power is at least one reason current oil and gas prices are so high. In an interesting move, several members of the Senate Judiciary Committee recently introduced the Oil and Gas Industry Antitrust Act of 2006 (“Oil and Gas Act”), which is designed “to improve competition in the oil and gas industry” and strengthen antitrust enforcement of energy industry mergers.87 The Oil and Gas Act is targeted primarily at “the escalating price of gasoline,”88 which have risen more than seventy percent between January 2001 and March 2007.89 Other targets include the increased prices for other petroleum products, such as heating oil and natural gas.90 Senator Specter, for one, has claimed that energy industry price increases are linked primarily to “rapid consolidation in the oil and gas industry,” which created a “collusive environment” and gave market power to the remaining entities.91 This, according to Senator Specter, created the opportunity to increase prices for oil and gas supplies beyond the proper market price.92

Beyond the effects of consolidation, recent history provides another indicator that deregulation, at least in the energy sector, does not lead directly to new infrastructure investment. The 2000-01 California Energy Crisis followed massive deregulation in the form of Assembly Bill 1890 (“AB 1890”) in 1996,93 and the investment in new power plants that was predicted to follow never came to fruition.94 Some commentators have argued that deregulation is a major hurdle to the success of the market, including increased infrastructure investment, when, as in California, it creates redundant regu-

87 S. 2557, 109th Cong. § 1 (2006). Interestingly, several of the senators, including Arlen Specter (R-Pa.), Mike DeWine (R-Ohio), Patrick Leahy (D-Vt.), and Dianne Feinstein (D-Cal.), who introduced this legislation to scrutinize energy industry mergers more closely, also voted for EPAct 2005 and the repeal of PUHCA. See Govtrack.us, H.R. 6: Energy Policy Act of 2005 (Vote On Passage), http://www.govtrack.us/congress/vote.xpd?vote=s2005-158 (providing the voting record for EPAct 2005). Certainly, these senators may have supported EPAct 2005 for other reasons, but this voting pattern may also indicate that the senators had some second thoughts about the wisdom of repealing PUHCA.
90 See id.
91 Id. at S3213–14.
92 See id. at S3214.
lation by both the federal and state government. This potential hurdle may be particularly worrisome against the backdrop of the newly created state access to books and records that will coincide with FERC’s review.

Indeed, redundant regulation may have recently affected the success of two proposed mega-mergers. The merger of PSEG with Exelon and of Constellation Energy with FPL Group, failed despite, and perhaps in part due to, PUHCA’s repeal. The PSEG-Exelon merger was a deal valued at about $17.7 billion that would have resulted in the United States’ largest utility. Exelon and PSEG obtained approvals from FERC, the U.S. Department of Justice, and Pennsylvania state regulators before getting bogged down by “insurmountable obstacles, chiefly rate concessions and power-plant divestitures sought by public officials and consumer advocates in New Jersey, where PSEG is based.” The companies’ offer of $600 million in rate concessions proved insufficient to satisfy New Jersey regulators and overcome concerns regarding the resulting market power of the merged entities. The failure was costly: Exelon spent more than $100 million in pursuit of the doomed merger. Similarly, Constellation Energy and FPL Group called off their $12.5 billion merger in the face of “continued uncertainty over regulatory and judicial matters in Maryland and the potential for a protracted and open-ended merger review process.” These failures have dampened the enthusiasm of many industry executives and analysts, who once believed that PUHCA’s repeal would lead to a friendlier merger environment. It now appears that PUHCA’s repeal...

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95 See, e.g., Orion, supra note 94, at 377 (stating that California’s regulatory redundancies created following deregulation “jeopardize[ ] the significant economic, environmental, and reliability benefits” deregulation was intended to reap).
96 See 18 C.F.R. § 366.2 (2006) (giving states access to utility and natural gas company books and records when “necessary or appropriate for the protection of utility customers with respect to jurisdictional rates”); cf. infra notes 205–214 and accompanying text (discussing the state and federal jurisdiction issues remaining for LNG siting).
97 See Housley Carr & Ray Pospisil, Constellation-FPL Merger Collapse to Hurt BGE Ratepayers, Chills Future Industry Mergers, Electric Util. Wkly., Oct. 30, 2006, at 1 (“The Public Utility Holding Company Act of 1935—repealed last year—presented less of an obstacle to energy giants considering mergers than the uncertainties that companies face when they take their merger plans to federal and state regulators.” (internal quotation marks omitted) (quoting Daniele Seitz, a utility analyst at Dahlman Rose & Company)).
98 Rebecca Smith, Exelon Abandons PSEG Acquisition, Faults New Jersey, WALL ST. J., Sept. 15, 2006, at A3. The deal started at a price of $12 billion, but Exelon’s escalating stock price raised the deal value by more than $5 billion. See id.
100 See id. (internal quotation marks omitted).
101 See id.
104 See Carr & Pospisil, supra note 97, at 1 (“[Large utilities] need to do a lot more legwork on the front end [and convince state regulators] why these deals make sense and how they will benefit customers in the long term.” (internal quotation marks omitted) (quoting David Ratcliffe, Chairman, President, and CEO, Southern Company)); id. (“One would expect
may have initially created excitement and incentives for additional mergers and acquisitions, yet the resulting regulatory redundancies have limited the likelihood such transactions would be completed.

Finally, even if PUHCA's repeal is actually successful in bringing new investors into the arena, such a “success” could, in fact, slow the actual development of new infrastructure that already was planned by a pre-PUHCA entity. Investors not familiar with the energy arena and its political and regulatory landscape may not be as effective in moving projects forward as current industry participants.105 In addition, state and federal legislators may be skeptical of new market participants, which could delay their review and approval of much needed new construction. Over time, the increased numbers of capital sources may very well translate into infrastructure enhancements. But any such benefits are years to leading to even applications for initial construction, let alone putting new facilities into service.106

B. Incentive Pricing and Market Forces: A Waiting Game

Transmission congestion has been rising steadily since 1998. Transmission underinvestment is a national problem. We need a national solution. Transmission pricing reform can be an important part of the solution.107

FERC has long used incentive-based pricing policies, including the use of market-based rates, in wholesale energy markets (i.e., those regulated by FERC) in order to increase efficiencies in the energy industry. FERC started harnessing market forces in the 1980s as a means to reduce wholesale power prices, permitting certain public utilities to move from traditional cost-based rates to market-based rates for wholesale power sales.108 The goal of this policy shift was “to create competitive pressures

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105 See Robinson & Terzic, supra note 71, at 15 (stating that closing mergers and acquisitions under the new regulatory scheme “will depend on multiple factors, among which will be the ability to understand and successfully navigate the new regulatory environment created by PUHCA’s successors at the state and federal levels”).

106 See Fellmeth, supra note 5, at 829 (noting that ideally supply increases as demand requires, but that the market problems are triggered “by a substantial time or cost component required where supply must increase to meet demand”); see also Alejandro Bodipo-Memba, Report Expected to Push for More Power Plants, DETROIT FREE PRESS, Jan. 3, 2006, at 3B (“It would take about $2 billion and nearly seven years to build a 1,000-megawatt coal-fired power plant, according to most experts.”); George, State Utilities Locked into Building Spree, GAINESVILLE SUN, Apr. 2, 1983, at B4 (stating that “electrical power plants require approximately 5-6 years to build”).

