

Regional Resource Planning and the Federal-State Relationship: What is the State of Play?

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Crafted constitutionally in the 1780s and shaped statutorily in the 1930s, the state-federal regulatory relationship is going through tough times. Our infrastructural industries are multi-state, yet much utility regulation remains state-by-state. The resulting disputes take multiple forms: differences over cost allocation, market structure, fuel sources, regulatory techniques and even the very purposes of regulation. Can these differences give way to a state-federal relationship that makes best use of both jurisdictions? Let's look first at law, then at politics. The law is clear, the politics muddy.

I. State-Federal Legal Jurisdiction: Sufficient Clarity, Plenty of Options

Given the many current legal disputes over the federal-state relationship, one would think the statutory relationship needs clarification. It doesn't. The relationship may need fixing, but it doesn't need clarifying.

A. Jurisdictional Basics

FPA sec. 201(b)(1): "The provisions of this subchapter shall apply to the transmission of electric energy in *interstate commerce* and to the sale of electric energy at wholesale in *interstate commerce*, but except as provided in paragraph (2) shall not apply to any other sale of electric energy or deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a State line. The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction, except as specifically provided in this subchapter and subchapter III of this chapter, over facilities used for the generation of electric energy or over *facilities used in local distribution* or only for the transmission of electric energy in *intrastate commerce*, or over facilities for the transmission of electric energy consumed wholly by the transmitter."

FPA sec. 215(b)(1): "The Commission shall have jurisdiction, within the United States, over the ERO certified by the Commission under subsection (c), any regional entities, and all users, owners and operators of the bulk-power system, including but not limited to the entities described in section 824(f) of this title, for purposes of approving reliability standards established under this section and enforcing compliance with this section. All users, owners and operators of the bulk-power system shall comply with reliability standards that take effect under this section."

- 1. Federal Power Act grants FERC exclusive jurisdiction over:**
 - a. sale of wholesale power in "interstate commerce"
 - b. sale of transmission service, whether bundled or unbundled, in "interstate commerce"
- 2. Federal Power Act denies FERC jurisdiction over:**
 - a. retail sales
 - b. generating facilities
 - c. "local distribution" facilities
- 3. Federal Power Act grants FERC potentially preemptive jurisdiction over reliability.**
- 4. Results for state regulation of regional actors and actions**
 - a. Market structure**
 - (1) Yes. Decide whether the market for retail sales should be a monopoly market or a competitive market.
 - (2) Yes. Establish and define monopoly utility's obligation to serve.
 - (3) Yes. For monopoly services, decide who the monopoly provider should be. This statement applies to all monopoly services, including physical distribution, retail electricity sales, energy efficiency services, the new "distribution system platform provider" or any other distribution-level activity.
 - (4) Yes. Establish mix between utility build and utility wholesale purchase
 - (a) Ex: Order a utility to build generation rather than buy wholesale.

- (b) Ex: Order a retail utility to make wholesale purchases (where the state does not state the price of the purchase)
 - (c) Ex: Order a retail utility to offer to make wholesale purchases at a state-specified price. (Note: A 1995 FERC decision disagrees: Connecticut Light and Power, 70 FERC 61,012 (1995))
- (5) Yes. Determine the market structure for demand response.
- (a) Ex: Require/allow/prohibit utility to purchase DR
 - (b) Ex: Require utility to sell DR into organized wholesale market
 - (c) Ex: Allow/prohibit independent aggregators to purchase DR
 - (d) Ex: Allow/prohibit anyone (utility, independent aggregator, retail customers) to sell DR into organized wholesale market.

b. Power supply mix

- (1) Yes. In general, establish mix of resources (*e.g.*, conventional, renewable, energy efficiency, demand response) .
- (a) Ex. Require purchases of renewable power
 - (b) Ex: Prohibit construction of nuclear plants (if the prohibition is based on economics, not safety)
 - (c) Ex: Prohibit construction of, or purchase from, coal plants (if the prohibition does not discriminate against out-of-state sources)
- (2) Yes. Favor technologies and fuel sources you like. That a favored technology happens to be an in-state business is ok. As long as the statutory focus is on technology.

