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REGIONAL REGULATION OF PUBLIC UTILITIES:

OPPORTUNITIES AND OBSTACLES

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EXECUTIVE SUMMARY

A dozen years ago, The National Regulatory Research Institute (NRRI) published a study entitled *Regional Regulation of Public Utilities: Issues and Prospects*. This current study is precipitated by the intensifying of the elements that gave rise to the first report. The elements include technology, utility organization, and configuration. Moreover, the possible options for collective action can now be more clearly delineated. Commissions are less reticent to consider those options and there may be circumstances when utilities might be less likely to oppose movement in this direction. Earlier initiatives at regional regulation in the 1970s and early 1980s were generally sporadic, not particularly focused, and more occasioned by a "let's communicate" motivation; current regional activities are often regularized, issue or utility oriented, and motivated by an increasingly strong perception that the mismatch between the utility industries' new configuration and the fragmented organization for regulatory oversight needs innovative concerted approaches.

During the last few years, developments in both the electric and telecommunications fields have raised the subject of multistate regulation. The developments include: (1) merger activity in the electric sector and divestiture (and reaggregation) in the telecommunications sector, (2) increased use of pooling and attention to transmission access and pricing, (3) widespread introduction of integrated resource planning and demand-side management considerations, (4) implementation of the acid rain legislation, (5) and the advent of open network architecture. Not surprisingly, these events resulted in a heightened awareness that individual state actions and "going it alone" was not always the best response.

For the purposes of this report, the term "regional regulation" is defined as two or more state commissions acting together to carry out their regulatory responsibilities. It can be as limited as having irregular, informal joint meetings on subjects of multistate concern or as complete as taking binding action through a Congressionally approved interstate compact. It can be as "light touch" as voluntary associations that band and disband as regional issues arise, or as "heavy" as a full-blown new intermediate "megacommissions" inserted between individual state

commissions and the federal ones--a "third level of regulation." In this study the spectrum of regional actions and arrangements focused on origins, requirements, and usefulness. Regional regulation embraces both state-to-state cooperation and federal-state-to-state relationships.

A review of the literature indicates that multistate regionalization was not a central topic in the political science or government organization literature. Some multistate activity was addressed in the literature. Moreover, the literature appeared split on questions of standardization versus diversity, centralization versus decentralization, and consolidation versus fragmentation in governmental arrangements.

A more fruitful approach was to examine the literature regarding American federalism. This literature used two descriptive labels which have special relevance to our topic: "permissive" and "cooperative" federalism. Permissive federalism emphasizes national supremacy without being exclusionary of state action. In fact, state action is often encouraged and sometimes insisted upon. Nuclear waste disposal and the Public Utility Regulatory Policies Act might be cases in point. "Cooperative federalism," best describes the setting and attitude in which multistate-federal joint regulation can occur. However, the realities of the present circumstances faced by the states may motivate them toward a form of regional regulation which could be called "defensive federalism." Accordingly, if state public utility commissions do not act constructively in concert with whatever institutional structure or process best fits that action, there may be increased preemption by the Federal Energy Regulatory Commission (FERC) and the Federal Communications Commission (FCC).

The legal framework and administrative procedures for regional regulation were reviewed and updated. These focused on the compact clause, various other less formal cooperative agreements, federal supremacy issues, and states rights. Recent and historical cases in the various utility fields were examined for policy implications. Many state commissions currently have specific statutory authority to join a regional grouping, others have implied authority. In particular, regional regulation is an alternative method for state public service commissions and federal agencies, particularly when acting as equal partners, to provide an appropriate level of control over multistate utility and regional holding companies. Indeed, regional regulation involving the FERC and state commissions might be a preferable alternative to the jurisdictional

conflicts and gaps that are a result of our current regulatory scheme. A discussion of the legal framework for regional regulation is contained in Chapter 3.

To date, the interstate compact has been the most commonly used institutional arrangement for regional regulation. When using an interstate compact, the regional regulatory entity is sanctioned by Congressional legislation to resolve economic issues that would otherwise be dealt with by federal agencies under the Commerce Clause. However, when interstate compacts are introduced in Congress they are rarely passed in their original form. This aspect of the political process often leads state commissions to the conclusion that other regional regulatory options might provide them with greater substantive and procedural discretion. A yield of modest returns was the result of a review of the FERC's actual pronouncements on regional regulation found primarily in connection with particular authorities in the Northwest Power Act, the National Governors' Association regional supply planning bills, and consideration of the Arkansas Plan. Interstate compact examples and other regional regulatory cases are discussed in Chapters 4 and 5.

Using joint boards or joint conferences for regional regulation might be an acceptable alternative to interstate compacts. Either approach provides a reasonable method of the coordination of state and federal regulatory policies. Both approaches have the attractive quality of providing state commissions with an alternative method of regional regulation which does not violate the Commerce Clause, thus eliminating preemption concerns. Both approaches also provide opportunities for state and federal commissions to participate in a regional decisionmaking process without violating the "nondelegation" doctrine. The use of existing legal authority within the federal agency structure is an alternative to state-state or federal-state structures.

This approach, however, assumes that the relevant agencies will use their legal authority to involve state actors in the decisionmaking process. When focusing on collections of state commissions with dual jurisdiction, considerable attention was given to legal authorities, pronouncements, and practices of the FERC and the FCC. Both federal regulatory commissions have the statutory authority for convening joint boards and joint conferences. However, only the FCC has used them. Despite the Congressional interest in federal-state coordination, the current

rules and practice of the FERC are not promising with respect to the use of joint proceedings. Thus, the current use of joint boards and conferences is somewhat disappointing. The FERC rarely, if ever, uses joint boards. The FCC uses them with some regularity but treats their decisions as advisory and hence subject to amendment. Chapter 6 contains a discussion of joint boards and conferences.

Alternatively, regional regulation is also attractive to state commissions when cooperation between states would yield a superior result to states "going it alone" or having a federal agency preempt the state and reach its own decision. Thus, state commission might sometimes find it to their advantage to form their own regional regulatory "clubs" without federal participation. This may be the case when regional policies create spillover benefits that accrue to all members of the club. Another reason for forming a regulatory club is to minimize and internalize negative externalities that flow across state boundaries. Spillover benefits and negative externalities can best be captured in a regulatory club setting when there is diversity in interest and interdependence among club members. Homogeneity of state interests would result in state commission decisions that are made in tandem without the need for cooperation or coordination. Experience has shown that diversity of state interests tends to be the norm. Diversity of interest, however, makes it difficult to form and maintain a regional club with decisionmaking authority. Nevertheless, it may be necessary for individual states to cede some decisionmaking autonomy in order to obtain the spillover benefits through regional clubs. Once a decision is made to form a regional club, then the club size, club finances, club stability, and club operation become relevant. These considerations are delineated in Chapters 7 and 8.

The theory of clubs and the concept of spillover benefits was the most useful aspect of the review of the literature. Applying these ideas to the regulatory context provides insight into how and why regional organizations with state commissions as "club members" can be usefully formed and sustained. The thesis put forth is that club formation is beneficial whenever multistate cooperation improves the productivity of each state commission. This is measured by the extent to which clubs achieve the states' goals within the context of regional regulation.

Four types of regional regulatory clubs are proposed by the authors. They are episodic clubs, sequential clubs, coordination clubs, and consolidated clubs. Each of these club types is associated with a different degree of formal structure and procedure.

The first three clubs, the episodic, sequential, and coordination, are cooperative clubs that do not replace state commission jurisdiction. Instead, decisions are self-enforced by the individual commissions that are club members. The distinctions among these three types of clubs are characterized mainly by the degree and regularity of cooperation when consulting, coordinating, and contracting with one another. Commissions considering regional regulation are faced with the task of judging which type of club would work best for specific regional topics. Examples include facilities siting, plant modernization, pollution abatement. When tackling different regional issues commissions are not limited to membership in one type of club because they can ally themselves under different arrangements. A consolidated club would effectively be a "megacommission" made up of representatives of state commissions (sometimes with a federal presence), making binding policy decisions.

The episodic club is the least structured of the four clubs. Typically, it would be used by state commissions to engage in irregular consultation to reach a unified, one-time decision. The policies themselves are self-enforced by the member state commissions. Once the policy is finalized, the club disbands and the commissions behave independently. The survival and applicability of episodic clubs depends on the degree of commitment and the ability of members to control equity effects arising from the policy. Its lack of formality makes it useful for simple, well-focused issues that do not have extensive negative externalities or spillover benefits.

The more certain and predictable the regulatory issue, the more easily redistributive equity effects can be predicted and the easier it is to control redistributive effects in the original policy. An example of an episodic club is the state steering committee overseeing regulatory impact reviews pertaining to U S WEST.

Sequential clubs, like episodic clubs, craft policies that allow state commissions to behave independently afterwards. However, cooperation is more regular in sequential clubs because actual outcomes are more sensitive to circumstances not entirely under control of individual states and not easy to predict. Consequently, state commissions find it useful to develop guidelines and

procedures to resolve potential future conflict. In its simplest form, a sequential club becomes a temporal sequence of episodic clubs supported by a set of dispute resolution procedures which strengthen intercommission harmony. There are not any existing examples of state collaboration behaviors that conform to the characteristics of a sequential club. The FCC continuing joint board on cost separation issues is the best example of a sequential club. However, the joint board differs from the definition of a sequential club because the states are not equal partners with the FCC in the proceeding.

Coordination clubs develop and implement polycentric (complex, multicentered) policies. A polycentric policy coalesces multiple regulatory issues in an attempt to build points of mutual advantage and capture regional economies of scale and scope on an ongoing basis. Still, a coordination club is not an autonomous regulatory agency. It does not exist independently of state commissions nor does it institutionalize power and decisionmaking authority. Instead, a coordination club operates through consensus building. State commissions abide by the club's policies and remain members as long as collaboration enables them to obtain state goals more efficiently. This assures Pareto efficiency. As regional trends change, coordination clubs must respect and treat the needs of all members. An example of a coordination club would be a group of state commissions setting the regional policy for intrastate telecommunications services.

A consolidation club differs substantially from the three types of cooperative clubs just discussed. It requires each state (and federal) agency to give up most or all of its decisionmaking autonomy so that a group decision can be reached. It also requires a high degree of club infrastructure and pooled investments by the individual club members. As discussed in Chapter 7, the amount of pooled resources used to make regional policy increases when moving from less structured regular clubs to more structured clubs. This is shown in Figure ES-1. A consolidation club's policy decisions are also institutionally-enforced. An example of a consolidation club is the Northwest Power Planning Council.

Figure ES-2 summarizes the different types of clubs and their characteristics. The various types of regional regulatory clubs are discussed further in Chapter 9.

Greater deference to legitimate local interests that are not merely parochial in nature is needed for a proper balance of national and local concerns. This balance might be accomplished

through use of consensus building procedures. Consensus building procedures can be valuable tools in the formation and maintenance of regional regulatory clubs. They can provide a means for creating a win-win situation that makes the formation and maintenance of regional regulatory clubs feasible. Chapter 10 discusses how consensus-building mechanisms can be matched with different regional regulatory clubs.

This study contains a constructive view of regional regulation. The authors conclude that some form of collaborative multistate action might be considered when one or more of the following conditions are present:

- a threatened or actual federal preemption of state commission authority,
- a need to better fit jurisdictional boundaries to actual operational boundaries of multistate utilities,
- a need to achieve more rational comprehensive planning regarding utility capacity, configuration, conservation, and abatement decisions,
- a need to achieve more consistent rules and practices in regulatory oversight of utility systems in a multistate area,
- a need to improve governmental efficiency through scale and scope economies or nonduplication,
- a need to "even the match" in technical staff resources and political power with major regional utilities under regulation.

Fig. ES-1. Continuum of resource mix by club type.

Fig. ES-2. Regional regulatory clubs and their characteristics.

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FOREWORD

In the last dozen years, a great deal of de facto regional regulation of public utilities at the state level occurred. This study explores the various reasons why this phenomenon is likely to be a permanent part of the regulatory landscape. It is recognized that short of the formation and operation of interstate compacts, multistate collaboration will always be constrained by the political reluctance and perhaps legal prohibitions against yielding state authority--in this case for the regulation of utilities jurisdictional to each. Also, of course, there are many times and instances where efficiency and effectiveness call for traditional individual state action.

Still, as this study demonstrates, there are increasing opportunities and needs for regulatory actions that are less than national, but more than statewide. In addition to identifying many of these actions, this study discusses the legal underpinnings and the analytical framework that surrounds the issue.