107 Kelliher, supra note 12.

108 See Market-Based Rates For Public Utilities, 107 FERC ¶ 61,019, at p. 61,088
that would improve efficiency and lower wholesale power prices.” The Commission’s policy was based on the concept that a competitive market leads to a reasonable exchange and that prices will lead a seller to obtain a “normal return on its investment.” This policy assumes that no participant in a Commission-approved transaction will have excessive market power and that there is sufficient competition in the market.

The Commission moved to market-based rates because it believed that traditional cost-of-service “rate regulation does not encourage the regulated utility to be efficient and provide service at a low cost.” Current FERC chairman Joseph T. Kelliher has stated that the Commission’s market-based rate “policy was never intended to deregulate wholesale power markets.” FERC merely shifted its focus, according to Chairman Kelliher, and FERC now regulates energy markets instead of only regulating energy prices. In limited circumstances, FERC’s market rules have been used in establishing price caps to prevent FERC-jurisdictional power sellers (wholesale energy sellers) from exacting monopoly rents, but such rules are clearly not the norm.

Courts have upheld market-based rates as adequate to assure just and reasonable rates for both electricity and natural gas. A recent case in
the Ninth Circuit similarly upheld this market-based rate authority, however, in upholding the market-based rate policy as just and reasonable, the court also stated that FERC cannot use market-based rates alone in carrying out its duties under the FPA. That is, a mere finding that a seller lacks market power is not sufficient oversight to ensure just and reasonable rates. Additional oversight, such as FERC's reporting requirement, is necessary.

FERC continues to view pricing policies as a key way in which to improve the U.S. energy infrastructure. FERC's first goal in its Fiscal Year 2007 Congressional Performance Budget Request is to "Promote Development of a Robust Energy Infrastructure." Admittedly, part of the reason FERC has focused on pricing programs to reach the goal of developing energy infrastructure is because, beyond hydroelectric power, FERC does not have direct jurisdiction over the development of electric generation capacity and natural gas reserves. As discussed above, FERC's jurisdiction extends to the wholesale markets in which such products operate.

Beyond granting market-based rate authority, FERC's ability to impact these areas was increased in EPAct 2005, which expanded the Commission's role in electric transmission siting and mandated a rulemaking proceeding to establish "incentive-based rates for the transmission of electric energy in interstate commerce." EPAct 2005 included a section entitled Transmission Infrastructure Investment. FERC accordingly amended its

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119 See California v. FERC, 383 F.3d 1006 (9th Cir. 2004).
120 See id. at 1013.
121 See id. ("FERC's system consists of a finding that the applicant lacks market power (or has taken sufficient steps to mitigate market power), coupled with strict reporting requirements to ensure that the rate is 'just and reasonable' and that markets are not subject to manipulation.").
122 In fact, the Ninth Circuit recently took FERC to task for failing to exercise adequate oversight of several market-based rate contracts necessitated by the 2000–2001 California Energy Crisis when it applied the doctrine of United Gas Pipe Line Co. v. Mobile Gas Serv. Corp., 350 U.S. 332 (1956) and Fed. Power Comm'n v. Sierra Pac. Power Co., 350 U.S. 348 (1956), which permit FERC to order modifications to certain power contracts when they "affect the public interest." Pub. Util. Dist. No. 1 v. FERC, 471 F.3d 1053, 1057, 1080 (9th Cir. 2006) ("We hold that although market-based rate authority can qualify as sufficient prior review to justify limited Mobile-Sierra review, it can only do so when accompanied by effective oversight permitting timely reconsideration of market-based authorization if market conditions change."). (emphasis in original)); see also Cal. Pub. Util. Comm'n v. FERC, 474 F.3d 587, 595 (9th Cir. 2006) ("FERC 'cannot use [its] choice [of regulatory regime] to excuse its duty to maintain effective oversight [of rates] and then invoke Mobile-Sierra as a ground for precluding ordinary rate review, including review of the propriety of market-based rate authority at the time the contracts became effective.'") (modifications in original) (quoting Pub. Util. Dist. No. 1, 471 F.3d at 1085).
124 See id. at 12.
regulations to establish “incentive-based (including performance-based) rate treatments” for electric energy transmission “for the purpose of benefiting consumers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion.”128 FERC’s proposed rules provide for a variety of incentives for transmission investment. These include:

(i) a rate of return on equity sufficient to attract new investment in transmission facilities;
(ii) 100 percent of prudently incurred Construction Work in Progress (CWIP) in rate base;
(iii) recovery of prudently incurred pre-commercial operations costs;
(iv) hypothetical capital structure;
(v) accelerated regulatory book depreciation;
(vi) recovery of 100 percent of prudently incurred costs of transmission facilities that are cancelled or abandoned due to factors beyond the control of the public utility;
(vii) deferred cost recovery; and
(viii) any other incentives approved by the Commission, pursuant to the requirements of this paragraph, that are determined to be just and reasonable and not unduly discriminatory or preferential.129

However, FERC’s rules are another example of initiatives with long-term potential but little short-term value. As discussed in more detail in Part IV, without clear authority to ensure a place to build the necessary infrastructure, these incentives are, at best, only half-measures.

These rules do demonstrate that FERC has recognized the infrastructure problem.130 There remains, however, what seems to be a misplaced faith in the abilities of the current market—one that implies that the market is providing correct infrastructure investment cues right now. For example, FERC Commissioner Nora Brownell recently stated:

I think it is important to recognize that scarcity pricing is the market response to a supply/demand imbalance that appropriately signals the need for infrastructure. For example, the high prices of 2000-2001 that reflected supply/demand fundamentals resulted

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129 Id. at 71,419–20 (codified at 18 C.F.R. § 35.35(d)(1) (2007)).
130 As FERC Chairman Keliher has plainly stated: “[u]nderinvestment in transmission is a national problem.” Transmission Pricing Release, supra note 9, at 1. In FERC’s fiscal year 2007 budget for “Energy Infrastructure Resources,” FERC proposed to add eighteen full-time employees and increase its budget by more than $13 million over their fiscal year 2005 actual numbers. See FERC 2007 BUDGET, supra note 123, at 11.
in the first new power plants being constructed in California in ten years; price risk being hedged through the use of long-term contracting; and renewed efforts to correct a flawed market design.\textsuperscript{131}

Such an assessment is accurate if massive blackouts and power shortages are merely considered “appropriate signals” for initiating long-term construction projects,\textsuperscript{152} but it is becoming more apparent that this type of reactive policy comes with significant costs.\textsuperscript{133}


The recent enactment of EPAct 2005 and the subsequent regulatory actions related to approval of mergers and acquisitions under the FPA have the potential to trigger improvements to the U.S. energy infrastructure, but not in the near term. Section 1289 of EPAct 2005, “Merger Review Reform,” amended section 203 of the FPA to restrict certain elements of FERC authority while expanding others.\textsuperscript{134} The amendment restricted FERC authority by raising the monetary threshold for FERC review of several types of transactions from $50,000 to $10 million.\textsuperscript{135} Similarly, it limited FERC’s

\textsuperscript{131}Amendments to Blanket Sales Certificates, 68 Fed. Reg. 66,323, 66,338 (Nov. 26, 2003) (Brownell, Comm’r, concurring). \textit{But see} Fellmeth, supra note 5, at 829 (“The most obvious flaw in deregulation arises from scarcity defects in the underlying market newly relied upon.”).

