HOARDERS: CLARIFYING FERC'S POLICY, AS ARTICULATED IN ORDER NO. 888, AGAINST WITHHOLDING ELECTRIC TRANSMISSION CAPACITY

INTRODUCTION

Adopted in 1998 with the express goal of curbing undue discrimination[1] in the interstate market for electric transmission, Order No. 888[2] has been referred to as the single largest step taken by the Federal Energy Regulatory Commission (FERC or the Commission)[3] to foster competition in the market for wholesale electric transmission.[4] Among its key features, Order No. 888 requires a utility[5] within FERC's jurisdiction[6] to separate its

1. Generally speaking, unduly discriminatory practices fall under two umbrellas. If a utility operates in an industry that has little to no competition, the utility discriminates unduly when it charges different rates to customers that impose similar costs of service on the utility. Where competition seemingly exists, rate disparities that have anti-competitive effects are considered unduly discriminatory. Under respective circumstances, treating dissimilar customers dissimilarly and charging rates that have no anti-competitive effects would be considered examples of "due discrimination," which is permissible under FERC precedent. The purpose of the distinction between "due" and undue discrimination is to prevent a utility that possesses the power to alter rates in a market where customers have no reasonable opportunity to obtain service from a different utility from abusing such power. *See* SCOTT HEMPLING, REGULATING PUBLIC UTILITY PERFORMANCE: THE LAW OF MARKET STRUCTURE, PRICING AND JURISDICTION 301–02 (2013).

2. Order No. 888, Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, 75 F.E.R.C. ¶ 61,080 (1996) [hereinafter Order No. 888], https://www.ferc.gov/legal/maj-ord-reg/land-docs/rm95-8-00w.txt.

3. FERC is "an independent agency that regulates the interstate transmission of natural gas, oil, and electricity. FERC also regulates natural gas and hydropower projects." *About FERC*, FERC (Jan. 26, 2017), http://www.ferc.gov/about/about.asp.

4. Gregory N. Basheda et al., *The FERC, Stranded Cost Recovery, and Municipalization*, 19 ENERGY L.J. 351, 351–52 (1998); *see also* Entergy Servs., Inc. v. FERC, 375 F.3d 1204, 1205–06 (D.C. Cir. 2004) (describing Order No. 888 as the culmination of a "massive regulatory revision" by FERC); William H. Penniman & Paul B. Turner, *A Jurisdictional Clash Over Electricity Transmission:* Northern States Power v. FERC, 20 ENERGY L.J. 205, 205–06 (1999) (footnotes omitted) ("Orders No. 888 and 889 . . . marked the most sweeping revision of the FERC's regulation of electric utilities' transmission services since the enactment of Part 2 of the Federal Power Act (FPA) in the 1930s.").

5. The Federal Power Act defines an "electric utility" as "a person or Federal or State agency . . . that sells electric energy." 16 U.S.C. § 796(22)(A) (2012). Specifically, a "transmitting utility" includes any electric utility "that owns, operates, or controls facilities used for the transmission of electric energy (A) in interstate commerce; (B) for the sale of electric energy at wholesale." *Id.* § 796(23).

6. "The Federal Power Act splits jurisdiction over the electricity system between the Federal Energy Regulatory Commission (FERC), which regulates the wholesale market and transmission, and state regulators, which have authority over retail markets." Recent Case, Electric Power Supply Ass'n v. FERC, *753 F.3d 216 (D.C. Cir. 2014)*, 128 HARV. L. REV. 1518, 1518 (2014). FERC regulation was necessitated by the Supreme Court's decision in *Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927). *See* Matthew R. McGuire, Comment,

transmission function[7] from its wholesale merchant function[8] and to charge separate rates for each of the services.[9] The Order also requires any public utility that "own[s], control[s] or operate[s] transmission facilities which transmit electricity in interstate commerce to file with the FERC open access transmission tariffs."[10] These open access tariffs cannot be discriminatory or anticompetitive.[11] Rather, the tariffs must "offer third parties access on the same or comparable basis, and under the same or comparable terms and conditions, as the transmission provider's use of its system."[12]

As such, Order No. 888 reflects a marked departure from the regulatory approach FERC has traditionally taken.[13] Its successors, Orders No. 888-

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(Mis)understanding "Undue Discrimination": FERC's Misguided Effort to Extend the Boundaries of the Federal Power Act, 19 GEO. MASON L. REV. 549, 553 (2012) (noting that the *Attleboro* decision provided that states "could not interfere with the interstate transmission of electricity"). This decision created a gap in regulation "because no federal body had the authority to regulate interstate electric transmission" at the time. *Id.*

7. Transmission is sometimes characterized as the "'interstate highway' of electricity delivery" as it involves the bulk movement of high voltage power over long distances. *See e.g.*, *Transmission & Distribution*, PJM LEARNING CTR., https://learn.pjm.com/electricity-basics/transmission-distribution.aspx (last visited Jan. 28, 2017). Via transmission lines, electricity is moved from generation facilities "to substations [that are] closer to areas of demand for electricity." *Id.* The electricity is subsequently transported through smaller "distribution lines that carry the [electricity] to consumers" such as homes and businesses. *Glossary*, FERC, https://www.ferc.gov/resources/ glossary.asp. A utility's transmissions functions therefore include "the planning, directing, organizing or carrying out of day-to-day transmission operations, including the granting and denying of transmission service requests." PACIFICORP, STANDARDS OF CONDUCT COMPLIANCE PROCEDURES 2 (Dec. 2016), http://www.oasis.oati.com/PPW/PPWdocs/socmanual.pdf.

8. Idaho Power Co. v. FERC, 312 F.3d 454, 456 (D.C. Cir. 2002). Wholesale merchant functions encompass the activities associated with the interstate sale of electricity to third parties that ultimately resell such energy to consumers. *See* TRI-STATE GENERATION AND TRANSMISSION ASSOCIATION, INC., STANDARDS OF CONDUCT CONCERNING OPEN ACCESS AND NON-DISCRIMINATORY TRANSMISSION SERVICES 1 (May 2001), http://www.oatioasis.com/TSGT/ TSGTdocs/ts_stand_conduct.pdf.

9. Ala. Mun. Elec. Auth. v. FERC, 662 F.3d 571, 574 (D.C. Cir. 2011).

10. Alan I. Robbins & Stacy D. Gould, *Traditional Municipalization and Duplication of Facilities Cases: Background, Facts, and Status*, 37 NAT. RESOURCES J. 155, 156 (1997).

11. MONICA GREER, ELECTRICITY COST MODELING CALCULATIONS 84 (2011).

12. STEVE ISSER, ELECTRICITY RESTRUCTURING IN THE UNITED STATES: MARKETS AND POLICY FROM THE 1978 ENERGY ACT TO THE PRESENT 137 (2015) (explaining FERC's first attempt to impose a comparability standard on the electric utility industry in 1993).

13. *See* Penniman & Turner, *supra* note 4, at 207.

A,[14] B, [15] C, [16] and Orders No. 889[17] and 890,[18] clarify and expand upon many of the policies articulated in Order No. 888. Among the articulated policies of Order No. 888, the FERC outlaws capacity hoarding.[19]

There are two issues associated with FERC's treatment of capacity hoarding under Order No. 888. The first is that the Commission never explicitly defines the concept. The second issue rests on the Commission's failure to identify a clear and transparent approach to policing hoarding (in the context of transmission capacity reservations).[20] In Order No. 888, FERC summarily refused to adopt a use-it-or-lose-it approach to regulating transmission customers who reserve capacity.[21] This decision needs to be expressly revisited in light of changes to the electric utility landscape.

Part I provides a brief historical background of the electric utility industry, with an emphasis on significant changes that occurred *prior* to the adoption of Order No. 888. It segues through the traditional vertically integrated utility model and the concept of natural monopolies to reach the

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14. Order No. 888-A, Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, 78 F.E.R.C. ¶ 61,220 (1997) [hereinafter Order No. 888-A], https://www.ferc.gov/legal/maj-ord-reg/land-docs/rm95-8p1-000.txt. Order 888-A "addressed petitions for clarification and rehearing relating to [Order No. 888]." Fla. Mun. Power Agency v. FERC, 411 F.3d 287, 289 (D.C. Cir. 2005).

15. Order No. 888-B, Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, 81 F.E.R.C. ¶ 61,248 (1997) (affirming, "with certain clarifications, the fundamental calls made in Order No. 888-A").

16. Order No. 888-C, Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, 82 F.E.R.C. ¶ 61,046 (1998) (clarifying "that the primary goal of Order No. 888's requirements for pooling arrangements 'is to ensure comparability regarding transmission services that are offered on a pool-wide basis.'"). For a brief explanation of pooling arrangements, see *infra* note 112.

17. Order No. 889 has been described as "establishing guidelines to limit affiliate coordination or favoritism in the administration of open access tariffs." Harvey Reiter, *The Contrasting Policies of the FCC and FERC Regarding the Importance of Open Transmission Networks in Downstream Competitive Markets*, 57 FED. COMM. L.J. 243, 259 (2005).