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PART I

BACKGROUND AND INTRODUCTION: NEW OPPORTUNITIES

CHAPTER 1

REGIONAL REGULATION: OCCASION AND APPROACH

Introduction

In 1980, under a grant from the Economic Regulatory Administration of the U.S. Department of Energy, the National Regulatory Research Institute published a study entitled *Regional Regulation of Public Utilities: Issues and Prospects.*[1] That report discussed why the idea should be examined at all; the general phenomenon of regionalism in government and industry; some of the constitutional and legal issues involved; several examples of state experiences with regional regulation in the public utility field; and the opportunities, pitfalls, and prospects for further use of regional regulatory arrangements as seen at the time. The overall conclusion of the study was that:

> The need for some level of regional regulation is not overwhelming but is substantial; that while pitfalls abound, so do the occasions and opportunities on both geographic and institutional grounds; and that existing traditional and inventive nontraditional organizational schemes are available in the political and public administration context of intergovernmental relations to accommodate multistate regulation.[2]

In support of this conclusion there were more particular findings that are relevant to the present inquiry. These include:

(1) Although legal issues of sovereignty, evidence, and procedures are obstacles to the most advanced kind of commission integration, they are much less so at more modest levels of cooperative commission action and may even be less obstructive

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[1] Douglas N. Jones et al., *Regional Regulation of Public Utilities: Issues and Prospects,* (Columbus, OH: The National Regulatory Research Institute, December 1980).

[2] Ibid., 85-86.

than the subjective forces of habit, familiarity, certainty, inertia, and lack of perceived advantage.

(2) Regional regulation need not be an "all or nothing" affair with respect to scope, that is, initial activity could be informal, limited, and focused on relatively noncontroversial matters, growing gradually to more regularized, broader activities as experience and need dictate.

(3) However intuitively sensible the idea of regional regulation, for much to happen, state public utility commissioners must first see real incentives for forming such relationships by way of effectiveness, efficiencies, savings, and equity.

(4) A further tilt in regulatory authority over public utilities from state to federal might be slowed if states organized themselves to successfully take on inherently regional issues.

(5) From the regulator's vantage point most kinds of regional regulatory cooperation can result in a pooling of commission resources and analytical skills that makes for "a better match" between the regulated companies and the regulators in dealing with a jurisdictional multistate utility.

(6) From the utility's point of view, while there is understandable wariness about facing "united fronts" and greater resources, the current fact of state-to-state differences in commission rules, policy, and practice is managerially complicating and troublesome.

What gave rise to the earlier study was the recognition that: utility companies--particularly electric and telecommunications ones--were often multistate in their operations, that technology may make them more so, that the regulatory issues to be faced frequently transcended individual state boundaries, that some groups of states were experimenting with collaborative arrangements for dealing with some of these issues, and that calls for regional regulation were beginning to be heard from both inside and outside of government.[3] The occasion for this current study,a dozen years later, is the intensifying of all these elements, and the addition of several more. Moreover,

[3] Ibid., Chapter 1.

the possible options for collective action are able to be more clearly delineated. Commissions are less reticent to consider those options, and utilities may be less likely to oppose some movements in this direction.

What Is Regional Regulation and What Is the Approach?

Like the word "conservation," the term "regional regulation" can mean many things. For our purposes, it means two or more state commissions acting together to carry out their regulatory responsibilities. As such, it can be as limited as having irregular, informal joint meetings on subjects of multistate concern or as complete as taking binding action through a Congressionally-approved interstate compact. It is helpful to note, for purposes of analysis, a distinction between regional regulation *as process* and *as structure*. Regional regulation as process can be consultation, cooperation, coordination, collaboration, and integration, depending on the need, will, and ability of state commissions for joint action.[4] The structure for regional regulation can take the form of a committee, council, forum, board, commission, and compact. It can be as "light touch" as voluntary associations that band and disband as regional issues arise and are handled, or as "heavy" as a full-blown new intermediate "megacommission" inserted between individual state commissions and the federal ones (a new level of regulation). In this study both the full spectrum of regional actions and structure will be addressed regarding origins, requirements, and usefulness.

The approach to the subjects as delineated, regional regulation as process and regional arrangements as structure, is three-fold. A legal analysis is made covering constitutional issues, federal and state laws and authorities, and statutory latitudes for the forming and exercise of regional oversight. Included in this detailed review will be the adequacy of state statutes for accomplishing multistate commission activity, the status of the issue of federal delegation of the

[4] In a sense, of course, all five actions mentioned here involve cooperation. The reader should be alert to the fact that the word "cooperation" is used in this report sometimes in its generic sense, but often (especially in later chapters on club theory) as a gradation of multistate action along a continuum of actions from merely consulting with one another to a full-blown compact.

necessary authority,[5] and the recent and current disposition of Congress toward the establishment of interstate compacts. Court decisions bearing on the subject are identified and appraised as either facilitating or hindering regional regulatory initiatives.

A second thrust is a public policy review of the strengths and weaknesses of regional activity among the states generally, with particular reference to public utility regulation. Contending forces toward collective action and inhibition to it are weighed. Also analyzed are the degree of salience required for multistate action to occur and the likely sources of that salience. In this last connection, recent policies of the FERC, the U.S. Environmental Protection Agency (EPA), and the Federal Communications Commission (FCC) are given special attention. Special attention is also given to major court decisions, such as Mississippi Power & Light v. State of Mississippi ex rel. Moore.

The third is the application of "club theory." This relatively recent development in economic literature provides a theoretical underpinning for why and how voluntary cooperation takes place for mutual advantage. Although club theory has been applied to explain why nations collaborate and corporations collude and sometimes has been used on utility company behavior, it has never (to our knowledge) been applied to the question of regional regulation. Interesting lines of inquiry include the determination of club size, membership and stability, the cost of admission, and the workability of the club if competition or multiproducts are involved.

What Was Happening?

The amount and type of attention that the general subject of regional regulation has received has changed in the past decade. At the beginning of the 1980s the idea was found in the

[5] Several of the current proposals for regional arrangements would involve the Federal Energy Regulatory Commission (FERC) delegating certain powers to new bodies composed of groupings of states. There is some question of whether the delegation of such authority to nonfederal officials (state or regional) is constitutionally permissible (Buckley v. Valeo, 1976).

National Power Grid study of the U.S. Department of Energy,[6] the U.S. House of Representatives hearings on "Regional Cooperation in Utility Ratemaking,"[7] and occasional law journal articles.[8] Some nineteen state commissions were participating in multistate informational consultation on regulatory matters[9] of interest to their regions. The topic of regional regulation was infrequently an item.

Events of the mid-to-late 1980s and the early 1990s brought a quantum jump in the seriousness of consideration of the subject.[10] Not surprisingly, this heightened awareness occasioned by utility, state, federal, and Congressional actions of various kinds made the idea of individual states "going it alone" increasingly difficult.

In addition to the changes in technology that allowed greater regionalization in the electric and telecommunications sector, utility company structure was changing. Merger activity in the electric sector has increased (reportedly less on traditional grounds of scale economies and more with an eye toward markets and strategic positioning).[11] The Pacific Power and Light and Utah Power and Light merger, involving the territory of seven state commissions, is a notable example. The formation of holding companies by electric utilities has had the effect of shifting jurisdiction away from the states to the FERC. Increased use of pool arrangements and special experiments

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[6] U.S. Department of Energy, *The National Power Grid Study* (1980).

[7] U.S. House of Representatives, "Hearings on Regional Cooperation in Utility Ratemaking" (May 19, 1979).

[8] See, for example, George Lagassa, "State Commissions as Vestigial Organs: The Regional Context of Electric Utility Regulation," *Kansas Law Review* 28 (Winter 1980), 29.

[9] Jones et al., *Regional Regulation of Public Utilities*, Chapter 4.

[10] While it is speculative to suggest, it may also be that the natural turnover in public utility commissioners during the decade has meant an increased receptivity to experimentation and innovation in new organizational arrangements as events dictate. This is only to say that when new participants come to regulation facing different challenges, they may view the landscape differently than their predecessors.

[11] See, for example, Dennis Ray, Rodney Stevenson, Roger Schiffman, and Howard Thompson, *Electric Utility Mergers and Regulatory Policy* (Columbus, OH: The National Regulatory Research Institute, 1992).

such as the Western System Power Pool in market pricing (involving thirty-one utilities in eleven contiguous western states), have regional implications. The creation of utility affiliates and subsidiaries, sometimes in different states from the parent company, points toward regional oversight. When this last phenomenon involves so-called independent power producers (IPPs) or nongermane diversified companies, the regional problems posed may be even more acute.

Probably the biggest change in utility structure, with dramatic regional implications, was the divestiture of AT&T which went from one telephone company to twenty-one telephone companies that promptly reaggregated into seven Regional Bell Holding Companies (RBHCs), the largest of which covers fourteen states. In three cases, U S WEST, Ameritech, and NYNEX, regional oversight committees were formed by the relevant state commissions.[12] This holding-company structure, with service corporations that charge the subsidiary companies for their support functions, presents special challenges to any state commission acting alone.

State commission actions during the period increasingly emphasized the greater need for a regional view. In the wake of the enormous and costly errors in electricity demand forecasting in the 1970s, commissions have increasingly called for independent estimates of demand with a regional focus. Also, the widespread move toward commission insistence on demand-side management (DSM) for meeting electric power requirements has, by definition, a regional component when the utility involved serves several states. Consistency of DSM requirements and rewards across the service territory is valuable. Similarly, commission rules mandating integrated resource planning (IRP) clearly require a system perspective that may well transcend individual state boundaries. Moreover, even where IRP results in new central-station power, the siting for a new plant and the transmission siting attendant thereto may best be done in a multistate context. A plant located on a state border with transmission lines crossing several states is an obvious example. In this connection, it is noted that in at least two states there is statutory authority to form "regional certifying bodies" for the siting of bulk power facilities. Also, formal authority

[12] In the case of NYNEX, the oversight committee is actually a New England one, covering New England Telephone with a loose relationship with the New York Public Service Commission which regulates New York Telephone (the other component of NYNEX), see Chapter 2.

exists in twelve states to employ standards for considering multistate impacts in certification proceedings.[13]

Two other state developments that have implications for regional regulation are the advent of competitive bidding for new power supplies and the widespread use of incentive regulation. The first of these can, for example, involve utilities and IPPs operating in neighboring states. The second, incentive regulation, describes a broad range of mechanisms: price caps, fuel and construction cost "split-the-savings" arrangements, conservation and pollution control premiums, and economic development and retention rates which are best applied on a systemwide and multistate basis.

Many federal agency actions since the mid-1980s have contributed to the renewed interest in regional regulation. AT&T divestiture carried in its wake preemptions of various kinds[14] and decisions about depreciation allocations, transactions with affiliates and network configuration (for example, open network architecture--ONA). Alterations in the Modified Final Judgement easing restrictions on lines-of-business for the Bell Operating Companies (BOCs) will have multistate implications for regulators.

FERC consideration of transmission access and pricing issues and its preemption of cost-redistribution actions in the Grand Gulf case (among the states of Arkansas, Louisiana, and Mississippi) has obvious regional dimensions, as would any FERC initiative to limit or preempt state authority over the reasonableness of utilities' fuel and power costs and the prudence of capacity additions.

The EPA standard setting for sulphur dioxide emissions and a utility holding company's or other multistate utility's compliance strategies to meet those standards are perhaps inherently regional in character. Major features of the Clean Air Act Amendments of 1990, such as emission

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[13] *1989 Annual Report on Utility and Carrier Regulation*, (Washington, D.C.: National Association of Regulatory Utility Commissioners, 1989) 572, Table 73A.

[14] See, for example, Edythe S. Miller, "FCC Preemption, State Telecommunications Deregulation, and the Public Interest," in *Public Utility Regulation in an Environment of Change*, P. C. Mann and H. M. Trebing, eds. (Lansing, MI: MSU Papers, 1987), 14-29.

allowance trading, can be seen as "naturals" for joint state commission approaches to valuation, accounting treatment, and relation to income and profits.

In addition to the acid rain legislation, two other legislative thrusts with regional implications are the passage of the 1980 Northwest Power Act and the reform of the Public Utility Holding Company Act (PUHCA). The 1980 Act created a Northwest Power Planning Council charged with coordination, energy planning, and environmental matters for four regional states. The recently-passed National Energy Act legislation contains important changes to PUHCA which would further alter the structure of the electric industry and complicate individual state regulation of these multistate companies.

The increasing use of the Joint-Board mechanism by the FCC presents another kind of regional regulation.[15] While joint boards are primarily thought of as facilitating intergovernmental action, because their composition includes both federal and state regulators, the structure can be used regionally depending on the particular membership and the subject assigned. Examples of recent use of this mechanism by the FCC are detailed in Chapter 4.

Finally, in the litany of activities pointing toward the serious revisiting of regional regulation as both process and structure, are a number of other recent noteworthy events. In February of 1991, the National Association of Regulatory Utility Commissioners (NARUC) passed a resolution endorsing legislation to amend the Federal Power Act to reform state-federal jurisdiction over electricity transactions and facilities siting.[16] It called for "regional regulatory bodies authorized by Congress and established on a purely voluntary basis by the states in which [holding company] systems operate." In a related development, the Arkansas Public Service Commission led the way in drafting legislation that would give state commissions, collectively or jointly with FERC, the authority to regulate integrated resource planning by holding companies. Regional "boards" were initially contemplated in the "Arkansas Plan" which surfaced in the fall of 1991.

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[15] The FCC's use, since 1989, of long-held authority for a "410(b) Joint Conference" as a forum for discussion of ONA matters crossing state lines should also be mentioned.

[16] *NARUC Bulletin*, No. 9-1991, 22-23, resolution adopted February 27, 1991.