\textsuperscript{132}Advocates of truly free markets, of course, find such cues perfectly appropriate. Unfortunately, externalities, including social costs, are often improperly accounted for by free market actors. \textit{See, e.g.}, Amy Lynne Bomse, \textit{Note, The Dependence of Cyberspace}, 50 DUKE L.J. 1717, 1736 n.107 (2001) (“Market theory defines an externality as anything that causes a market to fail to reach pareto optimality.”); \textit{see also infra} note 154 (discussing Pareto optimality). The presence of such externalities often provides the justification for government regulation. \textit{See, e.g.}, Allan Kanner, \textit{Toxic Tort Litigation in a Regulatory World}, 41 WASHBURN L.J. 535, 545 (2002) (“One explanation for public law and the need for regulatory agencies is that they address the failure of market exchange mechanisms. The classic example is the pollution externality, a social cost that common law and the free market arguably fail to force a firm to internalize.”); \textit{see also} Cheryl D. Block, \textit{Overt and Covert Bailouts: Developing a Public Bailout Policy}, 67 IND. L.J. 951, 991–92 (1992) (“Markets may fail for numerous reasons, including inadequate flow of information, nonexistence of a market for certain goods, concentration of power in the form of monopolies, high transaction costs for certain exchanges, and spillover or externality effects of individual behavior that the market does not take into account.”).

\textsuperscript{133}There are legitimate, if not wholly satisfying, arguments that a free market could remedy the current inefficiencies in the energy industry. However, a truly free market, in which market participants would operate as they desired, runs contrary to the long-held “central charge of the Commission.” \textit{See} FERC 2007 BUDGET, supra note 123, at 3 (“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.” (quoting NAACP v. FPC, 520 F.2d 432, 438 (D.C. Cir. 1975))). This central charge presumably encompasses acting to prevent electric power companies from profiting off avoidable market failures.


review of public utility acquisitions of the securities of other public utilities to transactions valued at more than $10 million, whereas there was no such monetary threshold before. On the other hand, the amendment expanded FERC authority to include some previously exempt transactions involving the transfer of generation facilities and certain other holding company transactions that have a value in excess of $10 million. Amended section 203 further requires FERC to examine cross-subsidization and pledges and encumbrances of utility assets when considering a transaction subject to section 203 review. Finally, FERC was ordered to adopt procedures to expedite review of applications for section 203 approval of dispositions, consolidations, and acquisitions. Even if these changes will make merger review more efficient in the long term, by simultaneously expanding and contracting FERC authority in these ways Congress has also created a new set of rules for energy companies to decipher before entering potential mergers.

Following a notice of proposed rulemaking, FERC issued an order, Order No. 669, adopting a final rule on the new mergers and acquisitions authority granted by EPAct 2005. In addition to implementing the rules related to FERC’s authority under section 203 described above, the final rule granted “blanket authorizations for certain types of transactions, including foreign utility acquisitions by holding companies, intra-holding company system financing and cash management arrangements, certain internal corporate reorganizations, and certain investments in transmitting utilities and electric utility companies.” The rule also provides for the “expeditious consideration of completed applications for the approval of transactions that are not contested, do not involve mergers, and are consistent with Commission precedent.”

FERC stated that the goal of Order No. 669 was to ensure that all transactions subject to FPA section 203 were “consistent with the public interest and at the same time ensure that our rules do not impede day-to-day

142 Transactions Subject to FPA Section 203, Order No. 669, 71 Fed. Reg. at 1349; see 18 C.F.R. § 33.1 (2006). This blanket authority permits a company to enter such transactions without seeking separate approvals for each transaction. See id.
143 Transactions Subject to FPA Section 203, Order No. 669, 71 Fed. Reg. at 1349; see 18 C.F.R. § 33.11 (2006).
business transactions or stifle timely investment in transmission and generation infrastructure.”

FERC noted that it believed it had accomplished that result but that it would be addressing additional issues, such as the “appropriateness of blanket authorizations” and whether “additional steps are needed to protect against cross-subsidization and pledges or encumbrance of utility assets,” in a technical conference announced in the PUHCA 2005 Final Rule.

The U.S. energy industry is likely to face a new wave of mergers and acquisitions activity following the recent legislative and regulatory changes. Of course, even before the repeal of PUHCA, the energy industry was experiencing significant merger activity, which started in the mid-1990s. This trend toward consolidation has not led to adequate, if any, infrastructure improvements. Given that this trend has been in place for nearly ten years, there is little reason to believe that making the mergers and acquisitions process easier or open to more potential investors would have any direct impact on the state of the U.S. energy infrastructure, particularly in the near term.

III. Market-Based Hope and Limited Scope: Long-Term Market Evolution and Emergency Orders Are Not Adequate Solutions

Critics of U.S. energy policies often focus on decisions to implement short-term gap-filling policies instead of developing comprehensive long-term programs. However, federal energy policies have actually “evolved”

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144 Transactions Subject to FPA Section 203, Order No. 669, 71 Fed. Reg. at 1349 (emphasis added); see also 18 C.F.R. § 33.2(g) (2006).

145 Transactions Subject to FPA Section 203, Order No. 669, 71 Fed. Reg. at 1349; see also 18 C.F.R. 33.1(c)(5) (2006) (granting blanket authorizations of foreign utility company acquisitions subject to certain conditions to protect U.S. captive customers). The technical conference was announced in PUHCA 2005 Final Rule, supra note 75, at P 6.

146 See Robinson & Terzic, supra note 71, at 14 (stating that, following the repeal of PUHCA, “the prognosis for utility M&A [is] strong over the next 12 to 24 months, driven by the increasing need to address the capital market’s earnings growth and investment performance expectations for the sector”).

147 See Edison Elec. Inst., One Plus One Doesn’t Always Equal Two, ELECTRIC PERSP., Jan.-Feb. 2002, available at http://www.eei.org/magazine/editorial_content/nonav_stories/2002-01-01-NT.htm; see also Robinson & Terzic, supra note 71, at 14 (“PUHCA repeal will not be the sole trigger for returning to M&A, with utility executives, investment bankers and regulators falling into many camps when describing the value creation potential of further consolidation.”).

148 As discussed above in Part II, it is not at all clear that EPAct 2005 actually made mergers easier to complete or more likely to occur. See supra notes 75–79 and accompanying text.

to the point of including equally inadequate long-term and short-term gap-filling policies. In fact, the majority of recent legislative and regulatory actions are intended to provide long-term solutions by increasing energy infrastructure through various types of market evolution. Unfortunately, such indirect, long-term “solutions” have not worked over the past thirty years, and there is little to indicate that the new proposals will, on their own, fare any better.