18. Order No. 890, Preventing Undue Discrimination and Preference in Transmission Service, 118 F.E.R.C. ¶ 61,119 (Feb. 16, 2007); *see* 2011 A.B.A. SEC. ENV'T, ENERGY & RESOURCES L. REP. 181 ("Order No. 890 required each public utility transmission provider to develop an open-access transmission tariff (OATT) and transmission planning process that satisfied nine principles: '(1) coordination, (2) openness, (3) transparency, (4) information exchange, (5) comparability, (6) dispute resolution, (7) regional participation, (8) economic planning studies, and (9) cost allocation for new projects.'"). The Order was designed to address, *inter alia*, "the potential for undue discrimination in the *planning* of transmission facilities." James J. Hoecker & Douglas W. Smith, *Regulatory Federalism and Development of Electric Transmission: A Brewing Storm?*, 35 ENERGY L.J 71, 76 (2014) (emphasis added).

19. *See* discussion *infra* Part II.b.

20. *See* discussion *infra* Part I.d.

21. *See* discussion *infra* Part II.b.

Commission's fight against what FERC considers the foremost barrier to competition, undue discrimination. In doing so, Part I contextualizes many of the issues raised by this Note. Part II addresses the current need for reform. It begins by arguing that FERC's hoarding policy, as described in Order No. 888, lacks both clarity and transparency. It contends that with rising mergers and acquisitions activity within the utility industry, FERC should expressly revisit its treatment of hoarding. Part III is concerned with establishing a comprehensive definition for capacity hoarding. Ultimately it defines capacity hoarding as "an electric utility's retention of transmission capacity when such utility possesses market power or otherwise has an intention to exert market power through its retention of such capacity." After establishing the definition, Part III concludes by suggesting that FERC adopt a modified use-it-or-lose-it approach to address hoarding.

I. BACKGROUND

A. Impetus Towards Increasing Competition/Decreasing Discrimination

Energy law's main objective has consistently been "to provide an abundant, stable energy supply at a low price."[22] The traditional utility model in the United States was the vertically integrated monopoly[23] that provided a bundled[24] service and charged its customers "a single price for generation, transmission, and distribution of electricity."[25] This system of nationwide vertically integrated utilities "began to unravel" in the latter half of the 20th century, as "electricity prices precipitously climbed, and the massive capital investments that utilities had been sinking into their systems came under heightened political scrutiny."[26] Simultaneously, numerous academic studies began encouraging reform.[27] The Commission considered

22. Lincoln L. Davies, *Power Forward: The Argument for a National RPS*, 42 CONN. L. REV. 1339, 1346 (2010) (explaining that the "central objective" has remained consistent despite changes to the regulatory landscape).

23. A vertically integrated electric utility generates power and transports it as well. ROBERT J. MICHAELS, CATO INST., VERTICAL INTEGRATION AND THE RESTRUCTURING OF THE U.S. ELECTRICITY INDUSTRY 2 (2006), http://www.ksg.harvard.edu/hepg/Papers/Michaels_vertical_integration_07.06.pdf (explaining that electric utilities have been vertically integrated "almost since their origins").

24. Bundled services consist of generation, transmission, distribution, and ancillary services bundled into one package and sold to an end-user. *See* SHIMON AWERBUCH & ALISTAIR PRESTON, THE VIRTUAL UTILITY: ACCOUNTING, TECHNOLOGY & COMPETITIVE ASPECTS OF THE EMERGING INDUSTRY 252 (1997).

25. Cal. Dep't of Water Res. v. FERC, 489 F.3d 1029, 1031 (9th Cir. 2007). See *supra* notes 7–8 for an explanation of generation, transmission, and distribution.

26. Davies, *supra* note 22, at 1348.

27. *Id.*; *see, e.g.*, Philip R. O'Connor et al., *The Transition to Competition in the Electric Utility*

the apparent lack of competition (under the traditional system)[28] to be an underlying cause of a growing problem: pervasive discrimination within the industry.[29]

B. The Importance of Competition and the Natural Monopoly

Competition is a relatively new addition to the electric utility landscape.[30] Historically, electric utilities have been considered natural monopolies.[31] A natural monopoly "is not like other businesses subject to the steady, constant pressure of competition."[32] In his article, *Natural Monopoly and Its Regulation*, Richard Posner explains the concept of a natural monopoly.

> The term does not refer to the actual number of sellers in a market but to the relationship between demand and the technology of supply. If the entire demand within a relevant market can be satisfied at the lowest cost by one firm rather than by two or more, the market is a natural monopoly, whatever the actual number of firms in it. If such a market contains more than one firm, either the firms will quickly shake down to one through mergers or failures, or production will continue to consume more resources than necessary.[33]

Essentially, "[a] natural monopoly exists when a single firm can produce a desired level of output at lower total cost than any output combination of more than one firm."[34] Under such conditions, a government might grant a

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Industry, 8 J. ENERGY L. & POL'Y 223, 224 (1988) (emphasis added) (criticizing the framework that regulated electric utilities as "built in the first forty years of [the twentieth] century, without any precedent, and structured to adapt to the changing environment of *that* time.").

28. *See* New York v. FERC, 535 U.S. 1, 5 (2002) (explaining that around the time the FPA passed, "[c]ompetition among utilities was not prevalent").

29. *See* discussion *infra* Part I.c.

30. *See generally* SALLY HUNT, MAKING COMPETITION WORK IN ELECTRICITY (2002).

31. AMY ABEL, CONG. RESEARCH SERV., RL32728, ELECTRIC UTILITY REGULATORY REFORM: ISSUES FOR THE 109TH CONGRESS 1 (2005).

32. RICHARD T. ELY ASSISTED BY JOHN H. FINLEY, TAXATION IN AMERICAN STATES AND CITIES 269 (New York, Thomas Y. Crowley & Co. 1888). "In a perfectly competitive market, firms expand output to the point where price equals incremental cost—the cost of producing an additional unit of their product. A monopolist, if unregulated, curtails production in order to raise prices." STEPHEN BREYER, REGULATION AND ITS REFORM 15 (1982) (footnote omitted). "A perfectly competitive market assumes . . . a firm faces many buyers and sellers in the market, all firms and buyers have equal access to information, the costs of transaction between any seller and buyer are extremely low, and there are no significant impediments to market entry . . . ." FRED BOSSELMAN ET AL., ENERGY, ECONOMICS AND THE ENVIRONMENT 51–52 (3d ed. 2010) (explaining market assumption of the neoclassical economic view of competition).

33. Richard A. Posner, *Natural Monopoly and Its Regulation*, 21 STAN. L. REV. 548 (1969).

34. Douglas Gegax & Kenneth Nowotny, *Competition and the Electric Utility Industry: An*

single firm a monopoly franchise to provide the particular service to customers.[35] Granting a monopoly franchise within an industry that is inherently monopolistic[36] typically results from a finding that the service sought to be provided is essential to the public.[37] Governmental entities then regulate the franchised monopoly to prevent it "from earning excess profits at the expense of the consumer."[38]

Electric utility companies were long considered natural monopolies for three main reasons. First, it was understood that the most economical way to transmit and distribute electricity was typically over "a single line or a single network of lines."[39] Second, such generation of electricity had to be "centrally dispatched (usually by computer programs) to meet both predictable changes and unforeseen contingencies."[40] This requirement resulted due to the infeasibility of storing electricity.[41] Third, the service rendered by electric utilities was inextricably linked to the public interest.[42]

The characteristics above led to a system of vertically integrated utilities[43] whose rates were heavily regulated by both the states[44] and the federal government.[45] The aim of such regulation was to set utility rates just

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Evaluation, 10 YALE J. ON REG. 63, 67 (1993).

35. *See* BOSSELMAN ET AL., *supra* note 32, at 4; *see also* Ariel Katz, *The Potential Demise of Another Natural Monopoly: Rethinking the Collective Administration of Performing Rights*, 1 J. COMPETITION L. & ECON. 541, 552 (2005) (explaining that such conditions make it "optimal, from a cost perspective, to have only one firm").

36. "Whether a particular market is a natural monopoly market . . . has occupied regulators for a century." HEMPLING, *supra* note 1, at 16.

37. *See, e.g.*, Munn v. Illinois, 94 U.S. 113 (1877) (finding that the rates charged by grain storage facilities were subject to regulation because such facilities were affected with the public interest).

38. BOSSELMAN ET AL., *supra* note 32, at 4; *see also* Katz, *supra* note 35, at 552 (explaining that natural monopolies are routinely "subject[ed] . . . to some form of regulation, in order to ensure socially desirable outcomes when competition cannot be relied upon to achieve them").

39. Robert J. Michaels, *Electric Utility Regulations*, CONCISE ENCYCLOPEDIA ECON., http://www.econlib.org/library/Enc1/ElectricUtilityRegulation.html [https://perma.cc/QA7D-H6SW] (last visited Jan. 28, 2017) (explaining that single lines "minimize[] . . . capital costs and losses to electrical resistance per unit of power carried").