In May 1991, the New England Conference of Public Utilities Commissioners included in its program a panel entitled "Regional Telephone Regulation--How States Might Respond." In September 1992, the Electricity Committee of the NARUC sponsored a "National Conference on Collaborative Jurisdiction in the Regulation of Electric Utilities: A New Look at Jurisdictional Boundaries." At its annual convention in November 1991, the NARUC devoted a session to the topic, "Are There Consumer Benefits for the Regional Regulation of Multistate Utilities?" In the same month *Public Utilities Fortnightly* featured a commissioners' forum on regional regulation. Twenty sitting state commissioners were asked the question, "Do you think that the regulatory structure in the United States will eventually evolve from state-by-state regulation to regional regulation? Why or why not?"[17] In early 1992, Linda Stuntz, the Deputy Undersecretary for Policy, Planning, and Analysis, the U.S. Department of Energy, answered affirmatively the question, posed in the title of her article in the *Electricity Journal*, "Is It Time to Consider Regional Solutions to Power Planning Problems? One Federal View."[18] While stating that no single solution is likely to work for all issues, she wrote:

> Perhaps. . .exclusive federal authority would work best for transmission pricing. Perhaps informal regional cooperation among states would be appropriate for regional integrated resource planning. Perhaps formal interstate compacts would work best for interstate transmission line siting. Maybe federal/state joint boards are most appropriate for allowance trading issues.

In the same periodical, Charles Curtis, a former chairman of the FERC, published an article entitled, "Maintaining a Proper Balance Between Federal and State Authority--Is There a Place for Regional Regulation?"[19] He also answered affirmatively and cited the Arkansas Electric Cooperative Corporation Supreme Court decision as he concluded, "So long as FERC reserves

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[17] "1991 State Regulators' Forum," *Public Utilities Fortnightly* (November 1, 1991), 29-37.

[18] Linda G. Stuntz, "Is It Time to Consider Regional Solutions to Power Planning Problems? One Federal View," *The Electricity Journal* (January/February 1992), 14-19.

[19] Charles B. Curtis, "Maintaining a Proper Balance Between Federal and State Authority--Is There a Place for Regional Regulation?" *The Electricity Journal* (January/ February 1992), 28-33.

the right to protect legitimate federal interests, its powers to defer to state judgements and processes may be considerably greater than FERC jurisprudence has heretofore tolerated."[20] He continued:

> . . .I believe it is easily within FERC's power to provide states a decisional role in FERC cases and to give special weight or even deference to state views in appropriate circumstances. In the multistate or regional context, the consensual judgments arrived at by affected states, if grounded upon the record, ought to command special respect in FERC's deliberations. Indeed, reason would suggest that FERC ought not override such consensual judgments unless significant federal interests compel the Commission to act in a contrary manner.

[20] Ibid., 32.

It is in this context of heightened awareness, and action and reaction that the present study was conceived.

Options and Actions

While the nature of the study is evaluative rather than prescriptive, the tilt is toward a constructive view of regional regulation, seeking innovative applications where opportunities might allow. A theme is that some form of collaborative multistate action may best be considered if any of the following motivations are strongly present:

- as a reaction to threatened and actual federal expansion of state commission authority;
- as a better fit of jurisdictional boundaries to actual operational boundaries of multistate utilities;
- as a way of achieving more rational comprehensive planning regarding utility capacity, configuration, conservation, and abatement decisions;
- as a way to achieve more consistent rules and practices in regulatory oversight of utility systems in a multistate area;
- as an improvement in governmental efficiency through scale and scope economies or nonduplication;
- as a way of evening the match in technical staff resources and perhaps political power with major regional utilities under regulation.

An early step is to ensure that each state commission has the express statutory authority for joint arrangements with sister state commissions. Slightly less than half the state commissions currently have that authority, and it would seem prudent that each should secure authority from its legislature even if formal regional behavior is not immediately contemplated.[21] The study indicates the nature and extent of such

[21] In recent years state legislatures have increasingly involved themselves in state utility commission matters including making sure that commissions have the authority to deregulate companies under their original jurisdiction. It would seem a smaller step to see to it that state commissions have clear authority to deal with other commissions in varying degrees of formality.

authority state-by-state and suggests illustrative phrasing to accomplish it. Perhaps political obstacles to joint actions and arrangements may be more formidable than legal ones; these aspects are also examined.

The matching of state motivations (needs) for regional action with various suitable process and structural models is attempted. Primary criteria employed are levels of effectiveness, difficulty, and appropriateness.

The *pressures* of the current institutional setting for solutions in the utility field that are less than national but more than statewide, the *insights* into particular forms of regional regulation that club theory provides, and a good *grasp* of the legal underpinnings required to attain them, taken together, may comprise the basis for formal moves by state commissions to ally themselves on areas of mutual concern and customer interest.

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CHAPTER 2

SETTING AND STATUS

Introduction

The purposes of this chapter are: (1) to extend the theme that more serious consideration of multistate regulatory action is now timely and warranted, and (2) to sketch a framework for examining some of the regional regulatory opportunities in the context of the political science, public administration, and government organization literature.

Although regional regulation initiatives in the 1970s and early 1980s were generally sporadic and not particularly focused, regional activities since that time have often been regularized, issue or utility oriented, and motivated by an increasingly strong perception that the mismatch between the utility industries' new configuration and the current organization for regulatory oversight needs innovative concerted approaches.

What has given the complex subject of multistate regulation special salience is a confluence of developments in both the electric and telecommunications fields during the last few years. This is in addition to the cumulative evolutionary experiences of commissions over the previous twelve years in ad hoc state-to-state cooperative arrangements.

It seems fair to say that five recent events in the electric sector have provided this salience. First, implementation of the Clean Air Act Amendments of 1990, while plant and state specific, have notable regional implications. Acid rain compliance actions by the electric utilities, while plant based, are intended to involve trading of emission allowances in a national market. How commissions handle utility transactions associated with their compliance plans matters a great deal in accomplishing the objectives of the statute in a cost-effective manner.

Second, the debate over transmission access and service pricing has narrowed so that some resolution has recently occurred. Questions concerning who is to pay and in what proportions, which concern the Federal Energy Regulatory Commission's (FERC) interests in efficiency and widening markets versus state commission concerns for native-load retail

customers, and concerns regarding broader load-dispatch criteria, point to the need for a federal-state-to-state consensus.

Third, the widespread acceptance by commissions of some form of integrated resource planning (IRP) as the logical way to consider changes in capacity and to capture size and scope economies should be mentioned. Preparation of an IRP by the host utility can, of course, be done on a statewide basis, but this is almost surely not optimal when the utility is interstate in its operations or is otherwise interconnected (even if only intrastate). The existence of holding companies presents a particularly troublesome case because the worry is that neither FERC nor the state commissions can reach holding companies for IRP purposes.

Fourth, is the formal highly-visible initiative of an IRP idea, the "Arkansas Plan." Originally crafted by a regional holding company, a city, and a state commission, it has evolved (with various changes) to be S. 2607, under consideration by the Senate during the 102d Congress. The bill would authorize regional IRP by registered holding companies and the state commissions that regulate these operating companies. Hearings on the proposal were held in May, and the NARUC testified strongly in favor of it.

A fifth event bringing special salience to regional regulation possibilities in the electric sector was NARUC's passage of a February 1991 resolution, "Endorsing Legislation to Amend the Federal Power Act to Reform State/Federal Jurisdiction."[1] In a national body as diverse as NARUC it was not a trivial accomplishment to formally adopt a position that included language stating:

> 3. Jurisdiction over multistate transactions (including system cost allocation, bulk power purchases and sales, emission allowance allocations, and use of transmission facilities) within registered holding company systems operating should be lodged in regional regulatory bodies authorized by Congress and established on a purely voluntary basis by the States in which the systems operate.

[1] Sponsored by the NARUC Committee on Electricity, adopted February 27, 1991 at the Winter Meetings of the NARUC, Washington, D.C. and reported in *NARUC Bulletin* No. 9-1991, 22-23.

4. Congress should authorize the creation of multistate compacts consistent with basic principles of administrative efficiency and fairness. States which voluntarily form such compacts would collectively determine rules of governance and internal procedures.

On the telecommunications side, three recent matters can be cited as heightening interest in regional regulatory arrangements. These are in addition to the obvious regionality of the major Bell operating companies (BOCs) themselves. One is the implementation of open network architecture (ONA) in response to the proliferation of services and offers that now characterize the computer/telecommunications industry. For its benefits and perhaps even attainment to be realized, consistency in the policies of neighboring jurisdictions is an important consideration. Rules as to service offerings, interconnection and access, cost allocations and pricing done cooperatively can make for a seamless regional regime as contemplated by ONA.

A second event is the new national audit of the seven Bell regional holding companies (RHC) conducted jointly by the NARUC and the Federal Communications Commission (FCC).[2] The audit focuses on the affiliate transactions of the RHCs with special attention to the problem of cross-subsidies which can arise in a multistate context. The initiative is supervised by the chairman of the NARUC Staff Subcommittee on Accounting; has an oversight committee comprised of one FCC member and nine state commission staff members; and has two project directors, one FCC and one state commission staff member, who are responsible for coordinating the efforts of seven audit managers (one for each RHC). When fully operating, the project will have fifty field staff auditors from the FCC and the state commissions.[3] Successful cooperation will demonstrate the workability of federal-state-to-state regulation.

The third item is the states'/FCC's rewrite of the separations procedures. As with the audit of the RHCs' affiliate transactions, NARUC and the FCC are collectively exploring new rules and regulations for avoiding cross-subsidization of intrastate or interstate telecommunications services. At the 103rd NARUC Annual Convention, FCC Chairman Sikes, announced the

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[2] Reported in *State Telephone Regulation Report*, 10 no. 5 (March 12, 1992), 1-4.

[3] Ibid., 2.

formation of a Joint Board, consisting of four state commissioners and three federal commissioners, to rethink the jurisdictional cost-separation procedures. In response, NARUC has formed the Cost Allocations Task Force comprised of staff members of the Communications Committee and the FCC. This group is focusing its attention on the separations issues associated with the restructuring of interstate access charges. It will supply data and other information to the Joint Board as the latter works through the complexities of determining jurisdictional indicators and cost-allocation factors. Even though this Joint Board is addressing an issue that transcends the interests of any individual region of the country, regional coordination among the states will be particularly fruitful in providing information and suggestions. As the Joint Board decides on the appropriate mechanisms for dividing costs between interstate and intrastate jurisdiction, the regional groups will examine jurisdictionally how intrastate costs could be apportioned within the region. In effect, the support provided to the Joint Board by the regional groups would serve as a springboard for the separation of costs among the region's states.

As mentioned in the previous chapter, there is a workable distinction between regional regulation as a change in process and regional regulation as a change in structure. As an example, state commissions conducting parallel cooperative inquiry into a multistate utility's IRP represent regional regulation as process. So would several states coordinating a planned realignment of the operating companies of a Bell holding company. Similarly, a regional set of commissions collectively dealing with FERC on a particular transmission question, through a joint-conference or joint-board mechanism is an example of regional regulation as process. These examples involve new behavior but not new structures. Thus, regional regulation as structural change would be exemplified by the actual creation of new multistate and/or state-federal forms (boards, councils, committees, compacts, commissions) that did not exist before for this purpose.

These examples suggest another way in which regional regulation can be divided. There are state-to-state actions, which do not involve the FERC or FCC, that comprise regional regulation. There are also federal-state-to-state actions in our federal system. The present study considers both varieties in the context of regional regulatory processes and structures (that is, lateral dealings among states as well as vertical dealings--federal to state--with the states dealing laterally among themselves).

Holding Companies and Regional Regulation

The multistate nature of many investor-owned holding companies in the electric sector presents a powerful reason for considering some form of regional regulation. The problem that an individual state has in grasping the full scope of interstate operations is formidable and increasingly troublesome. The ability of the company to hide its intentions, costs, profits, and other strategically important aspects of its operations from each of the states can be a severe handicap. It fosters an agenda at the state level that focuses on the current service offerings of the utility, and away from the strategic and organizational aspects of the total operations of the companies. Fifteen of the fifty-three holding companies in this field are multistate operations. Nine are registered under the Public Utility Holding Company Act (PUHCA) and six have exempt orders or claim exemption under the Act (see Table 2-1).[4] About half the states (twenty-six) have electric operating companies that are part of these holding companies.

It is noted that all but three of the electric holding companies involve three or two states, and only one involves more than four states (American Electric Power). This suggests that the consultation or even the collaborative process between and among the affected state regulatory commissions can be accomplished rather readily. The Ohio and

[4] Recall that the distinction between the registered companies and those exempt or claiming exemption is the fact that the former category involves the full range of SEC oversight, and the latter involves only Securities and Exchange Commission (SEC) examination of acquisition activity.