- (3) Yes. Disfavor technologies and fuel sources you don't like. That a disfavored technology happens to be an out-of-state business is ok. As long as the statutory focus is on technology.
- (4) Yes. Dampen demand by requiring in-state utilities to accept the maximum cost-effective demand response
- (5) Yes. Use the Order 1000 process to advance a region's common state interests
- (6) No. Favor in-state businesses over out-of-state businesses. No in-state preference in RPS statutes. An in-state preference is a trade barrier against out-of-state sources. In-state preference is unconstitutional regardless of whether the preference is expressed as a REC multiplier or an explicit preference.

c. Wholesale prices

- (1) No: Set wholesale prices. A state sets wholesale prices when it directs its utility to hold a wholesale procurement where the winner must enter into a wholesale supply contract in which—
 - (a) the winning generator is obligated to bid into the RTO markets and
 - (b) the utility's retail customers pay (or receive from) the generator the difference between the market price and a price pre-established by the state.
- (2) Exception to the prohibition on setting wholesale prices: PURPA
 - (a) A state can set wholesale price when it is setting the price paid to "qualifying facilities" under PURPA, provided the price does not exceed avoided cost.
 - (b) A state can supplement the avoided cost price by
 - (a) requiring the utility to buy RECs from the QFs,
 - (b) giving the QFs money funded by taxpayers (or, possibly system benefits charges)

- (3) No: Subsidize a utility's wholesale purchases from or sales to a wholesale market. Subsidy takes the form of guaranteed ratepayer support that, allowing the utility to offer lower prices than competition would otherwise produce.

d. Reliability

- (1) Yes. Set reliability standards (if "not inconsistent with" Electric Reliability Organization (NERC) standards; see FPA section 215(i))
- (2) Yes. Disallow from retail rates costs a utility incurs to carry out a federal reliability standard, if the reason for the disallowance is imprudence in managing and spending money to meet the standard.
- (3) No. Disallow from retail rates costs a utility incurs to carry out a federal reliability standard, if the reason for the disallowance is the state disagrees with the standard.

e. Retail cost disallowance

- (1) Yes. In general: Disallow retail cost recovery if a utility's action or inaction has exposed customers to unnecessary retail costs
- (2) Yes. Set cap on retail utility's wholesale purchase costs, including disallowing the cost of imprudent wholesale purchases
- (3) No. Refuse to allow retail recovery of costs that federal law required the utility to incur. [Note there is a difference between a federal obligation to satisfy a standard, and the utility's discretion to meet that standard. The state cannot disallow costs because it disagrees with the standard. The can disallow costs if the utility acted imprudently in meeting that standard.
- (4) Yes. Refuse to allow retail recovery of costs the utility incurs under a FERC-approved contract, subject to the next item.

- (5) No. Refuse to allow retail recovery of costs the utility incurs under a FERC-approved contract, if the utility was compelled to enter that contract due to a FERC mandate (such as a FERC allocation of costs on a centrally planned, FERC-regulated holding company system).

f. Other

- (1) Yes. Establish retail rate design.
- (2) Yes. Approve/disapprove sites for generation and distribution.
- (3) Yes. Approve/disapprove sites for transmission (except for FERC-preemptive situations covered by FPA sec. 216).
- (4) Yes. Require retail utility to pursue state preferences in regional processes, such as Order 1000 processes.

B. *Hughes v. Talen*: States may not manipulate regional wholesale prices to produce low retail prices

1. Summary of the decision

- a. Due to generation shortages in transmission-constrained areas, PJM capacity auctions were producing high wholesale prices in Maryland. The Maryland Commission designed a three-part solution: (1) Select competitively a wholesale generator to serve in the constrained area. (2) Order its retail utilities to contract for long-term capacity from the winning generator, at the price offered by that generator. (3) In the contract, guarantee that if the wholesale generator bid into, and was selected by, the PJM capacity auction, the utility would use retail ratepayer dollars to pay the difference between the FERC-authorized PJM price and the contract price. New Jersey passed a statute using similar techniques.
- b. Federal district courts and circuit courts (total of 10 judges) struck both efforts. Maryland appealed to the U.S. Supreme Court.

- c. In April 2016, the Supreme Court invalidated Maryland's order.¹ By guaranteeing the wholesale generator a level of compensation different from PJM's FERC-authorized compensation, Maryland had "disregard[ed] an interstate wholesale rate required by FERC." Because under the Federal Power Act, Congress had made wholesale rates-setting FERC's exclusive domain, the state order was invalid under the doctrine of "field preemption." The Court's vote was 8-0.