40. *Id.*

41. *Id.*

42. John S. Rilling, *Regulation of Utilities by a Regulator*, 23 PUB. SERVICE MAG. 38, 38 (1917) (explaining that the service was "of such public character as to make the agency rendering the same a public service company . . . impressed with a public interest"). It is interesting to note that "electric service to the public started with ice houses" that used "small generating systems . . . for making ice." H. Lester Hooker, *The End of Local Regulation—an FPC Goal?*, 1963 A.B.A. SEC. PUB. UTIL. L. REP. 12. Owners of these systems often had spare capacity, leading such owners to "[start] selling some of it to their neighbors." *Id.*

43. *See supra* notes 22–24 and accompanying text.

44. States began regulating utility rates in 1907. TIMOTHY J. BRENNAN ET AL., A SHOCK TO THE SYSTEM: RESTRUCTURING AMERICA'S ELECTRICITY INDUSTRY 4 (1996).

45. Federal regulation of wholesale electricity rates began in 1935 with Congress's passage of Part II to the Federal Power Act. *See generally* Dozier A. DeVane, *Highlights of Legislative History of the*

"high enough to ensure that utility investors had the opportunity to earn 'a fair rate of return' on their investments."[46] In doing so, regulators protected the public from potential abuses by monopoly owners.[47] By the 1980s, "there [was] a developing recognition that economic regulation accomplishes little in the public interest when it is directed at limiting competition."[48] Furthermore, with technological advancements making electric generation more and more efficient, Congress passed the Energy Policy Act of 1992.[49] The Act gave FERC "a clear signal that [Congress] would like to see more competition in wholesale electric power markets."[50]

In theory, the principal benefits that are realized from injecting competition into the electric industry come from a reallocation of risks.[51] When a utility is heavily regulated, its customers bear the risks of increased rates due to the utility's technology becoming obsolete and/or the utility's capacity exceeding the utility's anticipated demand.[52] In contrast, "[u]nder competition, these *risks are initially with the owners of the plants*—they will pay for mistakes or profit from good decisions and management."[53]

Testifying before the Committee on Energy and Natural Resources of the United States Senate in 1995, the Commission's Chair[54] accordingly

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Federal Power Act of 1935 and the Natural Gas Act of 1938, 14 GEO. WASH. L. REV. 30 (1945–46).

46. BRENNAN ET AL., *supra* note 44, at 4. Under the traditional rate-making process, a utility's rate of return had to be "commensurate with returns on investments in other enterprises having corresponding risks." FPC v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944). It is important to emphasize that regulators merely provided an *opportunity* rather than a *guarantee* that utilities would earn a fair return on their investments. *See* Harvey L. Reiter, *Competition Between Public and Private Distributors in a Restructured Power Industry*, 19 ENERGY L.J 333, 337 (1998) ("[T]here is no regulatory compact guaranteeing utilities a return allowance . . . ."). That said, "in effect . . . as long as [utilities] operated prudently, profit was assured." Joseph P. Tomain, *Traditionally-Structured Electric Utilities in a Distributed Generation World*, 38 NOVA L. REV. 473, 483 (2014).

47. BRENNAN ET AL., *supra* note 44, at 4; *see also* Reiter, *supra* note 46, at 337–38 (explaining that "utilities are regulated because they possess market power and because competition, while still valuable, was believed to provide insufficient protection to the public against abuse of that market power.").

48. O'Connor et al., *supra* note 27, at 229 (citing general legislative and regulatory moves to remove barriers to competition).

49. The advancements, which allowed electricity to be generated in smaller plants at a lower production cost naturally contributed to an increase in electricity providers. New York v. FERC, 535 U.S. 1, 7 (2002). In 1993, the Energy Policy Act was characterized as "the first comprehensive energy policy legislation enacted in over a decade." Donald F. Santa, Jr. & Patricia J. Beneke, *Federal Natural Gas Policy and the Energy Policy Act of 1992*, 14 ENERGY L.J. 1, 1 (1993). In relevant part, the Act "further advanced generation deregulation." David Schraub, *Renewing Electricity Competition*, 42 FLA. ST. U. L. REV. 937, 956 n.78 (2015) (highlighting the Act's removal of certain barriers to entry).

50. BOSSELMAN ET AL., *supra* note 32, at 10.

51. *See* HUNT, *supra* note 30, at 28–29.

52. *Id.* at 29.

53. *Id.*

54. The Commission's Chair at the time was Elizabeth A. Moler. *FERC Electric Utility Restructure: Hearing before the S. Comm. on Energy & Nat. Res.*, 104th Cong. 2 (1995) [hereinafter

highlighted FERC's desire to "ensure a fair and orderly transition from regulation to competition."[55] She recognized that consumers should be able to enjoy "competitively priced generation" but emphasized that the Commission was "not comfortable entirely with promoting competition by eliminating regulation" when there was "still a substantial potential . . . [for] discriminatory practices in the industry."[56]

The Commissioner indicated that FERC learns of most discriminatory practices through industry participants.[57] She asserted that although the electric generation segment of the industry had become more competitive organically, the transmission sector still sometimes prevented customers from realizing the benefits of this newfound competition.[58] Put differently, she claimed that "[w]ith the entry of significant, new third party power suppliers, [FERC had] heard an increasing number of complaints that those who own[ed] transmission facilities [were] discriminating against these third party suppliers."[59] She noted that this development was hardly surprising; one could expect utilities that had long enjoyed monopoly power to resist competitions and perhaps be "simply unwilling to give up their monopoly control over the transmission facilities."[60]

C. Order No. 888's Shift to Competition

In a Notice of Proposed Rulemaking that preceded Order No. 888, FERC echoed many of the concerns that its Commissioner had voiced in the previous year.[61] At times, FERC went further and found that "discriminatory transmission service [was] *the* foremost barrier to fair competition."[62] The Commission's view was precipitated by "evidence of

FERC Hearing] (statement of Elizabeth A. Moler, Chair, Fed. Energy Regulatory Commission). Although Moler had served on the Commission since 1988, four "pro-competition candidates" were selected to join the Commission in 1993. ISSER, *supra* note 12, at 135.

55. *FERC Hearing, supra* note 54, at 3.

56. *Id.*

57. *See id.* at 10. Although FERC can bring actions on its own, it is generally a "reactive" regulatory body. BOSSELMAN ET AL., *supra* note 32, at 63.

58. *FERC Hearing*, *supra* note 54, at 3–4.

59. *Id.* at 3.

60. *Id.* at 3–4.

61. *See* Notice of Proposed Rulemaking, Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities: Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, 70 F.E.R.C. ¶ 61,357 (proposed Mar. 29, 1995).

62. Hugh Goodday, *Reciprocity: Fair Trade or Free Trade? Challenging American Electricity Regulation Under NAFTA*, 23 DALHOUSIE J. LEGAL STUD. 130, 132 (2014) (emphasis added); *See also* Notice of Proposed Rulemaking, 70 F.E.R.C. ¶ 61,357, at 5–6 ("The key to competitive bulk power markets is opening up transmission services. . . . [M]arket power through control of transmission is the single greatest impediment to competition.").

pervasive discrimination" in the interstate transmission of electricity[63] and changes that had emerged in the market as a result of several technological advancements.[64] While those advancements had contributed to a dramatic increase in electric providers and had enabled customers around the United States to feasibly purchase electricity produced outside their home states, utilities, as the Commissioner had previously mentioned, still retained ownership and control of transmission lines that enabled the delivery (transmission) of electricity.[65] This retention of control, FERC insisted, essentially gave utilities the power "to refuse to deliver energy produced by competitors or to deliver competitors' power on terms and conditions less favorable than those they appl[ied] to their own transmissions."[66]

Reasoning that pursuant to section 206 of the Federal Power Act, the Commission was obligated[67] to prevent "unduly discriminatory practices in transmission access,"[68] FERC issued Order No. 888 in 1996. Mandating that utilities *functionally* unbundle,[69] the reforms captured in Order No. 888

63. Entergy Servs., Inc. v. FERC, 375 F.3d 1204, 1205–06 (D.C. Cir. 2004) (emphasis added). Though "pervasive," such discrimination, according to FERC, was limited to the market for wholesale electricity. *See* Ala. Mun. Elec. Auth. v. FERC, 662 F.3d 571, 574–75 (D.C. Cir. 2011) (explaining the Supreme Court's finding that FERC's decision to limit Order No. 888 to the wholesale market was reasonable).

64. New York v. FERC, 535 U.S. 1, 7 (2002). By the adoption of Order No. 888, "[s]mall, modularized generation systems c[ould] be manufactured and shipped to locations where either they could be plugged into the existing transmission system or they could provide electricity to a single consuming unit, such as a large factory. . . . [T]hese new, smaller units c[ould] generate electricity at the same low cost as the very large central power stations that were built only a few decades ago." BRENNAN ET AL., *supra* note 44, at 4. In essence, these advancements "created opportunities for competition [in electric generation] even if the transmission segment of electricity remained a natural monopoly." Katz, *supra* note 35, at 553 n.51.

65. *New York*, 535 U.S. at 8. See generally Tomain, *supra* note 46, for a discussion on the potential implications of distributed generation and self-generation.