TABLE 2-1

MULTISTATE PUBLIC UTILITY HOLDING COMPANIES (ELECTRIC)
AND STATES OF OPERATIONS

Registered

Southern Company

- Alabama
- Georgia
- Florida
- Mississippi

American Electric Power

- Virginia
- Indiana
- Ohio
- West Virginia
- Kentucky
- Tennessee
- Michigan

Entergy

- Louisiana
- Mississippi
- Arkansas

Eastern Utilities Association

- Rhode Island
- Massachusetts

Central & SouthWest Corporation

- Texas
- Oklahoma
- Louisiana

Northeast Utilities

- Connecticut
- Massachusetts
- New Hampshire

General Public Utilities Corporation

- New Jersey
- Pennsylvania

New England Electric System

- Massachusetts
- New Hampshire
- Rhode Island

Allegheny Power Systems

- West Virginia
- Maryland
- Pennsylvania

TABLE 2-1--Continued

Claiming Exemption and Exempt	
Ohio Edison Company	Cincinnati Gas & Electric
Ohio	Ohio
Indiana	Kentucky
Kentucky	
Pennsylvania	
Commonwealth Edison Company	Minnesota Power & Light
Indiana	Wisconsin
Illinois	Minnesota
Northern States Power	Orange & Rockland
Wisconsin	New Jersey
Minnesota	New York

Source: Authors' construct based on data in U.S. Department of Energy, Energy Information Administration, *Financial Statistics of Selected Investor-Owned Electric Utilities 1990*, DOE/EIA-0437 (90)/1 (Washington, D.C.: Government Printing Office, January 1992), Table A3.

Kentucky commissions, for example, would have three holding companies to deal with jointly; the Wisconsin and Minnesota commissions would have two; Indiana and Kentucky would have two; Indiana and Ohio would have two; Massachusetts and Rhode Island would have two; and Massachusetts and New Hampshire would have two.

The Regional Bell Holding Companies (RBHCs) that were formed after divestiture (1984) are perhaps a more familiar part of the corporate landscape of multistate utility holding companies. Seven in number, they cover forty-eight states (and the District of Columbia) and range in size from two states (Pacific Bell) to fourteen states (U S WEST). Two are comprised of five states (Ameritech and Southwestern Bell). Table 2-2 displays the state-by-state memberships of the RBHCs.

While the generally larger number of commissions in the telephone holding company regions may add to the difficulty of comprehensive multistate regulatory cooperation, some modest initiatives in this direction can be cited.

Regional regulatory telecommunications oversight in New England (as currently practiced) originated in a June 1991 letter to the president of the New England Telephone Company (NET) from the chairman of the Maine Public Utilities Commission, who was also chairman of the Committee on Telecommunications of the New England Conference of Public Utilities Commissioners, Inc. (NECPUC) and

TABLE 2-2

REGIONAL BELL HOLDING COMPANIES

I. Ameritech: MI, OH, IN, WI, IL

II. Bell Atlantic: VA, WV, DC, PA, NJ, DE, MD

III. Bell South: NC, SC, GA, FL, AL, KY, TN, MS, LA

IV. NYNEX: NY, ME, VT, NH, CT, RI, MA

V. Pacific Bell: NV, CA

VI. Southwestern Bell: TX, AR, KS, MO, OK

VII. U S WEST: AZ, NM, CO, WY, MT, WA, OR, ND, SD, NE, MN, IA, ID, UT

coincidentally chairman of NARUC's Committee on Communications. The letter cited the workability of the New England regulators' regional approach to energy matters and called for a counterpart arrangement in the case of telecommunications.

Specifically suggested were regular six-month meetings between commissioners, staff, and senior NET and NYNEX officials "to discuss. . .issues that have regional implications or applicability in more than one state."[5] Also suggested was the establishment of a new communications distribution channel centrally through NECPUC to supplement the bilateral contacts that NET conventionally makes through its state vice-presidents. The meeting format was in two parts: an open meeting with the company and others, and a closed one for regulators. The idea was accepted and two meetings were held (September 1991 and February 1992).

Agenda items at the first New England regional committee meeting, during the open session, included NYNEX restructuring regarding local exchange company and affiliate transactions, future applications of technology, Judge Greene's information services decision, and spectrum allocation for wireless technology. During the closed session, the additional subjects addressed the status of Caller ID filings within each state, the status of incentive regulation filings in each state, and a report on key telecommunications matters before the individual state commissions.[6] At the second meeting, agenda items at the open session were company presentations on the North American numbering plan, NYNEX-federal issues, and planned customer initiatives for 1992 and the cost analyses to support them. At the closed session, the topic was discussion of a New England position on the question of a NARUC audit of regional Bell holding companies.[7] It is notable that over this same 1991-1992 period the New England commissions collaborated with the New York commission on several regulatory matters that the

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[5] Memorandum from the Executive Director of NECPUC to the New England commissions entitled "Regional Regulatory Telecommunications Oversight" dated June 12, 1991 reporting on the Maine chairman's letter to NY Tel.

[6] Memorandum from the Executive Director, Ralph H. Gelder, NECPUC to the New England commissioners, dated August 30, 1991.

[7] Memorandum from the Executive Director, NECPUC to the New England commissioners, dated January 21, 1992.

latter had underway with NYNEX. The Executive Director of the New England Conference of Public Utilities Commissioners said:

> New England as a region does try to stay on top of telecommunications issues in the region and take regional positions when there is mutual advantage to do so. I must say since the New York Commission, together with the support of New England Commissions, got NYNEX to separate its telco from its nontelco activities at the holding company level, there has been a vast improvement in our relationships with both New England Telephone and NYNEX.[8]

The widespread territory of U S WEST embraces parts of two NARUC "regional conferences" (the Western Regional Conference and the Mid-America Regional Conference). In 1989, under the leadership of the Colorado Public Utilities Commission, the U S WEST Regional Oversight Committee was formed. While a number of matters of mutual interest to the participating commissions were addressed on a consultative basis, at least one initiative of the oversight committee provides a current example of specific cooperation. In 1991, a "Three-State Steering Committee" (TSSC) comprised of commissioners from the Iowa, Arizona, and Oregon commissions was formed to arrange for a "regulatory impact review" of U S WEST.

Agreed to by U S WEST, the review is intended to examine the services and the cost of services provided by the parent company to the local operating companies, in particular the services of its Advanced Technologies subsidiary. The TSSC after designing and issuing a Request for Proposal (RFP) chose a consulting firm to accomplish this objective and review by summer 1992. The joint initiative is described as fulfilling "an overall objective of state regulatory commissions to promote and encourage efficient and effective utility operation and management."[9] A three-party agreement, including a scope of work and an information and

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[8] Personal communication from Ralph H. Gelder, Executive Director, NECPUC, dated April 2, 1992. Note that the New England experience recognizes a difference between oversight of the multistate operating company and the parent regional holding company, a circumstance not faced, for example, in the midwest case of Ameritech.

[9] Request for Proposal for a Regulatory Impact Review of U S WEST, Inc. issued September

(continued...)

protective agreement, were signed by U S WEST Communications, the consulting firm, and the commissions of Arizona, Oregon, and Iowa, in December 1991. The work was completed in September 1992. Two final reports were approved by the TSSC and were distributed to all - fourteen states. The TSSC is monitoring implementation efforts in order to assure the successful completion of the regulatory impact review process.

The fact that organized joint commission arrangements can be successfully devised and take root is further illustrated by the following developments in the midwest. At the 1987 NARUC summer meetings, the chairman of the Michigan Public Service Commission approached the chairpersons of the other four state commissions in the Ameritech region about forming a special regulatory committee on telecommunications topics, which would develop a better information and communication system among themselves and the Ameritech Corporation.[10] The idea was well received, and each state designated one member of its commission and one member of its staff to be on the coordinating committee. A commissioner chair was appointed for a one-year period, along with a staff member chair who will coordinate staff activities. Initially called the Ameritech Regional Oversight Committee, the committee name was changed later to Ameritech Regional Regulatory Committee (ARRC) "to more accurately describe the group's intended function and the type of interaction it desired to establish with Ameritech on an ongoing basis."[11] Also in 1988, a mission statement, functional schematic of the organization (Figure 2-1), an issues framework, and a committee logo were adopted.

(...continued)
17, 1991, Part I and Request for Proposal for Regulatory Impact Review of Advanced Technologies, Inc., issued September 17, 1991, Part II, 2 of Part I. For a fuller discussion of this initiative in the context of regional regulation see Chapter 5, infra.

[10] "ARRC Organizational Description and Statement of Purpose, etc.," Report No. 1, prepared by the Ameritech Regional Regulatory Committee, May 1988.

[11] Ibid.

Fig. 2-1. Ameritech Regional Regulatory Committee (ARRC) (Source: Taken from Report No. 1, *ARRC Organizational Description and Statement of Purpose*, May 1988).

As of January 1992 a dozen meetings of ARRC were held. The agenda items appear substantive and have included regional interconnection, numbering issues, personal communication system (PCS) technology, and financial issues. Some closed sessions were held and an informal legal advisory was secured in late 1991 concerning the potential application of the Open Meeting Laws (OML), in the five states, to ARRC activities. Basically, it was opined that ARRC proceedings are outside the reach of open meeting statutes because ARRC is neither a "governmental subunit," an "agency," or a "public body." Hence, ARRC could develop whatever procedural rules or guidelines it wants. However, individual participating commissions must be careful that a quorum of *their* commissioners is not present, otherwise the OML requirements of due notice, and so on, applying to the "meeting" are triggered. Finally, for our purposes here, the "Policy Statement" of ARRC is instructive with regard to relationships to each other and with the industry. It reads in part:

> The primary purpose of the Ameritech Regional Regulatory Committee (ARRC) is to facilitate the exchange of information from telephone companies and other telecommunication related entities to the five member public utility commissions. This exchange requires the cooperation and assistance of the telephone companies we regulate. The fact finding role may lead to positions developed by ARRC and ratified by individual commissions for or against issues presented at ARRC meetings. In the case of ARRC's position, effort is made to solicit the views of all participants and individual representatives may defer endorsement until their respective PUCs consider the matter further.

In the fall of 1989, the Public Utilities Commission of Ohio (PUCO) proposed the formation of an American Electric Power Regional Coordinating Committee (AEPRCC). The purpose of the committee is "to identify and discuss common issues related to AEP and its operating subsidiaries and to assist in more efficient communications with American Electric Power."[12] The idea was promptly agreed to, and the first meeting of the AEPRCC was held in Ohio in December 1992. Members from four of the seven state commissions were present to discuss agenda items which included models for cooperation on transmission and dealing with

[12] Letter from the Honorable Ashley C. Brown, Commissioner, Public Utilities Commission of Ohio, to the six (other) state commissions, September 1989.

AEP's FERC filings, least-cost planning coordination, and environmental issues and strategies. In July 1990, the committee met in Los Angeles and discussed emissions trading and the distribution of allowances, and EPRI membership for AEP. Four months later the committee met on implementation of acid rain legislation and on opportunities for expanded demand-side management on the AEP system. In April and June 1991, the Regional Coordinating Committee met to consider AEP's clean air compliance activities in each state, as well as systemwide. This same important subject, "AEP Questions for Regulators," occupied much of the August meeting and the September meeting.[13] In November 1991, the staff members of the AEPRCC met with the company to "walk through how the AEP operating agreement allocates the cost of acid rain compliance among the AEP operating companies."[14] Reportedly, there is some indication that state regulators with electric regional holding companies of their own are looking to the midwest experience as a possible model for their own regions.

The idea that holding companies in the electric sector with multistate operations are candidates for some sort of multistate commission monitorship runs up against the current constraint that they are not directly regulated by state commissions.[15] Federal jurisdiction applies--FERC and the SEC. This obstacle does not pertain in the case of the forty-two investor-owned electric companies that serve more than one state (twenty-five serve two states, twelve serve three states, and five serve four or more states).[16] The companies and the states served appear in Table 2-3. Thus, 60 percent of this group (twenty-five companies) could cooperatively

[13] AEPRCC meeting agendas, Detroit, Michigan, August 2, 1991 and Indianapolis, Indiana, September 16, 1991.

[14] Memorandum from Jerry L. Wissman, Pubic Utilities Commission of Ohio, entitled "November 6, 1991 Meeting with AEP" and dated October 28, 1991.

[15] Of course some of these may be a part of a holding company.

[16] U.S. Department of Energy, *Financial Statistics of Selected Investor-Owned Electric Utilities, 1990*, Figure A2, 584.