Market-based rates, for one, without additional support, will not provide the necessary incentives to trigger infrastructure improvements in an efficient and acceptable manner. Barring almost complete deregulation, there is little indication that market-based rates can be successful at all. Social, political, and environmental costs, as well as safety and reliability concerns, make full deregulation imprudent and impractical. Additionally, although an open market might lead to better rates for those in high-demand areas, rural and other isolated locations could suffer without mandatory service obligations. Given the limited impact of recent market-based efforts, and the risks associated with any broader implementation, there is little reason to expect significant impact from such policies in the near future.

What is obvious is that the current energy infrastructure is insufficient for the current and ever-growing U.S. demand. Recent FERC emergency

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150 While “free-market rhetoric” is strong among business leaders and corporate law scholars, very few executives, especially in the energy industry, would seek full deregulation, except perhaps when it comes to corporate governance. See Kent Greenfield, September 11th and the End of History for Corporate Law, 76 Tul. L. Rev. 1409, 1420–21 (2002) (“[T]he very infrastructure of the market . . . is in large part a creation of government and government regulation.”).

151 This issue has long been recognized in the telecommunications industry. See Clinton Howard Brannon, Reach Out and Tax Someone: What Does the Future Hold for the Taxation and Regulation of Voice Over Internet Protocol Telephone Services?, 57 Ala. L. Rev. 173, 180 (2005) (describing the purpose and effect of 47 U.S.C. § 254 (2000)). Regulations in the telecommunications industry include a Universal Service Fund (“USF”), which collects a fee from all telecommunications providers in the United States and then pools the fees into a “fund maintained by the federal government as a way to subsidize the high costs of providing telecommunications services to rural areas.” Id. (footnote omitted). “The fund is later disbursed to telecommunications companies that provide service in rural areas to compensate them for the higher costs of providing access lines to their customers.” Id.

152 See supra notes 3–15 and accompanying text. It would seem sensible to consider reducing demand as another method to alleviate strains on the energy infrastructure. However, conservation is generally not a top priority of politicians. See, e.g., Oliver Houck, Can We Save New Orleans?, 19 Tul. Envtl. L.J. 1, 29–30 (2006) (“In more than 30 years, I do not believe I have heard a Louisiana politician say the words ‘energy conservation.’ By some gap in the neurons, the fact that reversing climate change will save coastal communities and the oil and gas infrastructure in Louisiana doesn’t seem to reach the head.”); Gary C. Bryner, The National Energy Policy: Assessing Energy Policy Choices, 73 U. Colo. L. Rev. 341, 346 (2002) (stating that the Bush Administration’s National Energy Plan “clearly emphasizes and gives priority to expanding the supply of traditional energy sources by opening new lands for exploration, streamlining the permitting process, easing regulatory requirements, and enlarging the nation’s energy infrastructure”) (citing Nat’l Energy Pol’y Dev. Group, NATIONAL ENERGY POLICY: RELIABLE, AFFORDABLE, AND ENVIRONMENTALLY SOUND ENERGY FOR AMERICA’S FUTURE, at viii (2001)).
orders tried incentives tied to specific deadlines to put new facilities in service.\textsuperscript{153} These FERC actions, in response to energy emergencies caused by the 2000–2001 California energy crisis and Hurricanes Rita and Katrina, would seem to warrant consideration as a possible larger-scale solution. The EPAct 2005 legislation enacted some provisions similar to these emergency actions, and should provide some promise as well. But more is needed to effectively and immediately improve the nation’s energy infrastructure, because even investment incentives tied to deadlines have not proven especially effective.

\textbf{A. Market-Based Rates Come Up Short}

Market-based rates are wholly inadequate as a short-term solution to the infrastructure problem. Because infrastructure construction itself is so time consuming, consumers necessarily suffer during the lag between market signals of infrastructure problems and the completion of infrastructure improvements prompted by such signals.

More fundamentally, it is unclear what the market is expected to provide in the first place. That is, most politicians and many court cases seem to imply that Pareto-optimal improvements\textsuperscript{154} will result from allowing market forces to work. Certainly, this kind of economic outcome is what most consumers would expect from a “market system.”\textsuperscript{155} However, it seems more likely that any benefits would, at best, represent a Kaldor-Hicks improvement,\textsuperscript{156} providing lower costs to industrial and other large users while raising individual rates for many consumers. To the extent consumers understand or believe that this is what is occurring, the result would be politically untenable.

\begin{footnotesize}
\begin{enumerate}
\item See infra notes 168 and 181 and accompanying text.
\item “Pareto optimality” refers to the point at which resources are distributed in a manner in which no change can be made making someone better off without making someone else worse off. See Richard A. Posner, \textit{Economic Analysis of Law} 13 (4th ed. 1992). A Pareto improvement is possible in an inefficient market; that is, a market that would allow a change in which at least one person can be made better off without affecting anyone else. See Thad Kousser & Mathew D. McCubbins, \textit{Social Choice, Crypto-Initiatives, and Policy Making by Direct Democracy}, 78 S. Cal. L. Rev. 949, 962–66, 982 (2005); Russell Hardin, \textit{Magic on the Frontier: The Norm of Efficiency}, 144 U. Pa. L. Rev. 1987, 1996–97 (1996).
\item The concept of Pareto optimality, in this sense, “has enormous intuitive appeal.” See Guido Calabresi, \textit{The Pointlessness of Pareto: Carrying Coase Further}, 100 \textit{Yale} L.J. 1211, 1216 (1991) (discussing the problems of seeking Pareto optimality and noting that “if Pareto optimality means a place where no improvement can be made without ex ante creating the possibility that there will be some losers, then we are always there”) (emphasis added).
\item “Kaldor-Hicks efficiency” is described by economists as the point at which social net benefits are maximized without regard to the particular distribution of benefits. See Posner, \textit{supra} note 154, at 13–14. A “Kaldor-Hicks improvement” has been described as “a change that increases social net benefits but does not necessarily make everyone better off.” Spence, \textit{supra} note 60, at 418 n.3.
\end{enumerate}
\end{footnotesize}
Such problems are inherent in a market system. The market may eventually provide an infrastructure that will provide sufficient transmission capacity. Most likely, the market would actually provide excess capacity in certain parts of the United States at some point because investors will be clamoring to get in on the action once energy prices rise high enough. Once the capacity exceeds demand, prices will drop. It is this principle that leads many to argue for deregulation as a trigger for investment.\(^{157}\)

Commentators have discussed the “market effect” deregulation had in the telecommunications industry in great detail.\(^{158}\) In the wake of the recent failures of many telecommunications companies, some commentators have argued that there was not really any deregulation of the industry at all and that the present regulatory scheme negatively impacts the telecommunications market.\(^{159}\) Regardless, it seems clear that the telecommunications market participants had some degree of freedom to build their systems, which they did at their own peril. Whether the trigger was deregulation or simply the changes in the subject markets (e.g., the Internet boom),\(^{160}\) when demand for telecommunications took off and prices soared, companies like Tyco, WorldCom, and Global Crossing put billions of dollars into communications infrastructure around the world.\(^{161}\) As the prices of the telecommunications services plummeted, along with corresponding stock valuations, many companies in the sector went bankrupt,\(^{162}\) the infrastructure

\(^{157}\) Note that with regard to energy infrastructure, Chairman Kelliher insists that deregulation is not what is occurring; rather, FERC is shifting toward having regulations that rely on the market. See Kelliher, supra note 109, at 9.