66. *New York*, 535 U.S. at 8–9. In the 1990s, California's failed attempt to completely deregulate its electric industry "threw two major utilities into financial distress with Pacific Gas and Electric declaring bankruptcy." Tomain, *supra* note 46, at 478. This failure highlighted both the complexity of complete deregulation and "the continued natural monopoly characteristics of the transmission . . . segments" of the electric industry. *Id.*

67. In pertinent part, Section 206 of the FPA, which is codified at 16 U.S.C. § 824e(a), compels the Commission to determine the just and reasonable practice and establish such practice through rule-making whenever the Commission finds that a current practice affecting any "rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale" subject to its jurisdiction is "unduly discriminatory or preferential[.]" 16 U.S.C. § 824e(a) (2012).

68. Notice of Proposed Rulemaking, Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities: Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, 70 F.E.R.C. ¶ 61,357 (proposed Mar. 29, 1995). *See generally supra* note 1 for a brief discussion on unduly discriminatory practices.

69. In Order No. 888, "FERC defined 'functional unbundling' as requiring each utility to state separate rates for its wholesale generation, transmission and ancillary services, and to take transmission of its own wholesale sales and purchases under a single general tariff applicable equally to itself and to others." *New York*, 535 U.S. at 11.

embodied FERC's belief that "broader transmission access would facilitate more competition."[70] To unbundle, utilities would have to charge separate rates for each of their services, rather than a single rate that encompassed generation, transmission, and ancillary services. To further facilitate competition, FERC imposed a "comparability standard," which required transmission owners to offer services to third parties on the same terms that the transmission owners themselves received due to their owning the infrastructure.[71] As such, the Order sought to level the playing field.

D. Order No. 888: Mixed Reactions

Initially welcomed with unbridled enthusiasm, Order No. 888 eventually faced many criticisms. In 1998, scholars hailed the order as perhaps the biggest move taken to boost competition within the market for wholesale electric transmission.[72] This enthusiasm was short lived, with commentators soon pointing out the order's voluminous shortcomings.[73] An article written by former FERC Chief of Staff John S. Moot, for instance, noted the concern that Order No. 888 had not solved the problem of undue discrimination in the provision of electric service.[74] In particular, Moot argued that Order No. 888 in many respects lacked "clarity," a standard he suggested "require[d] that the FERC's rules be known and understood by transmission providers and their customers."[75] Moot also advanced that the level of transparency[76] provided by Order No. 888 could use improvement.[77] Ultimately, he recommended that FERC "adopt clearer guidelines as to precisely which violations [would] result in which penalties," reasoning that

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70. Basheda et al., *supra* note 4, at 352 (explaining the Commission's rationale behind requiring public utilities owning transmission systems to file open access transmission tariffs). In Order No. 888-A, FERC expressed that Order No. 888 reflected the Commission's belief that "[t]he only way to effectuate competitive markets and remedy discrimination [was] through *readily available*, non-discriminatory transmission access." Order No. 888-A, *supra* note 14, at 11 (emphasis added). Today, "[c]ompetition in wholesale generation markets is legally possible anywhere in the mainland United States," while competition in transmission markets is only possible in a few states. HEMPLING, *supra* note 1, at 75.

71. JAMES H. MCGREW, FEDERAL ENERGY REGULATORY COMMISSION 154 (2d ed. 2009) (explaining that "[t]he Commission concluded that the public interest required the elimination of the undue discrimination by which transmitting utilities could deny third parties comparable access to their transmission systems").

72. *See, e.g.*, Basheda et al., *supra* note 4, at 351–52.

73. *See, e.g.*, John S. Moot, *Whither Order No. 888?*, 26 ENERGY L.J. 327 (2005).

74. *See generally* Moot, *supra* note 73.

75. *Id.* at 330.

76. Moot defined "transparency" as a consideration of whether one could "tell if the FERC's rules are being followed." *Id.*

77. *Id.*

greater certainty regarding penalties would in turn reduce various costs associated with compliance and enforcement and would encourage public utilities to implement greater internal controls.[78]

II. THE CURRENT NEED FOR REFORM

A. Revisiting Order No. 888 in Light of Consolidation Trends

Ten years after Moot's article was published, Order No. 888 and its successor orders continue to provide uncertain guidance and arguably ineffective rules to combat undue discrimination, specifically in the context of "hoarding" electric transmission. Admittedly, the question of how big of a problem undue discrimination really is remains—as it did in 2005—"unanswered."[79] Nevertheless, the risk posed by hoarding (as a means of undue discrimination) warrants special consideration today as the electric utility landscape continues to develop rapidly. In *Wither Order No. 888*, Moot's concerns about the lack of clarity and transparency in Order No. 888 were tempered by the fact that Order No. 888 may have encouraged the entry of new merchant generators in the years immediately following its adoption.[80] As such, Moot reasoned that Order No. 888 may have "faired [sic] quite well" in serving "as a *means* to foster the development of competitive wholesale markets."[81]

Today, the rise in mergers and acquisitions activity within the electricity market should cause renewed and particularized concern. With utilities' operating costs increasing largely because of enhanced environmental regulations and rising construction costs, the "traditional operating model of building large power generating plants to sell increasing amounts of electricity is changing."[82] Rather than investing in infrastructure as was

78. *Id.* Many other commentators and state regulators criticized Order No. 888 on different grounds. *See* Cassandra Burke Robertson, *Bringing the Camel into the Tent: State and Federal Power over Electricity Transmission*, 49 CLEV. ST. L. REV. 71, 88 (2001) (explaining that "[m]any state regulators . . . oppose[d] Order 888" on jurisdictional grounds); Reiter, *supra* note 46, at 345 (criticizing Order No. 888's open access policies for "not address[ing] the need to provide low cost, reliable, retail delivery services").

79. Moot, *supra* note 73, at 331.

80. *Id.* (explaining that "[s]ince Order No. 888 was adopted, new entry by merchant generators has flourished").

81. *Id.*

82. Saumya Ajila, *Consolidation in the Electric Utilities Industry*, VALUE LINE (Mar. 30, 2015), http://www.valueline.com/Stocks/Commentaries/Consolidation_In_The_Electric_Utilities_Industry.aspx. Across the board, construction costs have consistently risen since 2011. *See* RIDER LEVETT BUCKNALL, USA REPORT: QUARTERLY CONSTRUCTION COST REPORT 3, 6 (2015).

done in the past, utilities have instead turned to consolidation.[83]

Under the Federal Power Act ("FPA"), electric utility mergers must be authorized by FERC.[84] Section 203(a)(4) of the FPA requires the Commission to approve a "proposed . . . acquisition, or change in control, if [the Commission] finds that the proposed transaction will be consistent with the public interest."[85] In deciding whether mergers align with the public interest, FERC "examines a merger's effect on competition."[86]

Despite these safeguards, a 2012 report on the "Race to Consolidate" determined that "[i]n the last 10 years, the number of investor-owned electric utility holding companies in the United States ha[d] declined from 69 to 51."[87] The report's authors predicted that the trend, which had emerged in spite of the cumbersome process associated with obtaining regulatory approval for mergers and acquisitions,[88] would accelerate gradually.[89] By 2020, the authors expect the number of investor-owned electric utility holding companies to dip below forty.[90]

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83. Ajila, *supra* note 82. In addition to heightened environmental regulations and rising construction costs, utilities may be turning to consolidation due to the steadily declining demand for electricity. *See* Tomain, *supra* note 46, at 479. Historically, electric utilities were incentivized to invest in infrastructure largely because cost-of-service regulation enabled "companies to recover their actual (or prudently-incurred) costs, including the cost of capital." HUNT, *supra* note 30, at 426 (defining cost-of-service regulation). Under this cost-based system of ratemaking, so long as demand for electricity increased and the country's economy continued to expand, a utility's "building [was] a necessary and economically valuable strategy." Tomain, *supra* note 46, at 483. Since 1996, however, demand has declined in all but two years. *Id.* at 479.

84. "No public utility shall, without first having secured an order of the Commission authorizing it to do so . . . merge or consolidate . . . by any means whatsoever . . . ." 16 U.S.C. § 824b(a)(1)(B) (2012).

85. *Id.* § 824b(a)(4). In the mid-1990s, scholars complained that FERC's merger filing requirements, which "simply instruct[ed] merging applicants to describe '[t]he facts relied upon . . . to show that the proposed . . . merger . . . will be consistent with the public interest'" failed to provide specific standards for analyzing a proposed merger's potential effect on competition. John S. Moot, *A New FERC Policy for Electric Utility Mergers?*, 17 ENERGY L.J. 139, 156 (1996) (alterations in original) (quoting 18 C.F.R. § 33.2(j) (1995)).

86. *Mergers and Sections 201 and 203 Transactions*, FERC (Oct. 3, 2016), http://www.ferc.gov/industries/electric/gen-info/mergers.asp. The Commission also considers the mergers effect on "rates and regulation, and the potential for cross-subsidization." *Id.* In comparison, the Commission does not oversee mergers and acquisitions that occur in the natural gas industry. *What FERC Does*, FERC (May 24, 2016), http://www.ferc.gov/about/ferc-does.asp (outlining the responsibilities of FERC).

87. Jack Azagury et al., *The Race to Consolidate*, FORTNIGHTLY (Sept. 2012), http://www.fortnightly.com/fortnightly/2012/09/race-consolidate.