TABLE 2-3

MAJOR INVESTOR-OWNED ELECTRIC UTILITIES
OPERATING IN MORE THAN ONE STATE, 1990

Utility	States in Which Utility Operates
Appalachian Power Company	Virginia, West Virginia
Arkansas Power & Light Company	Arkansas, Missouri, Tennessee
Black Hills Corporation	South Dakota, Wyoming, Montana
Carolina Power & Light Company	North Carolina, South Carolina
Centel Corporation	Kansas, Colorado
Central Vermont Public Service Corporation	Vermont, New York
Citizens Utilities Company	Arizona, Hawaii, Vermont, Idaho
Delmarva Power & Light Company	Delaware, Maryland, Virginia
Duke Power Company	North Carolina, South Carolina
El Paso Electric Company	Texas, New Mexico
Empire District Electric Company	Missouri, Kansas, Oklahoma, Arkansas
Gulf States Utilities Company	Louisiana, Texas
Idaho Power Company	Idaho, Oregon, Nevada
Indiana Michigan Power Company	Indiana, Michigan
Interstate Power Company	Iowa, Minnesota, Illinois
Iowa Public Service Company	Iowa, South Dakota
Iowa-Illinois Gas & Electric Company	Iowa, Illinois
Kansas City Power & Light Company	Missouri, Kansas
Kentucky Utilities Company	Kentucky, Tennessee
Monongahela Power Company	West Virginia, Ohio
Montana Power Company	Montana, Wyoming
MDU Resources Group Incorporated	North Dakota, Montana, Wyoming, South Dakota
New England Power Company	Massachusetts, Vermont, New Hampshire
Northern States Power Company--Minnesota	Minnesota, North Dakota, South Dakota
Northern States Power Company--Wisconsin	Wisconsin, Michigan
Northwestern Wisconsin Electric Company	Wisconsin, Minnesota
Oklahoma Gas & Electric Company	Oklahoma, Arkansas
Otter Tail Power Company	Minnesota, North Dakota, South Dakota

TABLE 2-3--Continued

Utility	States in Which Utility Operates
PacifiCorp	Utah, Oregon, Wyoming, Washington, Idaho, Montana, California
Pennsylvania Electric Company	Pennsylvania, New York
Potomac Edison Company	Maryland, West Virginia, Virginia
Potomac Electric Power Company	Maryland, District of Columbia
Sierra Pacific Power Company	Nevada, California
Southwestern Electric Power Company	Texas, Louisiana, Arkansas
Southwestern Public Service Company	Texas, New Mexico, Oklahoma, Kansas
Texas-New Mexico Power Company	Texas, New Mexico
Union Electric Company	Missouri, Illinois, Iowa
UtiliCorp United Incorporated	Missouri, West Virginia
Virginia Electric & Power Company	Virginia, North Carolina
Washington Water Power Company	Washington, Idaho, Montana
Wisconsin Electric Power Company	Wisconsin, Michigan
Wisconsin Public Service Corporation	Wisconsin, Michigan

Source: U.S. Department of Energy, *Financial Statistics of Selected Investor-Owned Electric Utilities 1990*, Table A2.

be regulated by just two state commissions "getting together" and 88 percent of them (thirty-seven companies) could be served by no more than three commissions choosing to do so. If benefits are perceived for joint action, it would seem that this later form of regional regulation could be readily achievable.

State Authority for Regional Regulation

Several states have authorized their state utility commissions to conduct joint proceedings or to cooperate, in other ways, with the utility commissions of other states.

State statutes were reviewed to identify those statutory provisions that expressly provide for some form of cooperation of the state utility commission with other states. Of the fifty-one jurisdictions reviewed (fifty states and the District of Columbia), thirty-one appear to have no express statutory provisions providing for any form of cooperation. The absence of express statutory authorization may not necessarily foreclose cooperative actions. Many state utility commissions possess broad statutory authority subject to liberal construction, so that even without express statutory authority, commissions in those states may also possess cooperative powers.

Of the twenty jurisdictions that do have an express statutory provision authorizing some form of cooperation, fourteen expressly authorize the conduct of joint proceedings or hearings (Arkansas Colorado, Delaware, Idaho, Illinois, Maryland, Minnesota, Missouri, Nevada, New Mexico, Pennsylvania, South Carolina, Vermont, and Washington). Oregon law establishes a mechanism for making cooperative agreements with other states, subject to the approval of the Oregon Attorney General. Although not expressly stated, these agreements might conceivably include the conduct of joint proceedings and hearings.

In addition, Alabama and Wisconsin authorize the public utility commission to "confer" with the commissions of other states. This language appears to draw a distinction between conducting joint proceedings and conferring (the latter being a more limited authorization).

Alaska authorizes its commission only to "represent the interest and welfare of the state" before state and federal agencies, but does not expressly authorize joint hearings or proceedings. North Carolina does not expressly authorize joint hearings or proceedings, but the stated policy contained in the law encourages cooperation with other states and with the federal government. North Dakota authorizes its public service commission to "cooperate with and receive technical and financial assistance from" other states and the federal government for certain purposes. This language may not be sufficiently broad to authorize joint hearings or proceedings.

Idaho has a unique statutory provision. Its law not only authorizes joint hearings and proceedings, but it permits neighboring states to set rates for Idaho residents under certain circumstances and establishes a mechanism for Idaho commission review.

Relevant Regionalism in the United States

It is perhaps useful, as a general backdrop to further exploration of regional regulatory possibilities, to identify four examples of the use of regionalism nationally that demonstrate its workability (two by the electric utilities, one by the federal government, and one by the state governments). These are in addition to the many interstate compacts in existence which are sanctioned by Congress.

In addition to the frequently interstate character of individual utility companies, the electric industry itself is organized around nine electric reliability councils and twenty-six power pools. The National Electric Reliability Council (NERC) was established by the electric utility industry in 1968. Its purpose is to further ". . .augment the reliability and adequacy of bulk power supply in the electric utility systems of North America." Although membership of NERC is predominantly composed of investor-owned utilities, a large number of rural electric cooperatives, and municipal and federal public power utilities are also members.

NERC is governed by a board of trustees, consisting of two representatives from each regional council plus such additional members as necessary to assure at least two representatives from each segment of the electric utility industry. NERC is an organization representing electric utilities from nearly all of the United States. The joint planning and cost sharing of new generating plant and interconnection facilities by individual utilities and reliability councils, the development of NERC's Multiregional Modeling Group to develop computer-simulated demand for various network configurations, and the extensive sharing of staff of individual electric utilities with their own reliability council or with NERC are concrete examples of the extent and pervasiveness of utility industry cooperation within this framework. State commission cooperation that would follow these territories would range from four and five state groupings to a twelve state grouping.

Understandably the federal government makes substantial use of regionalism as an organizing concept. It was recognized that national programs may be more easily administered through a regional rather than an exclusively national perspective or by directly targeting recipients. An example of this recognition was the establishment by the federal government of ten federal administrative regions encompassing the country. Many federal governmental agencies, especially in the 1950s and 1960s when federal programs expanded, found it difficult to

administer centrally their programs. Problems of regional coordination of projects supporting federal programs were observed in education, housing, transportation, economic development, and public welfare. In order to deliver the federal programs to the state and urban area citizenry more effectively, these ten federal administrative districts were delineated with regional councils as a promising mechanism for resolving interagency issues at a regional level.

NARUC as an association of governmental regulatory agencies was formed in 1889 as a nonprofit organization to serve public utility regulation in the nation. Its membership includes certain federal agencies and governmental regulatory entities of the fifty states, Guam, Puerto Rico, the Virgin Islands, and the District of Columbia. (Counterpart Canadian agencies, both federal and provincial, are associated members.)

The objectives of NARUC, as contained in its constitution, include:

> . . .the promotion of uniformity of regulation of public utilities and carriers by the several commissions, *the promotion of coordinated action by the commissions of the several states* to protect the common interests of the people with respect to the regulation of public utilities and carriers, and *the promotion of cooperation of the commissions of the several states with each other and with the federal commissions* represented in the association (emphasis supplied).[17]

A primary mission of NARUC is to improve public utility regulation through joint action as a useful way of developing and maintaining strong federal-state cooperation in regulating utilities and carriers.[18] In this connection NARUC has encouraged the formation of regional organizations as NARUC affiliates. There are now five such groups (identified in Figure 2-2). They are as follows: The Southeastern Association of Regulatory Utility Commissioners, eleven states; the Western Conference of Public Service Commissions, thirteen states; the New England

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[17] Constitution of the National Association of Regulatory Utility Commissioners (as amended November 16, 1978). Although federal agencies have held memberships for a long time, the association is uniformly recognized as representing a state viewpoint in its advocacy before Congress and the judiciary.

[18] Paul Rodgers, *The NARUC Was There: A History of the National Association of Regulatory Utility Commissioners* (Washington, D.C.: The National Association of Regulatory Utility Commissioners, 1979), 54. (The material that follows is excerpted in part from the text, especially Chapter VI.)

Conference of Public Utility Commissioners, six states; the Great Lakes Conference of Public Utilities Commissions, thirteen states; and the Mid-America Regulatory Commissioners, fourteen states.[19]

Regionalism is well-established in government and utility companies and regulatory associations have also adopted this organizational arrangement. The reasons for doing so seem to hinge on efficiency and economy.

Strengthening Oversight Through Regional Regulation

Virtually never discussed and rarely noted (except perhaps by the regulated companies) is the impact that various forms of regional regulation could have on the multistate companies in terms of "evening up the contest." This is not, of course, to view all public utility regulation as adversarial, but the facts are that a great deal of money is involved, substantial economic and political power is endemic to these industries, monopoly or near monopoly positions were the occasion for regulation in the first place, and the interests of customers and those of shareholders and utility management are not identical and often in conflict. In this setting and legitimized in government authority, public utility commissions were conceived to balance competing interests with a tilt toward the unorganized public.

[19] Several commissions are in more than one regional conference, as indicated in Figure 2-8.

Fig. 2-2. Regional Regulatory Conferences (NARUC affiliates) (Source: National Association of Regulatory Utility Commissioners, 1980).

Administrative commission regulation, as practiced in the United States, is based on a technocratic model. Each state public utility commission is presumed to have been provided by its legislature with the technical staff resources to effectively regulate the utility companies jurisdictional to it. Information and analysis prepared by the permanent full-time professional staff flow upward to the commissioners, who prescribe policy and adjudicate outcomes. It is, of course, difficult to know what staffing levels are exactly appropriate to the regulatory task. Over time there are changes in responsibility, authority, activity, budgets, and management styles on the part of the commission and counterpart changes in the size, behavior, and general tractability of the regulated companies. The long-held theme that commissions are "overworked and understaffed" is probably correct. Ten state commissions have fewer than fifty employees and twenty-one have fewer than one hundred.[20] It is also correct to acknowledge that there always exists for regulators a large information gap between what they know about the utilities and what the utilities know. This "information asymmetry" and its resulting drag on truly effective regulation by commissions cannot be completely rectified by more staff resources, but larger staff numbers can help mitigate the degree of lopsidedness and create thorough oversight.

A temporary or long-lasting aggregation of commission staffs to help all of the regionally participating commissions regulate a multistate company would help to even up the sides. To make the point very broadly, there are in the AEP holding company's seven-state territory for example, about 2,000 full-time commission staff members with the smallest commission having 100 and the largest 600 staff members. Deploying technical staff for the regulation of this large holding company could thus be leveraged about 20:1 for the smallest commission and over 3:1 for the largest commission. As an example in the telecommunications field, choosing another midwest holding company (Ameritech), coordinated action of the five-state area would mean a total of about 1,500 staff resources, a 15:1 addition for the smallest commission and a 2.5:1 increase in capacity for the largest commission. Obviously it would be incorrect to imply that all personnel of a commission (or collection of commissions) would in actuality be devoted to participating in a particular case or in overseeing a particular utility. Also, it is assumed that it is

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[20] Paul Rodgers and Karon Bauer, *1990 Annual Report on Utility and Carrier Regulation of the National Association of Regulatory Utility Commissioners* (Washington, D.C.: National Association of Regulatory Utility Commissioners, 1991), Table 256.

in the interest of the larger commission's staffs to join in. The point here is merely to suggest scale economies exist here too and that the analytical power and the financial, accounting, engineering, and legal expertise could be summed in a way that makes the match more even with the company's counterpart resources.

It is recognized, of course, that state commissions do not directly regulate utility holding companies, rather the operating companies that comprise them. Still, state commissions, in fact, have considerable contact with the parent companies on important subjects, such as corporate restructuring, information flows, relationships with service corporations, system planning, and occasionally representations before the federal commissions. Moreover, if the scene is shifted to multistate power companies that are not parts of holding companies, or to holding companies that are exempt from PUHCA, direct commission regulatory authority obviously applies. Under the theme suggested here, much greater concentrations of staff from two states could ally to regulate, say, Oklahoma Gas and Electric Company or Commonwealth Edison Company with presumed efficiencies and economies.[21]

There may also be a gain from a regional approach through a reduction in redundancy and the opportunity for leveraged coordination. Rather than often having to do regulation "a mile wide and an inch deep," regional cooperation could permit in-depth work on several subjects to be undertaken by individual commissions and shared by the group.

[21] It is possible that multistate utility companies, faced with what they might consider a "ganging up" by several commissions against their interests, could resist such collective action by both political and legal means. Although the outcome of the argument is unclear, a company could claim that only staff members of the state in which the operating company functioned have any legitimacy in, say, an audit or data request and not neighboring "outsiders."

Political Science/Government Organization Vantage Point

Regionalization of a multistate kind (without federal participation) is not a central topic in the political science/government organization literature. Although quite a bit of multistate activity occurred in the United States, it has not usually been underpinned by specific rationales or scholarly inquiry. Moreover, the relevant academic professions are split on questions of standardization versus diversity, centralization versus decentralization, and consolidation versus fragmentation in governmental arrangements. More attention is placed on local government merger, metropolitan regions, and multicounty substate regionalism than on interstate cooperation.[22] Here "reformist" views push for consolidation while "public choice" advocates argue for continued separatism.[23] Administrative efficiency, scale economies, heightened expertise, and a broader planning horizon are identified as advantages of aggregating governmental units while the other side worries about intrusion of centralized power, loss of grass roots control, and erosion of distinctiveness. These same arguments, of course, can generally be applied as well to issues of multistate collaboration or structures (or indeed to the current debate in Europe over requirements of membership in the European Community).