2. **It's the means, stupid**

- a. "If a state-supported bid clears the auction market when it would not have done so without the state support, another unsupported bid (which otherwise would have cleared) may not clear. The lower market-clearing price that results ... distorts the price signals that would otherwise indicate a need for new capacity." (4th Cir.)
- b. Preemption "turns on 'the target at which the state law aims.'" (S.Ct.)
- c. "[T]he program directly targets the PJM market mechanism for setting the wholesale capacity rate....[It] partially displaces the market mechanism for setting wholesale price signals for new generators." (4th Cir.)
- d. "We reject Maryland's program ... because it disregards an interstate wholesale rate required by FERC." (S.Ct.)
- e. "That Maryland was attempting to encourage construction of new in state generation does not save its program...." (S.Ct.)
- f. "...States may not seek to achieve ends, however legitimate, through regulatory means that intrude on FERC's authority over interstate wholesale rates...." (S.Ct.)

¹ *Hughes v. PPL EnergyPlus*, No. 14-614 (Apr. 19, 2016).

C. *EPSA v. FERC*: FERC may require regional market operators to accommodate retail demand response to ensure reasonable wholesale prices

1. FERC's Order 745 requires operators of wholesale energy markets to treat demand side bids comparably to generation bids. Comparable treatment requires that demand side bidders—
 - a. be allowed to participate on the "supply side" of the market, and
 - b. receive the same compensation as generation bidders—the locational marginal price (LMP).
2. This entitlement to LMP compensation is available only to bids meeting a "cost-effectiveness" test, designed to ensure that no wholesale buyer was made worse off by the presence of demand side bids.
3. The US. Supreme Court upheld the Order. Demand side bidding was a "practice" "affecting" wholesale rates, phrases used in the Federal Power Act to define FERC's jurisdiction. Because FERC acted within its wholesale domain, it did not enter the states' FPA-preserved retail domain. The Court then held that FERC's justifications for LMP compensation were not "arbitrary and capricious."
4. The "opt-out" for states: Order 745 bars the wholesale market operators from accepting demand response bids from states that prohibit their customers from participating, even if those bids are cost-effective. (Some states have these prohibitions.) Although the Court cited this state veto in holding that FERC did not invade the states' domain, it made clear (in my reading) that Order 745 would have survived without the provision. FERC is, therefore, free to remove the state veto, allowing all demand response play its consumer- protective role of disciplining wholesale prices.

D. The new "bright line": "direct" vs. "indirect"

"Congress meant to draw a bright line, easily ascertained, between state and federal jurisdiction." *FPC v. S. Cal. Edison Co.*, 376 U.S. 205, 215-16 (1964). The new bright line is the difference between "direct" and "indirect."

1. Understanding "direct"

- a. The FPA distinguishes between "measures aimed directly at interstate purchasers and wholesalers for resale, and those aimed at subjects left to the States to regulate." *Oneok*.
- b. State requires interstate pipelines to obtain state approval before issuing long-term securities: Preempted, because 'directed at . . . the control of rates and facilities of natural gas companies,' 'precisely the things over which FERC has comprehensive authority.'" *Schneidewind* (explained in *Oneok*).
- c. The focus should be on "what the State seeks to regulate . . . , not why the State seeks to regulate it." Scalia and Roberts, JJ, dissenting in *Oneok*.
- d. "[T]he [RTO] practices at issue in the Rule—market operators' payments for demand response commitments—directly affect wholesale rates." *EPSA*.
- e. "[T]he [Maryland] program directly targets the PJM market mechanism for setting the wholesale capacity rate....[It] partially displaces the market mechanism for setting wholesale price signals for new generators." (4th Cir.)

2. Understanding "indirect"

- a. Under FPA Section 206(a), "FERC has the authority—and, indeed, the duty—to ensure that rules or practices "affecting" wholesale rates are just and reasonable." *EPSA*.
- b. "Taken for all it is worth, that statutory grant could extend FERC's power to *some surprising places*. As the court below noted, markets in *all electricity's inputs*—steel, fuel, and labor most prominent among them—might affect generators' *supply of power*. ... And for that matter, markets in just about everything—the whole economy, as it were—might influence LSEs' *demand*. So *if indirect or tangential impacts on wholesale electricity rates sufficed, FERC could regulate now in one industry, now in another*, changing a vast array of rules and practices to implement its vision of reasonableness and justice. We cannot imagine that was what Congress had in mind." *EPSA*.