\(^{158}\) See, e.g., Larry E. Ribstein, Bubble Laws, 40 Hous. L. Rev. 77, 83 (2003) (“The recent boom and bubble probably began in the mid-1990s, as people started seeing limitless potential in the Internet and in the deregulation of telecommunications and other markets.”).

\(^{159}\) See, e.g., Jerry Ellig, Costs and Consequences of Federal Telecommunications Regulations, 58 Fed. Comm. L.J. 37, 44 (2006) (“[A] regulatory system that imposes through administrative mandate a set of prices that tries to mimic those that competition would have set does not thereby become any the less a regulatory process, nor any the more a competitive one.”); Deborah Ellenberg et al., Antitrust: Will It Change the Lives of Telecommunications Executives?, 4 Rich. J.L. & Tech. 3 (1997), http://www.richmond.edu/jolt/v4si/speech3.html (“Sad to say, the 1996 Telecommunications Act did not significantly reduce regulation despite Congress’ professed ambition to do so. In the wake of the 1996 Act, there was an outpouring of new regulations from the FCC unequalled in the history of telecommunications regulation.”) (quoting Glen Robinson, Associate Dean and Professor of Law, University of Virginia).

\(^{160}\) See Ribstein, supra note 158, at 83. High prices, and the possibility of cashing in on such prices, may have been sufficient to move the market to some degree; however, deregulation helped, at least somewhat, to move the process along. See Numark & MacDougall, supra note 21, at 464 (stating that the deregulation of the airline, railroad, trucking, natural gas, and telecommunications industries brought “lower prices, expanded markets, and a smaller number of bigger, more competitive and more efficient producers and suppliers”).

\(^{161}\) Burton G. Malkiel, A Random Walk Down Wall Street 95 (8th ed. 2003) (stating that telecommunications companies laid enough fiber-optic cable “to circle the earth 1,500 times”).

was sold off, and consumers finally reaped the benefits with lower prices. Of course, these benefits were of little solace to stockholders and creditors of their dramatically devalued holdings.

This demonstrates how, over the long term, markets might be able to provide adequate infrastructure and proper pricing (i.e., producers being able to set prices that recover their total cost over a cycle) but can impose undesirable, and perhaps unacceptable, societal costs over short-term cycles. This is perhaps particularly true of energy markets. For instance, people often require a minimum amount of energy for survival, and extremely high costs over significant periods of time can have disastrous effects for consumers. A low average cost over time does not assist paycheck-to-paycheck consumers needing heat or air conditioning to survive during times of crisis. Concerning overinvestment, there are potential environmental concerns as well: building unnecessary infrastructure can cause significant harms to wetlands and increased emissions without related net price or efficiency gains.

B. Limited Small-Scale Success of Emergency “Remedies”

In March 2001, FERC issued an order announcing actions within its regulatory authorities under the Federal Power Act, the Natural Gas Act, the Natural Gas Policy Act, the Public Utility Regulatory Policies Act, and the Interstate Commerce Act to

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164 The telecommunications industry is not directly analogous to the energy industry, in the sense that there is significantly more regulation in the energy sector. See id. at 1 (discussing the effects of deregulation under the Telecommunications Act of 1996). However, the economic result in the telecommunications industry underscores the potential problems of allowing the market alone to dictate infrastructure developments.
165 See Michael E. Levine, Price Discrimination Without Market Power, 19 YALE J. ON REG. 1, 6–7, 12 (2002) (explaining that the recovery of total costs is normally achieved through prices that never fall below variable cost and that recover fixed costs through additional charges that vary with supply and demand).
166 See Press Release, Sen. Susan Collins (R-Me.), Senator Collins’ Statement on Release of Emergency LIHEAP Funds (Mar. 23, 2006), available at 2006 WLNR 4904591 (“Tragically, one Maine family was already lost earlier this year when after running out of heating oil, they sought to heat their home with a wood stove that led to the house catching fire. For low-income families, [Low Income Home Energy Assistance Program (“LIHEAP”)] funds can literally be a matter of life and death.”).
167 See Certification of New Interstate Natural Gas Pipeline Facilities: Statement of Policy, 88 FERC ¶ 61,227, at p. 61,737 (1999) (“In considering the impact of new construction projects on existing pipelines, the Commission’s goal is to appropriately consider the enhancement of competitive transportation alternatives, the possibility of overbuilding, the avoidance of unnecessary disruption of the environment, and the unneeded exercise of eminent domain.”).
help increase electric generation supply and delivery in the Western United States, in order to protect consumers from supply disruptions.\footnote{Removing Obstacles to Increased Electric Generation and Natural Gas Supply in the Western United States, 94 FERC ¶ 61,272, at p. 61,967 (2001) [hereinafter Removing Obstacles Order] (footnote omitted).}

Despite the lofty goals, FERC recognized its own limitations: “The Commission recognizes that the actions announced here, by themselves, will not solve the electricity crisis facing California and other areas of the West and will not prevent electricity blackouts in the summer of 2001.”\footnote{Id.} Nonetheless, FERC initiated a plan to help alleviate energy supply concerns in the short term while attempting to provide “medium and longer term solutions, including new infrastructure that [could] help avert future recurrences of the current electric supply shortage in the West.”\footnote{Id.}

To boost electric supply, FERC planned to provide premium returns on equity and a favorable depreciable life for facilities that could be placed in service quickly.\footnote{See id. at p. 61,969 (providing a 300 basis-point premium and a 10-year depreciable life for projects in service by July 1, 2001 and a 200 basis-point premium and a 10-year depreciable life for projects in service by Nov. 1, 2001).} This effectively raised the available return on equity from 11.5% to as high as 14.5%.\footnote{See id. Return on equity applies only to cost-based rates (and not market-based rates), where a fixed-percentage return (in addition to actual costs) is calculated as part of the rate. See, e.g., PJM Interconnection, LLC, 112 FERC ¶ 61,031, at P 57 (2005) (“The issues of return on equity and depreciation are concerns only with setting cost-based rates.”).} FERC also provided similar incentives for electric transmission system upgrades that required new rights of way (providing a return on equity of 12.5% and a 15-year depreciable life if in service by November 1, 2001) and for new “facilities needed to interconnect new supply to the grid” (providing a return on equity of 13.5% if in service by November 1, 2001 and 12.5% if in service by November 1, 2002).\footnote{Removing Obstacles Order, supra note 168, at p. 61,970.}