A somewhat more fruitful reference area is the considerable literature on American federalism. It can be said that within our system of "dual federalism" the preponderance of regulatory action was with the states until the Civil War and with the national government until

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[22] See, for example, Drew A. Dolan, "Local Government Fragmentation: Does It Drive Up the Cost of Government?" *Urban Affairs Quarterly* 26, no.1 (September 1990), 282-45; and Lewis G. Bender et al., "The New Federalism and Substate Regionalism: Changing Perceptions of Rural Officials," *Publius: The Journal of Federalism* 17 (Fall 1987), 161-74.

[23] See, for example, Bryan D. Jones, *Governing Urban America: A Policy Focus* (Boston: Little, Brown & Co., 1983), 203. Also, see, Vincent Ostrom, Charles M. Tiebout, and Robert Warren, "The Organization of Government in Metropolitan Areas: A Theoretical Inquiry," *The American Political Science Review* 55 (December 1961): 831-42; Elinor Ostrom, "Metropolitan Reform: Propositions Derived from Two Traditions," *Social Science Quarterly* 53 (December 1972): 474-93, as reprinted in *Urban Politics: Past, Present, & Future*, Harlan Hahn and Charles Levine, eds. (New York: Longman, Inc., 1980), 317-36; and Robert L. Bish and Vincent Ostrom, *Understanding Urban Government: Metropolitan Reform Reconsidered* (Washington, D.C.: American Enterprise Institute for Public Policy Research, 1973), 17-33.

the 1950s.[24] Since that time regulation, as with most other government activities, has been intergovernmental in character, pursued more often jointly than exclusively separately. Within this last period, two descriptive labels have special relevance to our topic. "Permissive federalism" emphasizes national supremacy without being exclusionary of state action--in fact state action is often encouraged and sometimes insisted upon. In our field nuclear waste disposal and PURPA might be cases in point. So might be the creation of interstate compacts and the use of joint boards and joint conferences.

The second label, "cooperative federalism," would seem to best describe the setting and attitude in which multistate/federal joint regulation can take place as viewed by the states. Here the two primary levels of government, with an amalgamation of states into regions, would regulate collectively or on the basis of comparative advantage to the extent the law allows.

There is a divergence of viewpoints in the academic literature on the subjects of state performance and the "states as laboratories," and on the concepts of "closeness to the people" and "states' rights."

Contrary to the famous thesis set out by Justice Brandeis, in his 1932 dissenting opinion in New State Ice Co. v. Liebman, saying that "it is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country," the political science literature is very mixed on this score.[25]

The issue of "closeness to the citizenry" as indicating a preferred instrument for public action meets a similar fate. The argument is that while there are a number of possible meanings to the term, at least as a supplier of services through the present delivery system of grants and assistance it is likely that the federal government is "closest," especially in nonurban areas.

Finally, on the unnecessarily emotional phrase "states' rights," most authors properly point out that persons not states have rights. States have powers, and states have an entitlement to a

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[24] For a good discussion of these periods see, Michael D. Reagan, *Regulation: the Politics of Policy* (Boston: Little, Brown & Co., 1987), Chapter 8.

[25] Richard H. Leach, "Federalism and Governmental Power," in *American Federalism* (New York: W. W. Norton & Co., 1970), 125.

share of the power exerted in our federal system. But "not to any particular share, either quantitative or qualitative."[26]

Perhaps the most lucid political science statement in favor of multistate arrangements is found in a 1925 *Yale Law Journal* article written by Felix Frankfurter and James Landis.[27] Writing on interstate compacts, which they term "interstate adjustments," these jurists concluded:

> The imaginative adaptation of the compact idea should add considerably to resources available to statesmen in the solution of problems presented by the growing interdependence, social and economic, of groups of States forming distinct regions. . .. Time and circumstances alone must determine the existence of such diversities and common needs and the wisdom of regional rather than national treatment. The overwhelming difficulties confronting modern society must not be at the mercy of the false antithesis embodied in the shibboleths "States Rights" and "National Supremacy." We must not deny ourselves new or unfamiliar modes in realizing national ideals. Our regions are realities. Political thinking must respond to these realities.

However, the realities of the present circumstance faced by the states may motivate them toward regional regulation under a less lofty banner that could be called "defensive federalism." This is to acknowledge that if state public utility commissions do not act constructively in concert with whatever institutional structure or process best fits that action, the FERC and the FCC may resort to further expansion of their authority.

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[26] Ibid., 35.

[27] Felix Frankfurter and James M. Landis, "The Compact Clause of the Constitution--A Study in Interstate Adjustments," *Yale Law Journal* 34 no. 7 (May 1925), 729.

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PART II

LEGAL ANALYSIS:
OPPORTUNITIES AND OBSTACLES

CHAPTER 3

LEGAL FRAMEWORK FOR REGIONAL REGULATION

Introduction

As indicated previously, interstate agreements and cooperation increasingly are viewed as providing an important alternative with which to address political or constitutional tensions raised by particular issues, which are national in scope or significance. The nature of interactions among states raises constitutional issues that are fundamental to the American system of coordinate federalism. Relations among the states, and between the states and the federal government, raise issues at the core of our system of government.

Many recent legal developments attest to the evolutionary and dynamic nature of interstate cooperation. In light of these legal developments, a further review and update of the early 1980's discussions of interstate cooperation and regional regulation are appropriate now.[1] These developments, along with a brief recapitulation of appropriate background, will be discussed in this chapter under three broad topics: interstate agreements, federal supremacy, and states' rights.

Interstate Agreements

This section provides an overview of the legal framework relating to interstate agreements by reviewing four areas: (1) the Compact Clause of the U.S. Constitution,

[1] See, Douglas N. Jones et al., *Regional Regulation of Public Utilities: Issues and Prospects* (Columbus, OH: The National Regulatory Research Institute, 1980); and Advisory Commission on Intergovernmental Relations, *Regulatory Federalism: Policy, Process, Impact, and Reform* (Washington, D.C.: Government Printing Office, February 1984).

(2) matters relating to the establishment of interstate commissions, (3) informal cooperative agreements, and (4) the federal government's role in interstate agreements.

The Compact Clause

The Compact Clause of the U.S. Constitution is the starting point in the discussion of legal considerations relating to cooperative regionalism. Article I, section 10, clause 3, provides, with respect to interstate compacts, that:

> . . .no State shall, without the Consent of Congress. . .enter into any Agreement or Compact with another State. . ..

Taken literally, the Compact Clause appears to prohibit all agreements between states without Congressional approval. However, the historical interpretation of the Compact Clause has not applied its requirements to all forms of agreements between states.[2] In the landmark case of Virginia v. Tennessee,[3] decided in 1893, the U.S. Supreme Court acknowledged that the Compact Clause was not intended to encompass every possible interstate agreement. Instead, the Court construed its purpose as protecting against state encroachment upon federal powers.[4] Thus, the purpose of the

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[2] Abraham Weinfeld, "What Did the Framers of the Federal Constitution Mean by `Agreement or Compact'?" 3 *University of Chicago Law Review* 453 (1936). For an extensive legal history of interstate compacts see, Note, "Some Legal and Practical Problems of the Interstate Compact," 45 *Yale Law Journal* 324 (1935).

[3] 148 U.S. 503 (1893).

[4] Justice Field, on behalf of the Court, made the following observation:

> "The terms `agreement' or `compact' taken by themselves are sufficiently comprehensive to embrace all forms of stipulation, written or verbal, and relating to all kinds of subjects; to those to which the United States can have no possible objection or have any interest in interfering with, as well as to those which may tend to increase and build up the political influence of the contracting States, so as to encroach upon or impair the supremacy of the United States or interfere with their rightful management of particular subjects placed under their entire control."

Id., 517-18.

Clause was deemed to protect against the undoing of other Constitutional attributes and powers of the federal government by means of agreements between and among the states.

The Virginia v. Tennessee rule requires, in order to ascertain the need for Congressional approval, case-by-case determination of the extent to which a particular agreement intrudes on federal prerogatives. Since Virginia v. Tennessee, the Supreme Court of the United States has reviewed several cases where it upheld a number of interstate agreements, entered into without the consent of Congress, which were reciprocal legislation.[5]

The analysis of the subject matter and the effect of a particular interstate agreement requires consideration of the constitutional powers vested with the federal government, and of the extent to which those powers have been exercised or might be exercised in order to ascertain the potential for encroachment. As an example, the power of Congress to regulate commerce, under the Commerce Clause[6] of the Constitution, is one of the principal federal prerogatives that may potentially conflict with the provisions of an interstate agreement, thus requiring Congressional consent to such agreement.

The potential for encroachment has expanded as federal powers have become more expansively viewed and exercised in this century.[7] Yet, the understanding of the Compact Clause as set forth in Virginia v. Tennessee has survived into the modern era.

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[5] See, Wharton v. Wise, 153 U.S. 155 (1894) (upholding a compact adopted prior to the Constitution not subsequently approved by Congress as valid); St. Louis & San Francisco Ry. Co. v. James, 161 U.S. 545 (1896) (reciprocal permission for out-of-state corporations to operate within state); Bode v. Barrett, 344 U.S. 583 (1953) (reciprocal exemption of nonresident motorists from highway use taxes requires no Congressional consent); and, New York v. O'Neill, 359 U.S. 1 (1959) (upholding state enactment of the Uniform Law to Secure the Attendance of Witnesses from Within or Without a State in Criminal Proceedings, adopted by some forty states). See also, David Engdahl, "Characterization of Interstate Arrangements: When is a Compact Not a Compact?" 64 *Michigan Law Review* 63 (1965).

[6] Article 1, Section 8, Clause 3.

[7] A more extensive discussion of the expansion of federal prerogatives can be found in this chapter under the heading of "Federal Supremacy."

As an example, in New York v. O'Neill,[8] the Supreme Court upheld a Uniform Law to Secure the Attendance of Witnesses from Within or Without the State in Criminal Proceedings adopted by the legislatures of forty-one states and Puerto Rico. The uniform statute allowed a judge in an enacting state to invoke process of the courts of an enacting sister state for the purpose of compelling witness attendance. The Court found that legislation enacted by a state in reciprocity with another state required no Congressional approval because there was no encroachment on federal powers.

In 1976, in New Hampshire v. Maine,[9] the Supreme Court applied the Virginia v. Tennessee test and held that under the Compact Clause an interstate agreement resolving an ancient boundary dispute did not require the consent of Congress.

More recently, in United States Steel Corporation v. Multistate Tax Commission,[10] the Supreme Court upheld the so-called "Multistate Tax Compact" as valid despite Congressional refusal to consent. When reconciling the rule under Virginia v. Tennessee with the later reciprocal legislation cases, the Court found no conflict. In its inquiry to determine the impact of the Multistate Tax Commission upon the federal structure, the Court made this important finding:

> . . .the test is whether the Compact enhances state power *quoad* the National Government. This pact does not purport to authorize the member states to exercise any powers they could not exercise in its absence. Nor is there any delegation of sovereign power to the [Multistate

[8] 359 U.S. 1 (1959).

[9] 425 U.S. 363 (1976).

[10] 434 U.S. 452 (1978).

> Tax] Commission; each state retains complete freedom to adopt or reject the rules and regulations of the Commission. Moreover. . .each state is free to withdraw at any time.[11]

The Court noted that although the historical practice under the Compact Clause has resulted in the submission of a wide variety of interstate agreements for Congressional approval, perhaps out of caution or convenience, this historical practice is not constitutionally controlling. Most recently, the Supreme Court upheld an interstate agreement concerning banking activities that had not been approved by Congress.[12]

Thus, the Supreme Court made clear that not all interstate agreements require Congressional consent and affirmed that the test of conflict with a federal prerogative is to be used to determine whether Congressional approval of an interstate agreement is required under the Compact Clause. By granting, withholding, or conditioning its consent, Congress can protect the interests of both the federal government and of those states that are not parties to the compact.[13]

Historically, the Supreme Court has acknowledged that the Compact Clause does not expressly specify the manner in which Congress must give its consent to interstate compacts. In Green v. Biddle,[14] the Court observed ". . .that the Constitution makes no provision respecting the mode or form in which the consent of Congress is to be signified, very properly leaving that matter to the wisdom of that body, to be decided upon according to ordinary rules of law, and of right reason."

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[11] Id., 473.

[12] Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System, 472 U.S. 159, 105 S.Ct. 2524 (1985).

[13] See, Petty v. Tennessee-Missouri Bridge Commission, 359 U.S. 275 (1959); and Felix Frankfurter and James Landis, "The Compact Clause of the Constitution--A Study in Interstate Adjustments," 34 *Yale Law Journal* 685 (1925).

[14] 8 Wheat (21 U.S.) 1, 85 (1823).