- c. "As we have explained in addressing similar terms like "relating to" or "in connection with," a *non-hyperliteral reading* is needed to prevent the statute from assuming *near-infinite breadth*." *EPSA*.
- d. "For that reason, an earlier D. C. Circuit decision adopted, and we now approve, a common-sense construction of the FPA's language, limiting FERC's 'affecting' jurisdiction to rules or practices that 'directly affect the [wholesale] rate.'" *EPSA*.
- e. "FERC regulation does not run afoul of sec. 824(b)'s proscription just because it affects—even substantially—the quantity or terms of retail sales. It is a fact of economic life that the wholesale and retail markets in electricity, as in every other known product, are not hermetically sealed from each other. To the contrary, transactions that occur on the wholesale market have natural consequences at the retail level. And so too, of necessity, will FERC's regulation of those wholesale matters." *EPSA*.

3. A way to think about it: Price-setting ("direct") vs. curve-shifting ("indirect")

States are preempted from *setting* the wholesale price, but they are not preempted from *affecting* the wholesale price. The Federal Power Act's "bright line" separates (a) policies that fix compensation for particular wholesale sellers from (b) policies that shift supply and demand curves in a wholesale market for all buyers and sellers. More concisely, the FPA separates price-setting from curve-shifting.²

Curve-shifting *affects* the market price but it does not *set* the market price. Nothing prevents states from acting on the supply curve and the demand curve. Consider these two examples:

a. State shifts supply curve.

- (1) A state can lower the cost of inputs for in-state generation: It can reduce taxes on property, sales or income; donate or subsidize land and improvements; provide employee

² The ensuing discussion is drawn from my article, "Pricing in Organized Wholesale Electricity Markets: Can We Make the Bright Line any Brighter?" in *Infrastructure* (American Bar Association Spring 2015).

training; and reduce environmental requirements. Each such state action shifts the state's generation company supply curves rightward. This supply curve shift means that at any given market price, the state's companies will be willing to increase supply because their production costs will be lower (all else equal).

- (2) This rightward shift in one state's generator supply curves will lead to a rightward shift in the regional market's supply curve, thus lowering the market price (all else equal). The state's policies will have affected, indirectly, the FERC-jurisdictional market price. But each seller's compensation will still be determined, directly and entirely, by that FERC-jurisdictional market price. There is no "correcting" of any wholesale seller's compensation through a state-ordered, ratepayer-subsidized payment, as occurred with Maryland's invalidated order.

b. State shifts demand curve.

- (1) The state can give away sweaters and compact fluorescent light bulbs, tighten building codes, tax consumption, set high retail prices during peak periods, or pay consumers to reduce demand and consumption.
- (2) These actions shift that state's demand curve leftward, causing it to intersect the wholesale market supply curve at a lower price. Again, that lower price—a FERC-jurisdictional price—is *affected* by the state but it is not *set* by the state. The state's effect on price is indirect, not direct.

c. So here are the relevant distinctions for states: between curve-shifting (yes) and price-setting (no), between affecting the price (yes) and setting the price (no), between affecting prices indirectly (yes) and directly (no). There was never an issue about states being able to give financial assistance, in some way, to sellers or buyers—that's curve-shifting. Maryland's mistake was to change a wholesale seller's specific compensation, by tying the ratepayer-guaranteed subsidy to the seller's participation in the wholesale market.

E. High regional prices: Next steps for states

The *Hughes* decision was a win for consumers, competition and states.

1. **Consumers:** The decision blocks states from using captive ratepayers to subsidize generator bids in wholesale markets. States facing high wholesale prices will need to turn to more productive paths, like reducing customer demand: through time-of-use rates that align prices with costs; through new meters and thermostats that help consumers master their costs; through solar panels and energy efficiency investments for our lower-income citizens so that they too can control their costs. States also may, wrote the Court, use

tax incentives, land grants, direct subsidies, construction of state-owned generation facilities, or re-regulation of the energy sector.... So long as a State does not condition payment of funds on capacity clearing the auction, the State's program would not suffer from the fatal defect that renders Maryland's program unacceptable.
2. **Competition:** Competition promotes the public interests when sellers compete on the merits—on quality and cost. In organized regional markets, quality is covered through minimum standards for reliability and penalties for failure to show up. So in the actual auctions, competition is based on cost. The Maryland-ordered financial assistance, when conditioned on the generator bidding and being selected, enabled the generator bid below its cost—the precise behavior that defeats the theory of competition. A state's favored generation source can still compete and win—but it must compete and win on its inherent merits, not on artificial merits assisted by Maryland's captive customers. When the winners are the least-cost rather than the most-subsidized, competition works and the public benefits.
3. **States:** The decision eliminates one path by one state acts adversely to other states. Yes, Maryland was supported by multiple states. Think circular firing squad. For if each state did Maryland did—substitute state-preferred compensation for FERC-authorized compensation—then each state-assisted bidder would bid below its actual costs. The PJM price for generation capacity would fall below the long-term replacement cost. Short-term price drops would lead to long-term generation shortages.