88. Ajila, *supra* note 82.

89. Azagury et al., *supra* note 87; *see also* Editorial, *Utility Companies to Continue Mergers and Acquisitions*, ELECTRIC LIGHT & POWER (Oct. 30, 2013), http://www.elp.com/articles/2013/10/utility-companies-to-continue-mergers-and-acquisitions.html (explaining the tendency of larger electric utilities to address expansion through acquisitions, "while smaller utilities adopt an 'eat or be eaten' strategy").

90. Azagury et al., *supra* note 87. A particularly notable recent acquisition occurred July 2012 when Duke Energy merged with Progress Energy to create the largest electric utility in the United States.

Another survey similarly identified that in the five-year period preceding the 1996 adoption of Order No. 888, the electric utility industry experienced seven major utility mergers.[91] In comparison, ten such mergers occurred in 1997 alone,[92] while close to fifty mergers have occurred since 1997, an average of over thirteen major mergers per five-year period.[93]

Thus, although empirical data on the scope of the problem posed by undue discrimination remains scant, concern should grow as utilities continue to consolidate. Conceivably, large utilities like NextEra Energy and Southern Company hold a disproportionate amount of market power,[94] the exertion of which could cause devastating impacts[95] within the wholesale market of transmission. As the risk of price gouging grows with markets consolidating to the verge of monopolization,[96] the time has come to revisit FERC's policy regarding the hoarding of transmission capacity.

Matthew L. Wald, *Duke and Progress Energy Become Largest U.S. Utility*, N.Y. TIMES (July 3, 2012), http://www.nytimes.com/2012/07/04/business/energy-environment/duke-energy-merger-creates-largest-us-utility.html; *see also* Jessica Resnick-Ault, *Duke Energy to Buy Progress Energy for $13.7 Billion*, BLOOMBERG BUS. (Jan. 10, 2011, 7:37 PM), http://www.bloomberg.com/news/articles/ 2011-01-10/duke-energy-to-buy-progress-energy-for-13-7-billion (detailing the specifics of Duke Energy's then-impending acquisition of Progress Energy).

91. Here, major utility mergers are defined as mergers with a target value of over one billion dollars. ISSER, *supra* note 12, at 157.

92. *Id.* at 147. To be fair, 1997's drastic increase in mergers was largely a result of "utilities maneuver[ing] to restructure themselves for the coming competitive market place." *Id.*

93. *Id.* at 157.

94. "Market power is the ability of a firm to set prices above competitive rates." BOSSELMAN ET AL., *supra* note 32, at 108. The abuse of market power is a particular concern in the electric utility industry as well as other industries that have traditionally been characterized by state-granted monopoly power. Although

> [t]he most likely route to market power in today's electric utility industry lies through ownership or control of transmission facilities. . . . market power also may be gained without ownership. . . . Entities with *contractual* control over transmission facilities can withhold supply and extract monopoly prices just as effectively as those who control facilities through ownership.

Order No. 888, *supra* note 2, at 26–27 (emphasis added) (quoting Citizens Power & Light Corp, 48 F.E.R.C. ¶ 61,210, at 61,777 (1989)).

95. In the early 2000s California experienced an energy crisis largely as a result of market power abuses. *See generally California's Electricity Crisis: Hearing before the S. Comm. on Energy & Nat. Res.*, 107th Cong. 27 (2001). At the time, a United States senator described California's crisis in dire terms: "California has serious problems. Shortages. Blackouts. Families sitting in the dark. Traffic lights out. People stuck in elevators. Production lines shut down. Utilities on the brink of bankruptcy. Stockholders and pension funds suffering major losses." *Id.* at 3 (prepared statement of Hon. Frank H. Murkowski, Chairman, S. Comm. on Energy & Nat. Res.). Id. (statement of Hon. Frank H. Murkowski, U.S. Senator, Alaska).

96. *See infra* notes 146–148 and corresponding comments.

B. Examining Order No. 888: FERC's Hoarding Policy Sans Definition

In Order No. 888, the Commission acknowledged the possibility of industry participants hoarding transmission capacity.[97] In doing so, FERC made intermittent references to a general prohibition on the practice. The Commission's first mention of hoarding was made in reference to arguments raised by industry participants that FERC had failed to prove that undue discrimination was in fact an industry-wide problem.[98] Highlighting those concerns, FERC cited an instance where a power pool[99] had allegedly refused to wheel out[100] available capacity "on the grounds that sending power out of the pool would drive up prices in the pool" as an example of the impermissible practice of hoarding.[101]

Next, the Commission mentioned hoarding as it related to particular instances of unused or unneeded transmission capacity.[102] In this context, FERC first identified a market participant's suggestion that the Commission adopt a "use-it-or-lose-it" scheme under which transmission customers would be required to either use all of the capacity they reserve or lose their rights to such capacity.[103] Under the proposed scheme, transmission providers could potentially reassign the surrendered capacity to other customers.[104]

FERC noted that several utilities opposed instituting such a scheme.[105] One utility had argued that the approach was "inappropriate" because a

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97. Notice of Inquiry, Preventing Undue Discrimination and Preference in Transmission Services, 112 F.E.R.C. ¶ 61,299 (Sept. 16, 2005), *reprinted at* 50 Fed. Reg. 55,796, 55,802 (Sept. 23, 2005) (explaining that "In Order No. 888, the Commission acknowledged that hoarding of transmission capacity was a possibility.").

98. Order No. 888, *supra* note 2, at 129.

99. Power pools facilitate the transferring of electricity between various utilities. They are typically managed from a central location. This structure often entails the "relinquish[ing] certain responsibilities to the pool operating office in return for greater economies in operation" for the relevant utilities. ALLEN J. WOOD & BRUCE F. WOLLENBERG, POWER GENERATION, OPERATION, AND CONTROL 339 (1984).

100. Wheeling refers to the practice of transferring electricity between different utilities. It allows utilities that have surplus capacity to "transmit excess power to other utilities with too much demand." *Wheeling,* INDEPENDENT ENERGY PRODUCERS ASS'N, http://www.iepa.com/wheeling.asp (last visited Jan. 31, 2017). Put simply, wheeling involves a third party transmitting electricity over a particular company's power lines. Joseph D. Kearney & Thomas W. Merrill, *The Great Transformation of Regulated Industries Law*, 98 COLUM. L. REV. 1323, 1354 (1998).

101. Order No. 888, *supra* note 2, at 133.

102. *Id.* at 166.

103. *Id.*

104. *Id.* at 173. Such reassignment would involve the "original holder . . . conduct[ing] the transaction directly with the assignee, but . . . remain[ing] obligated to the transmission provider." KEVIN PORTER, DEP'T OF ENERGY, OPEN ACCESS TRANSMISSION AND RENEWABLE ENERGY TECHNOLOGIES 4 (1996) (summarizing Order No. 888).

105. Order No. 888, *supra* note 2, at 167.

prudent utility that had reserved capacity[106] would naturally "seek to sell the service it [was] not using so as to recover some portion of its fixed costs."[107] Similarly, another utility claimed that reservation holders had little incentive to hoard capacity because other customers could use the capacity on a non-firm[108] basis during times when reservation holders did not schedule power.[109] It cautioned that allowing providers to reassign capacity rights could "result in undue influence and the exercise of market power."[110] Another utility that opposed the measure conceded that reassigning reservation rights "would help prevent [capacity] hoarding."[111]

After identifying these concerns, FERC discussed the potential of using pooling arrangements[112] to prevent "improper reservations" as a whole.[113] It cited a market participant's belief that a "pooling arrangement could provide an incentive to hoarders to release capacity during a shortage."[114] Another participant disagreed with the above contention, arguing that "a pooling arrangement would [not] prevent capacity hoarding unless nonsequential reservations [were] prohibited" as well.[115] A final participant insisted that "a use-it-or-lose-it rule would be fairer and more effective than pooling."[116]

Once the Commission had highlighted all of the foregoing concerns, it issued its conclusions on the issue of unused or unneeded capacity. Rejecting a "use-it-or-lose-it" approach, FERC concluded that firm[117]

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106. "For a producer of energy, [reserve capacity] refers to the capacity of a producer to generate more energy than the system normally requires. For a transmission company, it refers to the capacity of the transmission infrastructure to handle additional energy transport if demand levels rise beyond expected peak levels." *Energy Dictionary: Reserve Margin, Reserve Capacity*, ENERGYVORTEX.COM, https://www.energyvortex.com/energydictionary/reserve_margin__reserve_capacity.html (last visited Jan. 31, 2017).

107. Order No. 888, *supra* note 2, at 167.

108. Non-firm transmission service refers to service that is "provided on an *as-available* basis and is subject to interruption or curtailment before Firm Transmission Service." WALT CECIL, MO. PUB. SERV. COMM'N, TRANSMISSION SERVICE TYPES 10 (Nov. 5, 2012), http://pubs.naruc.org/pub/5377347A-2354-D714-5155-0E16D3B53538.

109. Order No. 888, *supra* note 2 at 167.

110. *Id.*

111. *Id.* at 167. Despite its helping prevent hoarding, the utility argued that reassignment would hardly "assure efficient use of the full transmission network," *id.* at 167, a goal that is central to effective utility regulation.