FERC subsequently approved a similar 200-basis point return-on-equity adder\footnote{A 200-basis-point adder translates to a 2% increase in the return on equity. One basis point equals 0.01%. See Stingray Pipeline Company, 98 FERC ¶ 63,004, at P 31 n.58 (2002) (explaining that “100 basis points equal 1%”). Thus, for example, if there is a uniform baseline return on equity of 11.5%, a 200-basis-point adder would provide a 2% premium, increasing the return on equity to 13.5%. See Removing Obstacles Order, supra note 168, at p. 61,970.} for a Pacific Gas & Electric (“PG&E”) expansion project (“Path 15 Project”) that would not be completed until late 2004.\footnote{See D.C. Circuit Signs Off on FERC’s California Path 15 Financial Incentives, Foster Electric Rep., May 19, 2004, at 8.} The Path 15 Project was designed to reduce congestion on an eighty-four-mile segment of high-voltage transmission lines that connects southern and
northern California. Despite protests by the California Public Utilities Commission ("CPUC") that FERC had "unlawfully extended the deadline" in the Removing Obstacles Order, the D.C. Circuit found that FERC had appropriately approved the incentive "on a case-by-case basis." 177

FERC’s approval of the Path 15 Project is an isolated example of aggressive and appropriate action that helped ensure needed infrastructure was built where it was most needed. Despite fervent (and expected) challenges, 178 FERC recognized that construction was needed to alleviate congestion and also knew "that unless it approved the PG&E incentives, the project would likely not be built in the near future." 179 This represented an uncharacteristically bold step through which FERC exercised its limited authority ‘to foster ‘the installation of critical transmission investment,’ by offering incentives to increase the supply of energy.’” 180 In doing so, FERC demonstrated the aggressive action that is appropriate in responding to a “crisis,” albeit on far too small of a scale.

More recently, in response to Hurricanes Katrina and Rita, FERC issued an order on November 18, 2005, 181 temporarily waiving its regulations and raising the limitations on the costs for projects that natural gas pipelines may construct without prior specific authorization under their Part 157, Subpart F blanket certificates. 182 The Commission stated that it was acting to help more natural gas reach the market to mitigate the cost impact on consumers. 183 To expedite the construction of infrastructure that might provide access to additional natural gas supplies, the Commission increased the costs of projects that can be constructed under the automatic provisions of blanket certificates from $8 million to $16 million and under the “prior-notice” provisions from $22 million to $50 million, thus eliminating several regulatory hurdles to infrastructure construction for larger scale projects. 184

Importantly, FERC provided that these temporary waivers would apply only to those projects constructed and placed in service by October 31, 2006. 185 Recognizing “that projects which cannot be completed in time to

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176 See id.
180 Id. at 930 (citation omitted).
181 Expediting Infrastructure Construction To Speed Hurricane Recovery, 113 FERC ¶ 61,179, at P 1 (2005) [hereinafter Katrina Relief Order I].
182 18 C.F.R. §§ 157.201–157.218 (2005). A blanket certificate permits the recipient to pursue certain construction, acquisition, operation, replacement, and miscellaneous rearrangement of facilities projects, as provided in the regulations, without seeking and obtaining separate authorizations for each project. See id. § 157.203(a).
183 Katrina Relief Order I, supra note 181, at P 1 (“The more natural gas that reaches the market, the less the price impact will be for users of that gas.”).
184 See id.
185 Id.
provide service at the start of the heating season might still deliver the benefits associated with additional gas supply if they are placed into service before the end of the heating season,” the Commission extended the waivers to include projects built and placed into service by February 28, 2007.\textsuperscript{186}

The Commission also expanded the definition of “eligible facilities” to include mainline facilities for this purpose.\textsuperscript{187} Specifically, the Commission temporarily waived several of its regulatory provisions to include the following as “eligible facilities:” main lines; extensions of main lines; facilities, including compression and looping, that alter the capacity of main lines; and temporary compression that raises the capacity of main lines.\textsuperscript{188} The cost-limit waivers described above were also permitted to apply to newly eligible facilities, and these temporary waivers were also put in effect through October 31, 2006.\textsuperscript{189} The waivers are still, however, capped at $50 million.\textsuperscript{190} As such, any eligible facilities built under these provisions would still be significantly limited in size and scope.

As FERC perhaps recognized, the emergency orders have not been especially effective. At the time the Commission issued the deadline extension, there had not been a single filing of a prior-notice application. That is not to say that the program was not helpful at all. However, while some smaller-scale projects ($16 million or less) may have been undertaken, not a single large-scale project ($16 million to $50 million) related to the emergency order had been announced five months after the order became effective.\textsuperscript{191} Of course, this is not especially shocking: one year is a short time frame to plan and complete construction projects with costs approaching $50 million.

Incentives of the type used in FERC’s emergency orders should be effective in increasing energy infrastructure, but often even those with strict in-service dates can fail to incentivize the appropriate investment in a timely manner.\textsuperscript{192} As the D.C. Circuit noted in California Public Utilities Commission: “Although it was well-known that Path 15 was constrained and although this suggested a ready market if new transmission lines were built, no party stepped forward to construct upgrades.”\textsuperscript{193} Participants for the expansion project were found only after specific requests for proposals

\textsuperscript{186} Expediting Infrastructure Construction To Speed Hurricane Recovery, 114 FERC \S 61,186, at P 2 (2006) [hereinafter Katrina Relief Order II].
\textsuperscript{187} Katrina Relief Order I, supra note 181, at P 1.
\textsuperscript{188} Id. at P 7 (waiving 18 C.F.R. \S 157.202(b)(2)(ii) (A)–(C), (F) (2005)).
\textsuperscript{189} See id.
\textsuperscript{190} See id. at P 1.
\textsuperscript{191} Companies cannot split their projects into smaller scale projects to avoid the prior-notice provisions because FERC’s regulations prohibit the segmenting of “projects in order to meet the cost limitations.” 18 C.F.R. \S 157.208(a) (2005).
\textsuperscript{192} See, e.g., Katrina Relief Order II, supra note 186, at P 2 (extending the initial in-service deadline to place new facilities constructed pursuant to emergency waivers just three months after issuing the initial deadline).
were issued, “and then only [after] incentives were offered” and the deadline was extended.194

The limited success of the Path 15 Project and the Katrina relief orders indicate that more is needed to trigger additional infrastructure investment, even for smaller scale projects. In addition to aggressive pricing incentives, realistic in-service deadlines (i.e., deadlines tied to the size and scope of a proposed project) and targeted outreach to current and potential industry participants are needed to promote much-needed infrastructure investment.