F. Demand response: Next steps for states

Cost-effective demand response requires regulatory decisions on market structure and seller compensation. Market structure addresses which consumers and aggregators are allowed to sell demand response, the barriers to entry and exit they face, and the buyers to whom sellers can sell. Seller compensation deals with the price buyers will pay, and how the resulting revenues are allocated among the market participants.

1. **Market structure:** The Supreme Court addressed and decided only one facet of market structure. It held that FERC may order market operators to invite demand response into the "sell side" access of organized wholesale markets, thus compelling wholesale buyers to pay compensation to retail consumers or their agents. This legal clarity now gives states options. States determine what types of companies may seek and aggregate customer-side sources of demand response. States also determine whether that demand response, once aggregated, should be used solely to reduce load of the local utility (sometimes called "retail demand response"), or may instead (or also) be sold into organized wholesale markets (sometimes called "wholesale demand response"). At the same time, FERC approves the rules for wholesale market operations, including responsibilities for both sellers and buyers. If states block offers by cost-effective demand resource providers, and if FERC loosens the rules that accommodate those offers, our regional electric markets will operate inefficiently. We will waste energy and money.
2. **Compensation:** Demand resource sellers, whether retail consumers or aggregators, are motivated, to seek the highest price. That highest price might be available through state decisions (such as in states that are replacing average pricing with time-of-use rates—the latter more reflective of actual cost), or through federal decisions (which can vary depending on whether wholesale markets are effectively competitive or instead require price caps to prevent monopoly rent-seeking). States need to decide whether providers of demand response may sell only to retail utilities (in which case states set the price) or may sell also (or instead) into wholesale markets (which case FERC-authorized markets set the price). Both options are worth pursuing; in fact the most enlightened states will make available the most options. *This diagram* displays the options.
3. **The opt-out for states:** The opt-out for states puts FERC in an awkward position. Order 745 says that absent bids from demand resources, wholesale generation prices will not be "just and reasonable": They will be higher than necessary, enriching generation sellers without

commensurately benefitting consumers. When consumers forego consumption, prices drop. So paying consumers to forego consumption increases economic efficiency, so long as those payments cost less than the total savings from the lower prices. And so allowing states to block entry by cost-effective demand response has the opposite effect: It leads to unnecessarily (and unlawfully) higher prices. Justice Scalia's dissent made that point precisely:

If inducing retail customers to participate in wholesale demand-response transactions is necessary to render wholesale rates "just and reasonable," how can FERC, consistent with its statutory mandate, permit States to thwart such participation?

4. So FERC has two options:
 - a. First, it can require wholesale market operators to accept demand resources from all states. States thus will be preempted from denying their citizens their federally-granted right to sell demand response. And consumers in other states will no longer pay unlawful prices due to the actions of the vetoing states. (Caution: Technically FERC would not be ordering states to change their policies; FERC has no power to do so. FERC instead would be establishing a policy under the FPA, a policy which the FPA in turn would preempt states from disregarding.)
 - b. Second, FERC can declare that market pricing in regions with state vetoes are no longer just and reasonable. Wholesale generators in those regions would have to sell at prices set or limited by FERC, based on some cost basis.
 - c. What FERC cannot do, I believe, is say nothing about the state veto. The FPA does not allow FERC to buy favor with some states to the detriment of other states. And as the Supreme Court has said, the Commission cannot ignore even "a small dent in the consumer's pocket." The FPA "makes unlawful all rates which are not just and reasonable, and does not say a little unlawfulness is permitted." *Federal Power Comm. v. Texaco, Inc.*, 417 U.S. 380, 399 (1974).