112. A pooling arrangement is an agreement between at least two "interconnected electric systems to operate on a coordinated basis to achieve economies and/or enhance reliability in supplying their respective loads." 7 C.F.R. § 1717.602 (2015).

113. Order No. 888, *supra* note 2, at 168.

114. *Id.*

115. *Id.*

116. *Id.* Order No. 888 also addressed other considerations implicitly related to hoarding, including granting a right to first refusal to customers that reserve capacity before others, limiting reservation periods, and mandating nonrefundable fees on customers that place advance reservations.

117. Firm transmission service refers to service that is usually constantly available even when a

transmission customers "should not lose their rights to firm capacity *simply* because they do not use that capacity for certain periods of time."[118] The Commission noted that the typical firm customer that has paid to reserve capacity "does not use the entire amount of reserved capacity at all times."[119]

Despite this widespread practice, the Commission concluded that "[t]his does not mean . . . they must permanently return the unused amount to the utility."[120] Instead, FERC deferred to the expertise of transmission customers, who in the Commission's view, are "in the best position to know the levels of electric energy they will be transmitting and the level of flexibility they need in carrying out their transmission activities."[121] FERC ultimately concluded that "[i]n the absence of evidence of hoarding or *other* anticompetitive practices, [the Commission] will not limit the amount of transmission capacity that a customer may reserve."[122]

In reaching its conclusion, FERC essentially argued that under the existing system, transmission customers had little incentive to hoard capacity.[123] The Commission did, however, recognize that "situations *could* arise in which a customer unlawfully withholds capacity. That is, a transmission customer could retain capacity in a way that could have an anticompetitive effect."[124]

Due to the apparently low likelihood of such withholding, the Commission determined that a generic remedy was currently unnecessary.[125] Rather, it mandated that "substantial allegations that indicate that a transmission customer is withholding scarce capacity in a way that has an anticompetitive effect [should] be addressed under section

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transmission system nears capacity. A utility that buys firm transmission service is "more likely . . . to be able to serve all of its customers" year-round. CECIL, *supra* note 108, at 6–8.

118. Order No. 888, *supra* note 2, at 168 (emphasis added). In addition to rejecting the proposed use-it-or-lose-it scheme, the Commission "declined [other] suggested policy measures such as . . . 'take or pay' charges, imposing nonrefundable fees, or imposing limitations on how far in advance reservations for transmission capacity can be made." PORTER, *supra* note 104, at 4.

119. Order No. 888, *supra* note 2, at 168.

120. *Id.*

121. *Id.* at 168–69.

122. *Id.* at 168 (emphasis added). The Commission also emphasized that firm customers were still required to pay relevant reservation charges associated with unused or unneeded transmission capacity. *Id.* at 169; *see infra* Part III.a (discussing Order 888's lack of an explicit definition of hoarding).

123. Order No. 888, *supra* note 2, at 169. The Commission claimed that the risk of a transmission customer "reserv[ing] capacity and then hold[ing] without using or reassigning it is mitigated" since customers stand to benefit economically from selling unscheduled capacity on a non-firm basis or otherwise making it available to the market. *Id.*

124. *Id.* (emphasis added); *see infra* Part III.a.

125. Order No. 888, *supra* note 2, at 169–70.

206."[126] If a customer was found guilty of unlawful withholding, the Commission might, pursuant to section 206, prohibit such customer from reserving capacity and "return the capacity reservation right to the transmission operator."[127]

There are several problems associated with the above policy. First, an explicit definition of hoarding is absent from FERC's hands-off approach to curbing the practice.[128] Second, Order No. 888 provides limited guidance on how proven instances of hoarding should be addressed in the future. As such, FERC's current hoarding policy, which emanates primarily from Order No. 888, lacks both clarity and transparency (as defined by Moot).[129] Lastly, FERC's decision to reject a use-it-or-lose it approach in favor of its uncertain remedial approach, is incompatible with today's utility landscape.[130] The Commission should issue a clarification of the first two issues and revisit its approach to hoarding, in light of recent utility consolidations.

III. DEFINITION AND APPLICATION

A. Defining Hoarding: Order No. 888

Without an express definition for hoarding, a risk emerges that transmission providers and their customers may not know or understand the rules surrounding the practice.[131] As a result, even well-intentioned customers might not realize they are violating FERC policy by failing to release a given amount of transmission capacity.[132] Explicitly defining hoarding is thus a requisite early step to achieving an effective policy that ultimately protects the public from unjustified price increases.

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126. *Id.* at 170. Essentially, the Commission instructed market participants to continue to file complaints with FERC if "evidence that a transmission customer [was] hoarding transmission capacity" arose. PORTER, *supra* note 104, at 4; *see supra* note 67, for a description of the pertinent statutory language of section 206 of the FPA.

127. Order No. 888, *supra* note 2, at 170. The Commission insisted that its approach struck a balance between the interests of not having capacity go unused "without forcing customers to demonstrate need or to reveal details of individual transactions." *Id.*

128. Seemingly, the only attempt FERC has made to explicitly define hoarding comes in the natural gas context, where FERC labels 'hoarding' an "uneconomic retention." Interstate Natural Gas Pipeline Rate Design, 47 F.E.R.C. ¶ 61,295 (May 30, 1989). In Order No. 888, FERC merely states that hoarding concerns will be addressed by the Commission on a case-by-case basis. Order No. 888, *supra* note 2.

129. Moot, *supra* note 73, at 330 (defining "clarity" and "transparency").

130. *See* discussion *supra* Part II.a.

131. *See* Moot, *supra* note 73, at 330.

132. *See id.* at 334 (explaining how the lack of an industry standard for calculating available transmission capacity "makes it difficult to determine whether any *particular* method violates Order No. 888's mandate to provide transmission service on a nondiscriminatory basis").

Through an examination of Order No. 888, one can develop a rough understanding of what actions, under FERC's view, constitute capacity hoarding (in the context of unused or unneeded capacity). FERC's example of the power pool that refused to wheel out available capacity because doing so would affect its bottom line clearly illustrates that an entity that intentionally withholds capacity in order to maximize its returns is guilty of hoarding.[133] It is also somewhat clear that the Commission is particularly concerned with hoarding if the practice is done when capacity is scarce.[134] FERC's statement that a firm customer should not lose its rights to firm capacity solely because it does not use that capacity for certain periods of time also indicates that hoarding amounts to something greater than merely holding onto unused capacity.[135] As such, the Commission's policy of not limiting reservation rights to capacity "in the absence of evidence of hoarding or other anticompetitive practices"[136] makes some sense.

Put together, these articulations indicate that FERC considers hoarding an anticompetitive practice that involves an electric utility withholding transmission capacity from third parties. While intentional withholding to exert market power is clearly hoarding, simply holding onto unused capacity is permissible. The distinction between the two ends of the spectrum must result from the intentional act to withhold, the existence of market conditions that make withholding harmful, or a consideration of both of these components.

FERC has previously alluded to intent being a requisite aspect of actions that are unduly discriminatory.[137] In Order No. 2000, FERC cautions however, that "instances of actual discrimination may be undetectable in a non-transparent market and, in any event, it is often hard to determine, on an after-the-fact basis, whether an action was *motivated by an intent* to favor affiliates or simply reflected the impartial application of operating or technical requirement[s]."[138] This observation confirms that the intentional act of the pool that refused to wheel is tantamount to an easy case of hoarding. At the same time, FERC's observation emphasizes that requiring

133. *See* discussion *supra* Part II.b.
134. *See* discussion *supra* Part II.b.
135. *See* discussion *supra* Part II.b.
136. Order No. 888, *supra* note 2, at 168.
137. *See* Order No. 2000, Regional Transmission Organizations, 89 F.E.R.C. ¶ 61,285 (Dec. 20, 1999) [hereinafter Order No. 2000].
138. *Id.* at 36 (emphasis added); *c.f.* Joe D. Pace & John H. Landon, *Introducing Competition into the Electric Utility Industry: An Economic Appraisal*, 3 ENERGY L.J. 1, 19 (1982) (explaining that FERC policy had recently decided that "the intent of the wholesale supplier was not relevant in determining either the existence of a price squeeze or whether a price squeeze, once found, was undue").

a finding that a utility withheld its capacity with the intent to favor the utility (or its affiliate) over third parties is perhaps impossible in practice.

Intent is routinely measured by an objective standard.[139] Imposing such a standard in the utility industry would be arduous.[140] The arguments raised by various market participants in opposition to the proposed use-it-or-lose-it scheme underscore the difficulty with making an "objective" determination that a utility has withheld capacity with intent.[141] Take, for example, the argument that any "prudent" utility would attempt "to sell the service it [was] not using so as to recover some portion of its fixed costs."[142] If this statement were accurate, it would lead to the conclusion that a utility acts imprudently *whenever* it withholds unused capacity. Arguably, one could equate imprudence to intentional action, or at least reasonably infer that a utility acts with intent if it undertakes the imprudent action of withholding capacity. This result, however, would conflict with FERC's explicit determination that holding onto unused capacity alone does not amount to the impermissible practice of hoarding.[143] Moreover, as FERC admits, detecting intentionality is difficult because a utility that consciously violates FERC policy seldom leaves a paper trail behind.[144]

Thus, FERC's definition of hoarding must rest either entirely on the market conditions that might make withholding capacity particularly harmful or some combination of such conditions and the motivation behind a utility's action. FERC's conclusion implies that the hoarding inquiry should focus primarily on the anticompetitive *effect* that withholding transmission "could have" on a given market.[145] The actual effect a utility's withholding ultimately has on the market is seemingly irrelevant to the inquiry.