The manner in which Congress gives its consent to compacts varies, although it appears that historically Congress has given its consent to interstate compacts through the enactment of law.[15]

In their widely-cited summary of compact law, Zimmermann and Wendell observe that historically Congressional consent is given by means of an act of Congress or joint resolution. Congress has approved compacts after agreement has been reached among the participating states and state implementing legislation has been passed. Similarly, Congress has given advance consent to the subject and content of particular compacts.[16] Often, Congressional approval merely recites the content of the agreement with a statement granting its consent. However, to the extent that the federal government is to have some role with regard to the operation of the Compact, authorization of federal activities may require implementation legislation.

The Compact Clause of the Constitution embraces all interstate arrangements from the most informal to the most formal.[17] Yet, it concerns itself with agreements that intrude on federal powers. Agreements not requiring Congressional consent tend to be more informal cooperative arrangements characterized by information sharing, reciprocal action, and other forms of coordinated activities of mutual benefit. Formal compacts, requiring the consent of Congress, typically entail both state and federal legislation describing the nature of the agreement, and the rights and obligations of all parties. A highly-structured formal compact authorizing interstate regulatory activities would probably consist of a mixture of federal and state sovereign powers.

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[15] See, *Congressional Consent to Interstate Compacts 1789-1936--State and Federal Statutes Authorizing Compacts* (Chicago: The Council of State Governments, 1936), indicating, for the compacts listed, Congress passed in each case either a joint resolution or an act to give its consent to the compact. See also, *Interstate Compacts 1783-1956* (Chicago: The Council of State Governments, 1956), a compilation of basic references to interstate compacts.

[16] F. Zimmermann and M. Wendell, *The Law and Use of Interstate Compacts* (Chicago: The Council of State Governments, 1961), 36-7.

[17] Various attempts have been made to describe and categorize interstate agreements. See, Reisman and Simpson, "Interstate Agreements in the American Federal System," 27 *Rutgers Law Review* 70 (1973).

Establishment of Interstate Commissions

As a matter of practice, interstate agreements that have as their purpose formal multistate or regional regulation often establish an interstate commission and empower it with the responsibility to exercise on behalf of the states, and perhaps the federal government, the regulatory powers delegated to it.[18]

Many interstate compacts have created regulatory bodies appointed by the participating states. The New York Port Authority Compact established a board to regulate the regional transportation needs of New York and New Jersey.[19] The Washington Metropolitan Area Transit Authority Compact established a multistate board to address interstate transportation in the Washington, D.C. area, including Maryland and Virginia.[20] The Tahoe Regional Planning Compact established a commission, comprised of state-appointed members, to develop and carry out a regional development plan.[21] The Delaware River Basin Compact established a regional agency, comprised of the state governors, for planning, conservation, water quality regulation, and other matters relating to the basin.[22]

The composition of a particular commission often appears to be critical to the success of compact negotiation, significant in determining the scope of the powers vested in the commission, and reflective of the importance of the subject matter. The manner of membership selection of the participating states is also an important element in the consideration of an interstate compact as an appropriate alternative to address a particular subject.

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[18] See, Chapter 5.

[19] See, 42 Stat. 174 (1921); and 42 Stat. 822 (1922).

[20] See, 80 Stat. 1324 (1966); and 86 Stat. 466 (1972).

[21] See, 83 Stat. 360 (1969).

[22] See, Public Law 87-328, 75 Stat. 688 (1961).

In recent years, constitutional considerations have focused on the manner of appointment of interstate commissions. In 1976, the Supreme Court decided the case of Buckley v. Valeo,[23] a case that constituted the first modern interpretation of the Appointments Clause of the U.S. Constitution.[24] The case involved the appointment of members, not of an interstate compact commission, but of the Federal Elections Commission through a means other than Presidential appointment. The Court concluded that a functional test was necessary to determine which officials constituted "Officers of the United States" such that Presidential appointment in accordance with Article II was required. The Court determined that Article II appointments were required when ". . .a significant governmental duty [was] exercised pursuant to public law."[25]

Buckley raised the specter that, contrary to the long-standing practice already noted, appointment of interstate commissions exercising federal powers pursuant to public law might also be required to be Presidential appointees.

Some guidance was provided by the Ninth Circuit Court's decision in Seattle Master Builders Association v. Pacific Northwest Electric Power and Conservation Planning Council,[26] where the court held that the Appointments Clause was not violated by the provisions of law that established the Council and permitted the appointment of members of the Council by the governors of the participating regional states. Instead, the court found that the Council was an interstate compact agency not subject to the Appointments Clause. Although the dissent in the case raises legal questions concerning whether or not the Council is really an interstate compact agency, in light of its apparent lack of state-derived powers, the case became the first significant judicial precedent regarding the matter of appointment to compact commissions.

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[23] 424 U.S. 1 (1976).

[24] The Appointments Clause, Article II, Section 2, Clause 3 provides in part, as follows: "The President. . .shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the Supreme Court, *and all other Officers of the United States*, whose Appointments are not herein otherwise provided for, and which shall be established by Law. . .(Emphasis added.)

[25] Buckley, supra, 140.

[26] 786 F.2d 1359 (9th Cir. 1986), cert. denied, 479 U.S. 1059 (1987).

Seattle Master Builders arose because under the Pacific Northwest Electric Power and Conservation Planning Act of 1980, Congress gave substantial responsibilities for future power, resource, and wildlife planning to a regional authority because the proprietary control of the Bonneville Power Administration by the federal government did not, in the judgment of Congress, provide adequate input and deference to regional and local needs.[27]

In 1988, during the Congressional debate over the approval of the Appalachian Low-Level Radioactive Waste Compact, the U.S. Department of Justice raised objection to the approval of the compact arguing that under Article II, the state appointment of members of the compact constituted an intrusion on the Presidential appointment prerogative.[28] Congress rejected this argument, following its consideration of a contrary analysis[29] and passed the consent legislation, which was signed into law[30] by President Reagan, who issued a brief statement noting the "constitutional defect" contained in the legislation.[31]

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[27] See, Gobel, "The Council and the Constitution: An Article on the Constitutionality of the Northwest Power Planning Council," 1 *Journal of Environmental Law and Litigation* 11 (1986); Blumm, "The Appointments Clause, Innovative Federalism, and the Constitutionality of the Northwest Power Planning Council," 8 *Journal of Energy Law & Policy* 1 (1987); and Hemmingway, "The Northwest Power Planning Council: Its Origins and Future Role," 13 *Environmental Law* 673 (1983).

[28] See, 134 *Congressional Record* S. 5196-5205 (Daily ed. April 28, 1988).

[29] See, Robert Poling, "Constitutionality of the Appointment of Low-Level Radioactive Waste Commission by the States," Congressional Research Service Memorandum (February 25, 1988); reprinted at 134 *Congressional Record* S. 5200-5204 (Daily ed. April 28, 1988).

[30] Public Law 100-319, 102 Stat. 471 (May 19, 1988).

[31] President Reagan's statement provided, in part: "In signing this bill, I note that one of the many provisions of the Compact suffers from a constitutional defect in that it assigns Federal law enforcement responsibilities to the Appalachian States' Low-Level Radioactive Waste Commission, but does not require that the Commission be appointed in a manner consistent with the Appointments Clause of the Constitution. Any effort by the Commission to enforce Federal regulations would contravene the Constitution. While I hope that no such effort would occur, I expect the Nuclear Regulatory Commission to take note of and report to the Attorney General on any such actions of the Commission in this area." 24 *Weekly Compilation of Presidential Documents* 637 (May 23, 1988).

President Reagan's position is curious for two reasons. First, the stated policy of low-level waste disposal, that the states would take responsibility for waste disposal seems inconsistent with the policy of federally appointing officials. Second, it is not clear what the specific federal powers to be exercised by Compact officials are. The right of a regional compact commission to exclude waste could be viewed as the exercise of a coordinate state power under circumstances where Congress has vacated a narrow aspect of the potential reach of the Commerce Clause. Nevertheless, it would appear that President Reagan's position would have invalidated the many interstate compact commissions already in place through appointments other than Presidential appointments under Article II.

In 1991, in Metropolitan Washington Airports Authority v. Citizens For the Abatement of Aircraft Noise, Inc.,[32] the Supreme Court decided its first case involving appointment issues relating to an interstate compact commission. The issue presented involved a regional organization, established by interstate compact, to manage Washington National Airport and Dulles International Airport (both are federally-owned airports in the Washington, D.C. metropolitan area).[33] The compact gave operating control of the airports to a regional Board of Directors comprised of eleven members appointed for staggered six-year terms (five members were appointed by the Governor of Virginia, three were appointed by the Mayor of the District of Columbia, and two were appointed by the Governor of Maryland. A Board of Review, composed of nine Members of Congress, was given veto power over the major decisions of the Board of Directors.

The Court found that the composition of the Board of Review was offensive to the doctrine of Separation of Powers, because service by Members of Congress in this role was not a proper exercise of their responsibilities as legislators.[34] Although the effect of the legislation did not permit Presidential appointments, the finding of the Court that the appointments were

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[32] ___ U.S. ___, 111 S.Ct. 2298 (1991).

[33] A more extensive discussion of this compact can be found in Chapter 5.

[34] See, Immigration and Naturalization Service v. Chadha, 462 U.S. 919 (1983); Bowsher v. Synar, 478 U.S. 714 (1986); and Springer v. Philippine Islands, 277 U.S. 189 (1928).

unconstitutional on a Separation of Powers basis obviated any need to consider the question of whether the appointment process of the Board of Review contravened the Appointments Clause. The Court expressly so stated.[35]

Although these recent cases and events provide some guidance to the constitutional terrain of appointments to interstate compact commissions, many questions remain open. The most important question, which has not been directly addressed by the Supreme Court, is whether under the Appointments Clause continuation of the extensive past practice of state appointment of members of interstate commissions with clear federal regulatory powers is constitutionally valid. Seattle Master Builders suggests that such appointments are valid. Perhaps the most persuasive argument supporting constitutionality is the importance of the use of the compact commission in the federal system to permit limited exercise of power by multistate authority to advance the purposes of cooperative federalism. A large part of the allure of interstate compacts lies in the mixture of federal and state powers exercised by a multistate body comprised of state-appointed officials.

Cooperative Agreements

Not all interstate agreements involve the formalized federally-approved creation of an interstate commission vested with regulatory authority. Over the years states have undertaken many informal efforts to share information, pool funding and other resources, enact reciprocal or uniform legislation, and build cooperation. Because these types of informal cooperation are not regulatory, federal approval is not necessary. In the most informal cases of cooperation state legislation may not be necessary.

Informal interstate cooperation is based on decentralized reciprocity, serves as an important check on the federal government, expands participation in decisionmaking processes, and increases diversity in policymaking and governance. Informal interstate cooperation often

[35] Infra, footnote 32.

receives little attention, yet can have significant impact. For example, the development of guidelines for law enforcement could have a significant effect in eliminating the adverse effects detrimental to one state and advantageous to another (without significant modification of law).[36]

The adoption of uniform state legislation providing consistent rules regarding matters that are clearly outside the federal realm often reduces burdens on commerce and movement among the states and eliminates unnecessary diversity. Similarly, reciprocal agreements among states can be mutually advantageous to the states and generally require no federal approval. Several examples of reciprocal legislation were

[36] See, Note, "To Form a More Perfect Union?: Federalism and Informal Interstate Cooperation," 102 *Harvard Law Review* 842, 863 (1989) (discussing both the application of game theory and constitutional principles to the informal cooperation evidenced by the adoption of state antitrust enforcement guidelines by the National Association of Attorneys General).

cited in connection with litigation where the courts determined that Congressional consent was not necessary. (Many others exist, particularly in the area of taxation.[37])

It is easy to envision the possibilities of state reciprocal arrangements undermining federal powers and the Supremacy Clause. The limits of reciprocal legislation were more clearly defined by the Supreme Court in Sporhase v. Nebraska.[38] Here a Nebraska requirement, authorizing exports of water only to states with reciprocal authorization of export to Nebraska, was struck down in the absence of Congressional approval. The Court viewed this effort as an erection of a trade barrier to nonreciprocating states.

In their many permutations, cooperative agreements among the states provide an important form of interstate agreement.

The Federal Role

The federal government often plays other roles in the operation or implementation of interstate agreements. Federal involvement in interstate agreements takes a variety of forms: Congressional oversight, participation, judicial review of the terms of the agreements, financial support, and nonmonetary technical assistance.

The role of Congress does not necessarily end with Congressional approval of a compact. Clearly, Congress has oversight powers and responsibilities with respect to operational interstate compacts.[39] Congress may impose durational limitations, in effect requiring periodic renewal of Congressional approval.

It is generally understood that Congressional approval of an interstate agreement is a political judgment on the part of Congress to which the Courts will defer and that such approval,

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[37] See, State of Missouri v. Brunow, 320 S.W.2d 80 (App. 1959), dealing with reciprocal agreement between Missouri and Iowa concerning exemption from certain motor vehicle taxes.

[38] 458 U.S. 941 (1982).