C. Small Solutions Are Inadequate for a Large Energy Crisis

Energy industry professionals are aware and agree that infrastructure needs exist all over the United States similar to those in California and the areas affected by Hurricanes Katrina and Rita,195 yet persuading utility companies to make the needed infrastructure investments remains difficult. Motivating utilities to make the necessary infrastructure investments is imperative if reliable energy is to remain available in the fastest-growing regions of the country.196

EPAct 2005 in fact includes several provisions that are similar to FERC’s recent emergency orders. The provisions requiring DOE to identify and report NIETCs197 are very similar to those used to combat the California issues in 2000 to 2001.198 The NIETC provision identifies key areas in need of investment and provides a clear deadline for both federal and state action.199 This provision provides for federal intervention (via FERC) to ensure that transmission lines are built if a state cannot or will not act to move forward a project in the areas targeted by DOE.200 The purpose of this provision is, in part, to address the not-in-my-back-yard (“NIMBY”) problem, which often stops much-needed infrastructure development.201 Even with the changes, though, it has been recognized that NIMBY issues could mean that necessary energy projects will not be

194 Id.
195 See William McCall, More Power Lines Needed—Soon, DESERET MORNING NEWS, Dec. 4, 2005, at M9 (“There is one thing that everybody agrees has to be done about the thousands of miles of electricity transmission lines that crisscross the West—build more of them.”).
196 See id. (stating that unless new transmission lines are built in the West, “the risk of a blackout like the one that left the East Coast in the dark in 2003 keeps rising”).
197 EPAct 2005 § 1221, 16 U.S.C.S. § 824p (LexisNexis 2006); see also supra text accompanying notes 34–36 (describing FERC’s authority to identify NIETCs under these statutory provisions).
198 See supra notes 168–180 and accompanying text.
As FERC Commissioner Nora Brownell recently stated: “Nobody wants anything in their backyard. I don’t want anything in my backyard either, but I want to turn the lights on when I flip a switch.”

EPAct 2005 also purportedly provided FERC with “exclusive” jurisdiction over onshore LNG siting. Construction of new LNG terminals unquestionably faces a NIMBY problem, and proposed new construction has been vociferously opposed. Congress acted to provide this “exclusive” jurisdiction in response to a dispute in California over a proposed LNG terminal in Long Beach. The CPUC had asserted that California, not FERC, had the power to approve or deny the siting of an LNG terminal. The case was dropped following the passage of EPAct 2005.

However, while it is technically accurate that LNG siting is now solely a federal issue, the legislative history is replete with contradictory statements concerning the scope of FERC’s exclusivity. The House and Senate committee reports assert that LNG siting is now completely under FERC’s authority, while acknowledging that a significant state role remains.

202 See id.
203 Id.
205 See, e.g., Procedural Complaint, Environmental Review Highlight Latest Flap over SES LNG Project, INSIDE FERC, Dec. 12, 2005, at 9 (“Although the Energy Policy Act settled the jurisdictional fight over the proposed liquefied natural gas terminal in Long Beach, Calif., tensions between California and federal officials appear anything but resolved.”).
206 See id.
207 John A. Sullivan, Greens Vowing to Continue Fight Against Long Beach LNG Project, NAT. GAS WEEK, Dec. 5, 2005, at 1 (stating that both FERC and the CPUC claimed that “they had the final say in siting LNG terminals”).
208 See Order Instituting Investigation into the Proposal of Sound Energy Solutions to Construct and Operate a Liquefied Natural Gas Terminal at the Port of Long Beach, D.05-11-010, 2005 Cal. PUC LEXIS 477, at *1 & n.1 (Nov. 18, 2005) (order closing proceeding) (stating that FERC and the CPUC filed consent motions to dismiss the petition for review as moot in light of EPAct 2005); FERC and Long Beach Request Comments on Draft Environmental Studies for LNG Terminal; California PUC Withdraws Challenge, Seeks Either Dismissal of Application or Hearing at FERC, FOSTER NAT. GAS REP., Oct. 13, 2005, at 13 (“[T]he California Public Utilities Commission (CPUC) recently dropped its appeal in the U.S. Court of Appeals for the Ninth Circuit of FERC’s order asserting exclusive jurisdiction over siting and operation of the terminal and the outlet pipe.”).
209 See H.R. Rep. No. 109-215, at 235 (2005) (stating that section 320, “Liquefaction or Gasification Natural Gas Terminals,” of the original House version of the Energy Policy Act of 2005, which became section 311 of the final bill as modified and passed by both the House and Senate, “makes clear that FERC has preemptive authority to site liquefaction or gasification natural gas terminals to the extent the terminal involves foreign or interstate commerce”); S. REP. NO. 109-78, at 29 (2005) (stating that section 381 of the Senate version of the Energy Policy Act of 2005, S.10, 109th Cong., which was the parallel provision to the final section 311 of H.R. 6, both titled “Exportation or Importation of Natural Gas,” “clarifies FERC’s exclusive jurisdiction under the Natural Gas Act for siting, construction, expansion and operation of import/export facilities located onshore or in State waters”).
210 See H.R. Rep. No. 109-215, at 235 (2005) (“Section 320 also requires FERC to consult with the State commission of the state in which the liquefaction or gasification natural gas terminal is located regarding local safety considerations during the authoriza-
Statements by members of Congress indicate an even more nuanced sharing of authority with the states. For example, several representatives from California warned Governor Arnold Schwarzenegger: “The bill will hand over exclusive jurisdiction for the siting of [LNG] facilities to [FERC], preventing the states from having a role in approving the location of LNG terminals and the conditions under which these terminals must operate.”211 Yet the states still have a role in the process of bringing an LNG facility online, which could ultimately dilute the effectiveness of FERC’s exclusivity:

States retain their authority to issue or deny permits under federal statutes such as the Coastal Zone Management Act and the Clean Water Act. This bill takes away no state authority, as long as state permitting agencies issue timely decisions. Let me repeat: State permitting authority remains in place under [EPAct 2005]. States can still deny LNG facilities on their coasts. But they need a reason—Clean Air Act, Clean Water Act, or the Coastal Zone Management Act.212

As such, states cannot choose or deny a particular site,213 but they still retain significant authority over an LNG terminal at a given site.214 The scope of potential dilatory tactics has simply been reduced.

Additionally, EPAct 2005 created a new section of the FPA, which requires FERC to “establish, by rule, incentive-based (including performance-based) rate treatments for the transmission of electric energy in interstate commerce by public utilities for the purpose of benefitting [sic] con-

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213 151 Cong. Rec. H2189 (daily ed. Apr. 20, 2005) (statement of Rep. Barney Frank (D-Mass.)) (“This bill takes a limited State role in the siting of these [LNG terminals] and makes it a nonexistent State role.”).

sumers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion.” The rules must include provisions to: (1) promote capital investment in efficient and reliable generation and transmission; (2) provide an attractive return on equity to attract new investment; (3) encourage increases in the capacity of current facilities; and (4) permit the recovery of all prudent costs related to reliability and infrastructure investment.

As discussed above, the incentives found in FERC’s emergency orders have worked in some smaller-scale circumstances, but it is clear from these instances that the market required additional prodding and concessions to achieve the investment goals. As the Path 15 Project indicated, specific requests for action may be necessary to motivate investors to act. In contrast, the repeal of PUHCA simply removes impediments to certain types of investors. But there is no indication that these investors will actually initiate new construction. In fact, history has shown that market participants have failed to act until expressly asked (and then motivated through additional incentives), even when the market seemed to be sending appropriate investment signals.