An environment where a number of utilities have the ability to "set prices above competitive rates"[146] (i.e., where utilities possess market power), suffers particular harm when a utility with that ability withholds capacity. Naturally, in such markets there is an inherent risk that prices could increase

139. *See* Devenpeck v. Alford, 543 U.S. 146, 154 (2004) (explaining that "of course subjective intent is *always* determined by objective means").

140. HUNT, *supra* note 30, at 104 ("How do you know whether a plant that is not running at all is out of service for physical reasons, or being withheld deliberately to raise the price? This is a question of intention, and unless there is a string of e-mails saying 'forget about maintaining the sucker' there may be no way to tell.").

141. *See* discussion *supra* Part II.b.

142. Order No. 888, *supra* note 2, at 167.

143. *See* discussion *supra* Part II.b.

144. *See* HUNT, *supra* note 30, at 104.

145. *See* discussion *supra* Part II.b.

146. BOSSELMAN ET AL., *supra* note 32, at 108.

precipitously. Sally Hunt offers the following insight in reference to a utility exercising market power by unilaterally withdrawing its capacity:[147]

> Of course you take a loss on the capacity you unilaterally withdraw. If there is freedom of entry, a competitor can replace your capacity and make your behavior unprofitable, but this may take a while. In markets where entry takes time, the secret of successfully exercising market power is to have enough other units that the increased price for your other units' output more than makes up for the loss on the withdrawn capacity. *To make this work, in general you have to be big, compared with the size of the market.*[148]

As Sally Hunt's insight demonstrates, the bigger a utility is in relation to its market, the more likely its withholding of capacity is intended to alter market prices. Over the last decade, various articles have "noted the existence of market power in U.S. electricity markets . . . including PJM, ISO-New England, [and] New York ISO."[149] PJM, ISO-New England, and New York ISO are known as Regional Transmission Organizations (RTOs), which are voluntarily formed entities that "administer the transmission grid on a regional basis throughout North America."[150] One of the key required functions of an RTO is to monitor regional markets "to identify . . . market power abuses."[151]

Arguably, the Commission was implicitly referring to market power when it insisted that "firm transmission customers . . . should not lose their rights to firm capacity *simply* because they do not use that capacity for certain periods of time."[152] Such a reference would underscore FERC's belief that hoarding is particularly problematic if it occurs when transmission capacity is scarce.

Despite the difficulty with determining whether a utility withheld capacity with the intent to exert market power, FERC's wheeling utility example[153] indicates that intentionality is still a relevant consideration. With this in mind, this Note offers the following definition, which is based on a complete reading of Order No. 888:

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147. The scenario explained by Hunt (a transmission provider unilaterally withdrawing its own capacity from the market) is different from, but analogous to, a transmission customer withholding unused reserved capacity from third parties.

148. HUNT, *supra* note 30, at 90.

149. ISSER, *supra* note 12, at 448.

150. *Regional Transmission Organizations (RTO)/Independent System Operators (ISO)*, FERC, http://www.ferc.gov/industries/electric/indus-act/rto.asp (Oct. 20, 2016).

151. Regional Transmission Organizations, 18 C.F.R. § 35.34(k)(6) (2015).

152. Order No. 888, *supra* note 2, at 168 (emphasis added).

153. *See* discussion *supra* Part II.b.

> Capacity hoarding refers to an electric utility's retention of transmission capacity when such utility possesses market power or otherwise has an intention to exert market power through its retention of such capacity.

Here, the actual presence of market power and the intent to exert market power are two alternate elements.

B. Defining Hoarding: Applying Preceding Scholarship

Although scholars have seldom defined capacity hoarding in the American context, European scholars have defined the term in various articles.[154] An article addressing the role of the European Union's competition rules in shaping the continent's electricity markets defines capacity hoarding as "the withholding of transmission capacity through excessive capacity reservations in order to prevent or hinder competition."[155] A second article analyzing commitment decisions in the European energy sector defines capacity hoarding as "a strategy by which companies aim to keep transport capacity on their gas or electricity network for themselves."[156] The article notes further that "capacity hoarding is seen as a sub-category of the concept of refusal to supply" that focuses on "'whether' capacity is offered."[157] Also in the European Union context, a third article describes capacity hoarding as "refusing to grant third parties access to capacity in the network."[158]

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154. *See, e.g.*, Luis Aníbal Avilés Pagán, *The Role of the European Union's Competition Rules in Shaping the Electric Energy Markets in Europe*, 82 REVISTA JURÍDICA U.P.R. 85, 116 (footnote omitted) (2013) (describing proceedings against a Czech utility accused of "incurring in capacity hoarding of its transmission network in an effort to prevent the entry of third parties into the wholesale market of electricity"). Indeed, capacity hoarding is far from a uniquely American practice. Scholars have identified "evidence that exercise of market power in the United Kingdom has taken place through capacity withholding: at high-demand times the two large firms in the United Kingdom appear to have made some of their capacity unavailable in order to raise the market-clearing price." Severin Borenstein, James Bushnell & Steven Stoft, *The Competitive Effects of Transmission Capacity in a Deregulated Electricity Industry*, 31 RAND J. ECON. 294, 308 (2000) (citing Frank A. Wolak & Robert H. Patrick, *The Impact of Market Rules and Market Structure on the Price Determination Process in the England and Wales Electricity Market* (Univ. of Cal. Energy Inst., Working Paper No. PWP-047, 1997), https://ei.haas.berkeley.edu/research/papers/PWP/pwp047.pdf)).

155. Pagán, *supra* note 154, at 116 n.127.

156. Michael Hofmann, Commitment Decisions in the European Energy Sector–Implementation of Sector-Specific Regulation via Competition Law, 2014 EUR. NETWORKS L. & REG. Q. 131, 135 (2014).

157. *Id.*

158. Barbora Hrabčáková & Tomáš Lipták, *EU Legislation on the Electricity Market: Introducing Competition. Interaction Between Sector-Specific Regulation and EU Competition Rules. Third Legislative Package*., 13 COMMON L. REV. 62, 66 (2014); *see also* Per Hellström et al., *Remedies in European Antitrust Law*, 76 ANTITRUST L.J. 43, 57 (2009) (defining capacity hoarding as "refusal to grant access to capacity available on the transport network").

These characterizations, although somewhat different from one another, seem compatible with the definition this Note identifies.[159] Common in each of the characterizations is the concept of refusal, which implies an element of intent involved in the practice of hoarding electric transmission. The characterizations, however, do not uniformly require a utility to intend a particular outcome.

The second characterization, for instance, merely requires that a utility "aim" to keep capacity for itself.[160] Under the first definition, that intention alone is likely insufficient. The first characterization instead explicitly requires an intention to "prevent or hinder competition."[161] The third characterization of capacity hoarding implies, at the very least, that a utility must intentionally withhold its capacity.[162] This last characterization, however, fails to mention whether the motivation behind the utility's withholding is relevant to the inquiry.

Despite their differences, each characterization describes an occurrence that could conceivably amount to unlawful withholding under the Order No. 888 concept of hoarding. The second characterization amounts to the easy case of a utility acting with the specific intent of exerting market power. In this situation, the utility has hoarded capacity even if the utility never actually possessed market power. Essentially, this scenario is akin to the wheeling utility that FERC references in Order No. 888.[163] The other two characterizations focus on the *act* of withholding, rather than the potential outcome of such withholding. As such, they seem at odds with FERC's clear instruction that holding onto certain capacity alone does not constitute hoarding. Essentially, they ignore market conditions, a feature this Note imposed in the definition established earlier.[164]

The definition that emerges from a critical reading of the Commission's Order is therefore more comprehensive than any of the European market-based characterizations alone. It is important to emphasize that this definition, although more comprehensive, still comports with the ideas expressed in preceding scholarship[165] and with the probable intent behind

159. *See* discussion *supra* Part III.a.

160. Hofmann, *supra* note 156, at 135.

161. Pagán, *supra* note 154, at 116 n.127.

162. Black's Law Dictionary defines "refusal" as "the declination of a request or demand, or the omission to comply with some requirement of law, as the result of a positive *intention* to disobey." *Refusal*, BLACK'S LAW DICTIONARY (6th ed. 1990) (emphasis added).

163. *See* discussion *supra* Part II.b.

164. *See* discussion *supra* Part II.b.

165. *See, e.g.*, Pagán, *supra* note 154, at 116 n.127.