G. FPA "power grab": On whose foot is the shoe?

1. FERC did not exceed its jurisdiction when it required regional transmission organizations to accommodate retail demand response. *EPSA*. (6-2)
2. Maryland was preempted from ordering its retail utility to enter into a contract that guaranteed to a state-selected wholesale seller, via a contract for differences funded by retail customer payments, the difference between a state-specified compensation and the compensation received from the wholesale market. *Hughes*. (8-0)
3. FERC did not exceed its jurisdiction by eliminating the exemption from the minimum offer price rule for state-mandated resources; FERC's action was not direct regulation of generating facilities. *New Jersey Bd. of Public Utilities*. (3-0)
4. FERC did not exceed its jurisdiction in allocating among retail utilities responsibility for having sufficient capacity relative to load. *Connecticut DPUC v. FERC*. (3-0)
5. FERC did not violate the Tenth Amendment when it allocated costs of a regional transmission network among the retail utilities that use the network. *Illinois Commerce Comm'n v. FERC* (3-0)
6. Louisiana was conflict-preempted from disallowing from a utility's retail rates costs charged to that utility under a FERC-authorized cost allocation agreement. *Entergy Louisiana v. LPSC*. (8-0).
7. FERC did not exceed its jurisdiction in approving (with modifications) an allocation of wholesale generating capacity among affiliated retail utilities of a centrally planned holding company, even though the allocation would affect retail rates. *Mississippi Industries*. (3-0)
8. FERC did not exceed its jurisdiction in requiring that a utility could not use its state law eminent domain powers for its own interconnection facilities unless it offered to use the same powers for its competitors. *NARUC v. FERC*. (2-1)
9. FERC did not exceed its FPA authority in exercising jurisdiction over the unbundled transmission of retail electricity. *New York v. FERC*. (9-0)

10. The Mississippi Commission was conflict-preempted when the state Attorney General demanded that it investigate the prudence of a utility's subsidiary's purchase of high-cost nuclear capacity allocated to it by a FERC-approved wholesale contract. *Mississippi Power & Light Co v. State of Mississippi*. (6-3)
11. The North Carolina Commission was conflict-preempted when it treated a retail utility as having access to more low-cost, wholesale hydropower than the limited amount allocated to the utility by FERC. *Nantahala Power & Light Co. v. NCUC*. (7-0)

II. State-Federal Political Relations: "Can We All Get Along?"

A. No escape: Federal-state simultaneity is unavoidable.

1. Until the 1980s, state regulation and effective regulation coincided. Why? Because infrastructural assets, corporate boundaries, business activities, and relevant markets were primarily intrastate. That's true no longer. Electric and gas consumers depend on production from distant states, brought by multistate transmission lines and pipelines; their consumption pollutes the air and water in other states. Local water users benefit from (and pay for) national water quality standards. Local phone callers depend on a national market of providers who use an interstate telecommunications infrastructure.
2. So the regulatory mission is not jurisdictional preservation; it is jurisdictional effectiveness. We must to define roles rationally, to induce regulated industries to perform at their best.
3. When instead we focus on jurisdictional gains and losses, the disputes are endless. We isolate one regulatory action from another, crying fouls while committing fouls. Outside of regulation, we see such hypocrisy all the time: decrying "Hollywood" but enjoying its movies; deriding "New York" but tuning in to David Letterman and Jay Leno; complaining of federal "subsidies" while driving the interstate; opposing the federal government until we're hit by a hurricane; the Nazi skinhead whose favorite food is burritos.³

³ From essayist Richard Rodriguez, McNeil-Lehrer Newshour, Nov. 2, 1995; see http://www.pbs.org/newshour/bb/race_relations/race_relations_11_2.html.

B. Our regulatory procedures create a "tragedy of the commons"

Picture a pasture open to all....As a rational being, each herdsman seeks to maximize his gain. Explicitly or implicitly, more or less consciously, he asks, "What is the utility to me of adding one more animal to my herd?" ... [T]he rational herdsman concludes that the only sensible course for him to pursue is to add another animal to his herd. And another; and another. ... But this is the conclusion reached by each and every rational herdsman sharing a commons. Therein is the tragedy. Each man is locked into a system that compels him to increase his herd without limit—in a world that is limited. Ruin is the destination toward which all men rush, each pursuing his own best interest in a society that believes in the freedom of the commons. Freedom in a commons brings ruin to all.⁴