The introduction of market forces, the repeal of PUHCA, and other recent policy changes might assist in the process of enhancing infrastructure, but a more comprehensive and focused approach is needed. The availability of financial resources (i.e., investment capital) is clearly a prerequisite to infrastructure enhancement. Thus, Congress has made construction of new infrastructure more feasible by making new funding sources available through such measures as the PUHCA repeal. But this is only a small first step. Providing availability of new funding sources without providing direct incentives and specific locations for new infrastructure construction is like oiling a hamster wheel: the wheel will spin faster, but it still won’t go anywhere. Bringing in new funding sources is unlikely to be effective in a market where the current funding sources are not willing to invest in an industry that already represents solid and stable investment.

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216 See id.
217 See supra notes 175–180 and accompanying text.
218 See supra Part II.A.
219 See, e.g., Cal. Pub. Util. Comm’n v. FERC, 367 F.3d 925, 928–29 (2004) (stating that despite a clear need for infrastructure construction on “a uniquely critical path,” incentives were needed or “the project would likely not be built in the near future”).
220 See Rob Carrick, Infrastructure: A Safe Road to Riches, GLOBE & MAIL (Toronto), Mar. 31, 2007, at B8 (“Investing in infrastructure is increasingly popular with pension funds because of the stable returns.”); cf. supra notes 93–95 and accompanying text.
IV. Conclusion

To improve the U.S. energy infrastructure effectively, additional measures are necessary. These measures must include the aggressive implementation of processes for identifying necessary infrastructure enhancements, such as those related to NIETCs, and the use of incentives combined with realistic in-service deadlines so that investors will invest and initiate construction quickly.

Despite the touted “comprehensive” nature of EPAct 2005, there remains a need for action. A few recent proposals provide examples of the types of aggressive, innovative approaches that should be applied to improving energy infrastructure.

In the natural gas sector, for instance, a “unique alliance” of five CEOs representing natural gas consumers and producers in the United States has outlined an “immediate” proposal to increase U.S. natural gas supply. The proposal calls for Congress to “[r]educe the permitting backlog and accelerate the processes for applications to work on onshore federal non-park, non-wilderness lands,” open up certain lands in the Gulf of Mexico, and “push to lift the exploration moratoria on the East Coast, West Coast and offshore Alaska.” Although the wisdom of these proposals might be debatable, they are at least the kind of proposals that could have a direct and immediate impact on the U.S. energy supply.

In the electricity area, Congress could have taken a bold move toward improving the U.S. energy infrastructure but instead stopped short of implementing a proven and much-needed measure: granting FERC exclusive siting authority for transmission lines. Although Congress granted limited backstop authority to approve federal electric transmission line siting in a few specific circumstances, the process is protracted and inefficient. Congress should have granted FERC exclusive jurisdiction

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221 See, e.g., supra note 197 and accompanying text.
222 See OilOnline, supra note 44. The alliance is made up of CEOs from Anadarko Petroleum Corporation, CF Industries Holdings, Inc., Nucor Corporation, New Jersey Resources, and Devon Energy. Id. Characterizing this group as an alliance between consumers and producers gives the CEOs the benefit of the doubt in assessing whom they represent. While Nucor Corporation and CF Industries Holdings, Inc., are direct consumers, it can be persuasively argued that a consumer representative for everyday people would really be a state rate-payer advocate, e.g., the State Of New Jersey Division of Ratepayer Advocate, and not a local distributing company that provides natural gas directly to consumers. Nonetheless, it is accurate that the alignment of CEOs is somewhat unique given the potentially competing interests of the various parties.
223 Id.
225 See notes 34–36 and accompanying text; cf. Steven J. Eagle, Securing a Reliable Electricity Grid: A New Era in Transmission Siting Regulation?, 73 TENN. L. REV. 1, 46 (2005) (noting the limitations and uncertainty of the federal siting authority granted under EPAct 2005 but stating that “if the Act is well implemented it has the potential to encourage investment in new transmission capacity and to stave off a catastrophic electric transmission shortage”).
over transmission siting, making the FPA mirror the Natural Gas Act ("NGA").226

Historically, electricity was believed to be a local commodity: one better generated and monitored locally.227 When it comes to electricity transmission, transactions (buying and selling capacity on transmission lines) are inherently "interstate" in nature, and are exclusively federally regulated under the FPA.228 However, when it comes time to site and build the transmission lines upon which that federally regulated capacity will be bought and sold, the states have authority to restrict the construction. Thus, the competitive wholesale market concept is being advanced by federal regulators who lack siting jurisdiction, and the states with the siting authority may lack the statutory authority (if they were to have the inclination) to promote that market concept.229 Exclusive federal transmission siting is the surest way to change course and initiate new interstate transmission infrastructure where it is desperately needed.

EPAct 2005, current market-based rate programs, and FERC's limited emergency orders all lack the scope and focus needed to trigger significant infrastructure investment. Even where such initiatives show promise, recent programs have been too fragmented and isolated to lead to significant change. The current large-scale programs are too long-term and speculative to be an adequate response to an energy crisis; recent short-term emergency solutions are so limited in time and scope that vast infrastructure

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226 Natural Gas Act, 15 U.S.C. §§ 717–717z (2000). Exclusive federal control for siting interstate natural gas pipelines was codified as part of the NGA in 1938. See Schneidewind v. ANR Pipeline Co., 485 U.S. 293, 300–01 (1988). Under this exclusive control, natural gas companies have been far more efficient in building necessary infrastructure than electric utilities. The primary issue in the natural gas industry has been supply, not the ability to move the commodity throughout the country once it is obtained. See Berry, supra note 37, at 137–38 (discussing FERC's efforts to increase natural gas supplies in light of continually increasing demand). Although there is also need for continued infrastructure enhancements in the natural gas industry, when compared to the electric industry, the NGA has provided a much better structure through which needed construction is authorized. As noted above, there remains a recognized lack of infrastructure (LNG terminals) for actually putting more natural gas supply on the grid. Congress at least tried to address this by confirming that siting of LNG terminals is also part of FERC's exclusive jurisdiction under the NGA. See supra notes 205–214 and accompanying text.

227 See Eagle, supra note 225, at 1–2 ("The United States now is undergoing a transition from local command-and-control electric production and distribution to regional market-controlled production and distribution. This profound transformation requires changes in federal and state regulatory regimes to ensure the availability of an adequate and reliable supply of electricity throughout the nation.")


needs remain even in the targeted areas. A large-scale, coherent, and comprehensive federal energy program is needed. This program must quickly and clearly identify energy infrastructure needs, provide significant financial incentives and realistic deadlines to entice and enable investors, and expand and exercise all available federal authorities to ensure that regulatory delays do not impede the process.

Despite the political battles that might lie ahead, the nation needs programs and plans that directly address the nation’s energy crisis by improving the U.S. energy infrastructure. Given the unquestioned need for additional generation facilities and transmission lines and increased access to natural gas supplies to avert potentially drastic energy outages, it is time for FERC, Congress, and the Administration to put forth an innovative plan, building upon EPAct 2005, which will lead to immediate and sustained energy infrastructure enhancements. The need for energy is too significant, and the time line for construction too long, to tolerate additional misguided policies.