FERC's prohibitive policy.[166]

Furthermore, the definition outlined in this Note recognizes that a utility might withhold available transmission capacity from the market for legitimate reasons. For instance, a utility that does not possess market power might prudently withhold capacity for reliability-based reasons. Since the prospect of such action adversely affecting market prices is slim (and the utility has no anticompetitive intention), it seems appropriate to allow the utility's withholding to remain unpunished.

Moreover, the definition excludes an inquiry into whether a utility's withholding had an actual and measurable effect on the market from the equation altogether.[167] This approach underscores the recognition that "[t]here is no consensus about how to model market power in electricity markets."[168] Determining whether a utility's action has a real and tangible effect on market conditions is thus a futile endeavor; it would be wholly impractical to demand that FERC determine the precise effect a utility's action had on prices before holding the utility accountable.[169]

With this definition, one can revisit FERC's treatment of unused or unneeded capacity under Order No. 888. Keeping the increase in electric utility consolidations in mind, FERC should expressly reassess its approach to the use-it-or-lose-it scheme advocated by various market participants in Order No. 888.[170] The Commission might look to the American gas industry for guidance. In terms of general regulation, the United States' natural gas industry has followed a similar trajectory to the electricity industry.

Similar to the market for wholesale electricity, the natural gas industry was once heavily regulated[171] From the 1950s through the 1970s, however, the Commission struggled to ascertain how much federal regulation within the industry was appropriate.[172] In 1954, the Supreme Court decided *Phillips Petroleum Co. v. Wisconsin*,[173] requiring the Federal Power Commission

166. *See* Order No. 2000, *supra* note 137.

167. *See* discussion *supra* Part II.b.

168. ISSER, *supra* note 12, at 451.

169. *See id.* at 275 (explaining that "[t]he controversy over the exercise of market power in California illustrated the complexity of identifying and quantifying the existence and *impact* of such behavior.") (emphasis added).

170. *See* discussion *supra* Part II.a.

171. PAUL W. MACAVOY, THE NATURAL GAS MARKET: SIXTY YEARS OF REGULATION AND DEREGULATION 2 (2000) (explaining that regulation of the natural gas industry was aimed at "goal of a secure low-cost supply").

172. *See generally id.*

173. 347 U.S. 672 (1954).

(FPC)[174] to regulate wellhead prices of natural gas.[175] The resulting regulations, which were implemented in the late 1960s, [176] quickly led to a drastic reduction in prices[177] that ultimately contributed towards widespread "natural gas shortages in the 1970s."[178] To address these shortages, the Commission subsequently deregulated prices associated with production from new gas reserves.[179] This strategy proved just as ineffective. "By continuing the regulation of prices for production out of old reserves . . . the commission forced deregulated prices for new supplies to . . . artificially high levels . . . ."[180] This increase in price, analogous to the precipitous price increase that encouraged the adoption of Order No. 888, subsequently led to gas surpluses in the mid-1980s.[181]

Since the 1980's, America's natural gas industry has undergone several significant changes that are not too dissimilar from the electricity industry. Among these changes, the Commission no longer regulates wellhead prices and "interstate pipelines no longer take ownership of the natural gas commodity; instead they offer only the transportation component, which is still under federal regulation."[182] Regulators now require "open access to pipeline space for distributors and consumers."[183] As a result, "[t]he natural gas industry today . . . is much more open to competition and choice."[184]

In the gas industry, gas pipeline contracts are analogous to capacity reservations in the electricity industry.[185] FERC regulates the prices of such contracts, "but the contracts are renewable virtually in perpetuity, and the capacity can be sublet on competitive terms."[186] These conditions make the

174. The FPC, FERC's predecessor, was established in 1935 with the passage of the Federal Power Act, which initially "gave the FPC rate and accounting jurisdiction over wholesale sales and transmission of electric in interstate commerce." *A Salute: 75 Years for the FPC and FERC*, 16 ENERGY L.J. 293, 294 (1995). In 1938, Congress expanded the FPC's jurisdiction to natural gas companies. *Id.*

175. MACAVOY, *supra* note 171, at 2 (describing the holding and aftermath of the Supreme Court's decision in *Phillips Petroleum Co.*).

176. *Id.*

177. *Id.*

178. *Industry and Market Structure*, NATURALGAS.ORG (Sept. 20, 2013), http://naturalgas.org/business/industry/.

179. MACAVOY, *supra* note 171, at 2.

180. *Id.*

181. *Industry and Market Structure*, *supra* note 178.

182. *Id.* (describing recent developments in America's natural gas industry). This development is similar to the deregulation and functional unbundling of vertically integrated electric utilities. *See generally* MICHAELS, *supra* note 23 (detailing the restructuring of the electricity industry).

183. MACAVOY, *supra* note 171, at 4.

184. *Industry and Market Structure*, *supra* note 178 (describing recent developments in America's natural gas industry).

185. *See* discussion *supra* Part II.b.

186. HUNT, *supra* note 30, at 207.

pipeline market "very competitive."[187] In essence, holders of gas pipeline contracts "have a 'property right' to the pipeline capacity."[188] In response, the industry has adopted a "use-it-or-lose-it" feature to curb "potential monopolization of the pipeline by holders of contracts."[189] Under this scheme, holders are required to use gas each day. In the event that they fail to do so, their contracts are reassigned.[190] This system, rather successful in the gas industry, should be replicated in wholesale markets for electricity.

A prudent utility will likely take hoarding seriously if it risks losing its reservation rights. Certainly, utilities that do not have market power or an intention to exert market power should not lose their reservation rights simply because they hold on to capacity for too long. Only those who hoard, under the expressed definition in this Note, should lose their rights.

At first glance, this modified use-it-or-lose-it approach seems to mimic FERC's statement that "[i]n the absence of evidence of hoarding or *other* anticompetitive practices, [the Commission] will not limit the amount of transmission capacity that a customer may reserve."[191] It is different, however. This approach mandates that where the Commission has evidence of hoarding, it *shall* restrict the amount of transmission capacity a customer may reserve. The definition of hoarding established in this Note enables the implementation of such a policy.

By way of the foregoing definition, the proposed use-it-or-lose-it approach has both clarity and transparency.[192] The approach is clear because the definition specifies that the presence of market power or an intention to otherwise exert market power through the retention of transmission capacity will be considered capacity hoarding. Thus, transmission providers and their customers know when withholding capacity constitutes hoarding and are similarly aware that reservation rights will be restricted if and when capacity is hoarded.[193] In a similar vein, the approach is transparent because the definition enables market participants to tell "if the FERC's rules [on hoarding transmission capacity] are being followed."[194]

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187. *Id.*
188. *Id.* They also pay nominal usage charges for operating costs incurred by a given pipeline. *Id.*
189. *Id.*
190. *Id.* at 211.
191. Order No. 888, *supra* note 2, at 168 (emphasis added). The Commission also emphasized that firm customers were still required to pay relevant reservation charges associated with unused or unneeded transmission capacity. *Id.* at 169.
192. *See* discussion *supra* Part I.d.
193. *See* Moot, *supra* note 73, at 330.
194. *See id.*

C. Resolution and Conclusion

To be sure, there is value in articulating a policy that is sufficiently broad to afford FERC discretion in policing instances of hoarding.[195] That said, a definition that specifically references intent while still allowing FERC the ability to construe certain terms broadly or narrowly is optimal. For instance, in the workable definition established in this Note, FERC is free to determine the threshold for "retention," the meaning of "market power,"[196] and the exact contours of the market for electric transmission.

The widely held concern that Order No. 888 has not solved the problem of undue discrimination in the provision of electric transmission service is well founded. However, in the context of FERC's policy against capacity hoarding, it is a stretch to assert that Order No. 888 actually *frustrates* FERC's avowed purpose. While admittedly some degree of discretion will make it harder for utilities to comply with and for FERC to detect violations to the hoarding policy, a level of uncertainty and ambiguity prevents participants from finding creative ways to legally offend FERC's articulated policy (by acting outside of a meticulously defined rule).

It is crucial that FERC at least clarify whether the act of "hoarding" includes an element of intent. In this regard, a comprehensive definition that identifies whether hoarding requires a general intent to withhold transmission (a requirement that is unlikely after a careful reading of Order No. 888), or a specific intent to manipulate market conditions, or no intent at all is an imperative first step. With an appropriate definition in place, FERC can effectively revisit the policies outlined in Order No. 888 with a keen eye on developments within the electricity industry.[197]

The definition[198] and the use-it-or-lose-it approach[199] offered in this Note assure a level of certainty, consistency, and predictability with FERC's treatment of capacity hoarding, a notable form of undue discrimination.

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195. Note that defining a policy in such terms inevitably gives the utility a degree of discretion as well. Such discretion, even if small, will provide opportunities for undue discrimination. *Id.*

196. My proposition considers market power as "the ability of a firm to set prices above competitive rates." BOSSELMAN ET AL., *supra* note 32, at 108. But, "a serious question, which has not been resolved, is what exactly constitutes market power in an electricity market." ISSER, *supra* note 12, at 451. FERC "has no hard and fast rule" for evaluating market dominance. HUNT, *supra* note 30, at 314.

197. *See* discussion *supra* Part II.a.

198. *See* discussion *supra* Part III.a.

199. *See* discussion *supra* Part III.b.

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