1. Why is there so much controversy about who pays for interstate transmission? Two reasons are statutory and cultural. Under regulatory statutes—in this case the Federal Power Act—there is almost always an opportunity to litigate: New facilities require new costs; new costs require rate filings; rate filings produce rate proceedings; rate proceedings attract parties who support and oppose.
2. What makes conflict inevitable is the narrowness of the typical proceeding. A 500 kV transmission facility is, inarguably, a "big project." But for a nation with 300 million citizens, who rely on electricity for everything from incubators to funeral homes, a single transmission facility is a small contributor to life's daily costs. Yet under our statutes it receives its own proceeding. And because it has its own proceeding, it attracts parties their lawyers who focus on winning benefits, and avoiding costs, associated with that single facility.
3. Implicit in this approach is that every proposal must have a positive outcome for every party; that a proposal is "bad" if it makes anyone worse off, that it is logical and useful slice-and-dice regulatory decisions into a series of win-lose polarities. But no alert citizen (*i.e.*, one not infected with regulatory experience) has expects to contest every public policy costs exceed benefits for that citizen. Otherwise, we would—

⁴ Garret Hardin, "The Tragedy of the Commons," Science (Dec. 13, 1968), available at http://www.garretthardinsociety.org/articles/art_tragedy_of_the_commons.html.

- a. cease funding for multiple sclerosis because not everyone gets it;
- b. eliminate the crossing guard at the corner of State and Main because everyone crosses there;
- c. close the schools in Northeast Milwaukee because not everyone attends there;
- d. eliminate the Air and Space Museum because not everyone goes there;
- e. eliminate every program for which the cost-bearers differ from the benefit-receivers.

C. The right form of cooperation

- 1. We can save our regulatory commons if we can break out of zero-sumsmanship.
 - a. We need proceedings whose substantive scope ensures that total benefits exceed total costs. A transmission system benefits not only the generation and loads it connects, but also the regional economy it supports—just as a highway helps the neighborhoods, business districts, schools and hospitals that it serves.
 - b. Unlike highway planners, the transmission regulator lacks statutory authority to take into account most non-rate values. But we can broaden the decisional context. There is usually some combination of transmission proposals whose total benefit exceeds its total cost. By organizing proceedings around such net benefit combinations, the parties can fight over benefits rather than cost. The result: More cooperation, more speed, more results.
- 2. "[T]he Federal Power Act, like all collaborative federalism statutes, envisions a federal-state relationship marked by interdependence."⁵ Interdependence requires cooperation. But "cooperation" must mean cooperation toward the statutory goal or just and reasonable rates.⁶

⁵ Sotomayor, J., concurring.

⁶ See again Justice Sotomayor's concurrence, explaining that the Court "[u]se[d] the purpose of the Federal Power Act as the 'ultimate touchstone' of its pre-emption inquiry."

"Cooperation" does not mean states cooperating to undermine FERC's policies. And "cooperation" does not mean FERC deviating from its own obligations just to buy peace with states. If granting a state-requested exemption from the minimum offer price rule would lead to sub-competitive prices, that is not useful cooperation. If ordering RTOs to reject demand response bids from states who ban them leads to supra-competitive prices, that is not useful cooperation. (That was Order 745's only error. When a state limits demand response participation, the demand curve remains artificially rightward, causing unnecessarily high prices for consumers in all the region's states.) FERC should not say "yes" to states just to win points for "cooperation."

3. Our regulated industries perform many services, some near the customer, some distant; some local, some multistate. Regulation's purpose is to induce high-quality performance. The allocation of regulatory roles requires us to ask: What performance we do want from our regulated industries? What regulatory agencies are best positioned to produce that performance? Effectiveness over turf, substance over emotion: Those are the emphases most likely to ensure success.
4. To shift from jurisdictional challenges to bijurisdictional policymaking, focus less on "national interests" and "state interests," and more on industry performance. We measure industry performance in terms of economic efficiency, reliability, product innovation, customer satisfaction. The relevant economic actors—the manufacturer choosing a plant location, the a generation investor selecting technology and site, the load-serving utility designing its supply portfolio—do not think about federal vs. state; they think about results.
5. There are not two interests, national and state. There is a single goal: high-quality industry performance. To produce that performance, there may be a national role and a state role, but there is not a national interest and a state interest.

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Taking office in August 1974, President Gerald Ford said: "Our Constitution works." So it did here. The Supremacy Clause protects the commons—the national good as defined by Congress—from actions by one state that can harm citizens in other states. The Supreme Court got it right. Now it's the states' turn.