[39] See, Tobin v. United States, 306 F.2d 270 (D.C. Cir. 1962), cert. denied 371 U.S. 902 (1962). See also, Note, "Congressional Supervision of Interstate Compacts," 75 *Yale Law Journal* 1416 (1966).

if granted, transforms that agreement into the law of the United States.[40] The federal character of approved compacts is significant because it provides the federal courts with federal question jurisdiction over the compacts so that any disputes arising under the agreement may be litigated in federal courts rather than state courts.[41]

Actual federal participation in the implementation of an interstate agreement or an interstate commission, established by an interstate agreement, is one option that may be adapted to informal, as well as formal interstate arrangements.[42]

Increasingly, federal participation in regional interstate compacts is viewed as significant in providing financial assistance while avoiding federal control or preemption.[43]

There is great flexibility offered by the use of an interstate agreement melding federal and state powers together under circumstances agreeable to all those affected or involved. The federal role, with regard to agreements, can vary through the entire range of otherwise permissible federal actions and potentially provides a unique opportunity to focus federal attention and resources on the specific subject of the interstate agreement.

Federal Supremacy

[40] See, Cuyler v. Adams, 449 U.S. 433, 438 (1981); and West Virginia ex rel. Dyer v. Syms, 341 U.S. 22 (1951). See also, F. Zimmerman and M. Wendell, "The Interstate Compact and Dyer v. Syms," 51 *Columbia Law Review* 931 (1951).

[41] Compare, David Engdahl, "Construction of Interstate Compacts: A Questionable Federal Question," 51 *Virginia Law Review* 987 (1965) and Note, "Federal Question Jurisdiction to Interpret Interstate Compacts," 64 *Georgetown Law Journal* 87 (1975).

[42] See, Clark, "Joint Activity Between Federal and State Officials," 51 *Political Science Quarterly* 230 (1936); and Frank Grad, "Federal-State Compact: A New Experiment in Cooperative Federalism," 63 *Columbia Law Review* 825 (1963).

[43] See, Marlissa Briggett, "State Supremacy in the Federal Realm: The Interstate Compact," 18 *Boston College Environmental Affairs Law Review* 751 (1991).

In the American system of coordinate federalism, conflicts between federal and state sovereign powers are resolved under the Supremacy Clause of the Constitution,[44] which makes federal law the supreme law of the land. In exercising its broad powers, Congress often considers the impact of its actions on the states. A brief review of some basic principles provides assistance in understanding the potential encroachment on federal prerogatives protected by the Compact Clause and the legislative alternatives available to the federal government. Under the Commerce Clause of the Constitution,[45] Congress has broad powers "[t]o regulate Commerce with foreign Nations and among the several states, and with the Indian Tribes."

From the earliest days of the Republic, the power of Congress to regulate interstate commerce has remained fundamental to the federal system of government.[46] Today, there is little doubt that the reach of the Commerce Clause is expansive, both with regard to the subject matter of commercial activity and with regard to the jurisdictional scope of permissible regulation. The area of commerce in energy of all forms has been a major source of the rich case law that has illuminated the dimensions of the Commerce Clause over the years.[47]

In the modern view, even activity that is purely *intra*state in character is held to be within the purview of the Commerce Clause and may be subject to regulation by Congress when the activity affects *inter*state commerce.[48] Moreover, Congress may use the commerce power to protect instrumentalities of interstate commerce or persons or things moving in commerce.[49] The

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[44] Article VI, Clause 2.

[45] Article I, Section 8, Clause 3.

[46] Gibbons v. Ogden, 9 Wheat (22 U.S.) 1 (1894).

[47] See, for example, Edward Tanzman, "Commerce Clause Limitations on State Regulation and Taxation of the Energy Industry," 13 *Loyola University of Chicago Law Journal* 277 (1982).

[48] See, United States v. Darby, 312 U.S. 100 (1941); Wickard v. Filburn, 317 U.S. 111 (1942); United States v. Wrightwood Dairy Co., 315 U.S. 110 (1942); and Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 294 (1964).

[49] Perez v. United States, 402 U.S. 146 (1971).

crucial, but liberal, judicial test of valid uses of the Commerce Clause is whether Congress acted reasonably in adopting a particular regulatory scheme.[50]

Not everyone views the expansion of federal powers in a favorable light. A narrower view of the Commerce Clause argues that the Clause has expanded, perhaps irretrievably, beyond its proper scope of merely providing national regulation in order to prevent unhealthy types of competition among jurisdictions. Thus, instead of preventing state balkanization, the Commerce Clause has become a perilous form of national regulation imposing uniformity that frustrates instead of facilitating markets.[51]

Dormant Commerce Clause

Although Congress possesses broad power to regulate under the Commerce Clause, an exercise of that power is not a prerequisite to the preservation of the federal prerogative. The power to regulate interstate commerce, when unexercised, is said to be dormant.[52] As an example, prior to the establishment of federal authority over interstate electricity rates, a state could not regulate the price charged for electricity generated in that state and sold in another.[53]

The inability of states, in the absence of federal regulation, to undertake regulation of matters affecting interstate commerce is now well-established in the energy and natural resource area. State intrusion into the zone of federal prerogative is especially egregious when it involves state protectionism. As Chief Justice Field wrote on behalf of the Supreme Court in West v. Kansas Natural Gas Company:

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[50] Heart of Atlanta, supra; and Katzenbach v. McClung, 379 U.S. 294 (1964).

[51] See, Richard Epstein, "The Proper Scope of the Commerce Power," 73 *Virginia Law Review* 1387, 1454-1455 (1987).

[52] See, Wardair Canada, Inc. v. Florida Department of Revenue, 477 U.S. 1, 7 (1986).

[53] Rhode Island Public Utilities Commission v. Attleboro Steam and Electric Co., 273 U.S. 83 (1927).

> If the states have such power [to intrude upon matters of interstate commerce] a singular situation might result. Pennsylvania might keep its coal, the Northwest its timber, the mining states their minerals. And why may not the products of the field be brought within the principle? Thus enlarged, or without enlargement, its influence on interstate commerce need not be pointed out. To what consequences does such power tend? If one state has it, all states have it; embargo may be retaliated by embargo, and commerce will be halted at state lines. And yet we have said that "in matters of foreign and interstate commerce there are not state lines."[54]

These broad principles continue to be applied in a contemporary setting. In the area of interstate waste disposal, the Supreme Court in City of Philadelphia v. New Jersey[55] struck down a New Jersey statute barring the importation of waste for disposal in the state because it was a burden on interstate commerce. Similarly, in New England Power Co. v. New Hampshire,[56] the New Hampshire Public Utilities Commission sought to restrict the export of hydroelectric power generated within the state. Because the export ban was designed to give New Hampshire customers an economic advantage, at the expense of customers in neighboring states, and because the ban imposed direct and substantial burdens on interstate commerce, the Supreme Court declared the ban "protectionist regulation" in violation of the Commerce Clause.

Thus, in the absence of federal regulation over a particular aspect of interstate commerce, the states are not free to undertake such regulation when state regulation would burden interstate commerce.[57]

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[54] 221 U.S. 229, 255 (1911).

[55] 437 U.S. 615 (1978). See, also, Chemical Waste Management, Inc. v. Hunt, ___ U.S. ___, 60 U.S.L.W. 4433 (June 1, 1992); and Fort Gratiot Sanitary Landfill v. Michigan Natural Resources Department, ___ U.S. ___, 60 U.S.L.W. 4438 (June 1, 1992).

[56] 455 U.S. 331 (1982).

[57] Rhode Island Public Utilities Commission v. Attleboro Steam and Electric Co., 273 U.S. 83 (1927) (invalidating state regulation of the interstate transmission of electricity in the absence of federal regulation); and Southern Pacific Co. v. Arizona, 325 U.S. 761 (1945) (invalidating state regulation of train lengths of interstate trains).

Federal Preemption

In areas where a valid scheme of federal regulation is established, it is well settled that the states may not intrude into the federal domain with a conflicting form of regulation. This proposition was recently reiterated by the Supreme Court in Mississippi Power & Light Co. v. Mississippi,[58] where the Court held that the Federal Energy Regulatory Commission's (FERC) electric rate proceedings preempted a prudence inquiry by the Mississippi Public Service Commission in an electricity rate case.

Other examples might be cited. In Pacific Gas & Electric Co. v. State Energy Resources Conservation and Development Commission,[59] the Supreme Court held that a California state law imposing a moratorium was an unconstitutional intrusion into an area of nuclear power plant licensing that had been preempted by the federal government under the Atomic Energy Act of 1954.

However, when the effects of a state statute do not directly conflict with federal law or the state statute does not clearly burden interstate commerce, it is more difficult to ascertain the constitutionality of state action in light of possible legitimate local benefits.[60]

Because of the breadth of the power found under the Commerce Clause and because the Supremacy Clause makes valid federal law superior to state law, the Congress often enacts legislation regulating interstate and intrastate commerce that has the effect of preempting otherwise valid exercises of state police powers. However, it must be acknowledged that the Supreme Court in many of its recent opinions has adopted heightened standards of scrutiny to assure rigorous clarity of Congressional intention in order to uphold a preemption of state regulation under federal law.[61]

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[58] 487 U.S. 354, 108 S.Ct. 2428 (1988).

[59] 461 U.S. 190 (1983).

[60] Pike v. Bruce Church, Inc., 397 U.S. 137 (1970).

[61] See, Ingersoll-Rand Company v. McClendon, ___ U.S. ___, 111 S.Ct. 478 (1990); and
(continued...)

Rather than fully occupy a field of regulation by exercising its Commerce Clause powers and preempting any state regulation, Congress frequently chooses, as a matter of policy, to permit a coordinate scheme of simultaneous federal and state regulation. One important example of coordinate regulation has developed in the area of energy regulation. During the 1970s, in the aftermath of petroleum supply disruptions in the mid-East, Congress enacted important statutory powers dealing with the price and allocation of petroleum and petroleum products under the Emergency Petroleum Allocation Act (EPAA). Even while the EPAA with its state preemption provision was in effect, the states were not foreclosed from all regulations governing sales of petroleum products. As an example, in Exxon v. Governor of Maryland,[62] the Supreme Court upheld, in the face of Commerce Clause and Due Process challenges, a Maryland statute prohibiting producer and refiner operation of retail service stations within the state and requiring certain "voluntary allowances" to those retail stations supplied with a product.

One option available to the federal government is to induce the states to act on their own by conditioning federal spending for the general welfare on specified state actions.[63]

Congressional Deference to the States

In a limited number of instances, Congress has deferred in major ways to state regulation by absenting itself from the field. The McCarran Act[64] is a frequently-cited example of Congressional deference to the states within one area of interstate commerce. In 1944, in United

(...continued)
Wisconsin Public Intervenor v. Mortier, ___ U.S. ___, 59 U.S.L.W. 4755 (June 21, 1991).

[62] 437 U.S. 117 (1978).

[63] South Dakota v. Dole, 483 U.S. 203 (1987) (conditioning the receipt of highway funds on the adoption of a minimum drinking age).

[64] 59 Stat. 33 (1945), 15 U.S. Code §§ 1001-15.

States v. South-Eastern Underwriters Association,[65] the U.S. Supreme Court ruled that insurance transactions across state lines involve interstate commerce. At the time of that ruling, there were not any federal regulations of insurance. After deciding to maintain regulation in its status prior to the South-Eastern Underwriters decision, Congress passed the McCarran Act authorizing state regulation and taxation of the insurance industry (even when such regulation involved interstate transactions). In a case subsequent to the enactment, the Court upheld Congress' deference to state regulation of insurance by finding that the McCarran Act was valid.[66]

Even when Congress chooses to act to emplace a regulation, there is often reluctance to totally preempt state law, and Congress sometimes defines a zone of regulation that can be appropriately and coordinately carried out by the states.

Congress on several occasions has delegated federal powers to the states.[67] There are several instances in which Congress has mandated or permitted state enforcement of federal standards. In Hodel v. Virginia Surface Mining & Reclamation Association,[68] the Supreme Court upheld the Surface Mining Control and Reclamation Act of 1977,[69] which invited the states to submit proposed surface mining regulations to the Secretary of Interior. If the Secretary approved those regulations, the state enforced them. Alternatively, if a state did not submit a regulatory program, the Secretary could develop and implement a program for that state.

Several statutes, particularly environmental laws, apply federal-state regulatory schemes similar to those upheld in Hodel.[70] By preempting conflicting state law and permitting state

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[65] 322 U.S. 533 (1944).

[66] Prudential Insurance Co. v. Benjamin, 328 U.S. 408 (1946).

[67] See, for example, United States v. Sharpnack, 355 U.S. 286 (1958); and see, Paul Kauper, "Utilization of State Commissioners in the Administration of the Federal Motor Carrier Act," 34 *Michigan Law Review* 37, 46-49 (1935).

[68] 452 U.S. 264 (1981).

[69] 91 Stat. 445 (1977), 30 U.S. Code §§ 1201 *et seq.*

[70] See, The Clean Air Act--42 U.S. Code §§ 7401 *et seq.*, which permits state enforcement of (continued...)

enforcement only of state regulations that are identical to federal standards, these statutes effectively provide for the establishment of federal standards that may be enforced by the states. The fact that a state must also adopt the federal standards as its own as a precondition to enforcement amounts to no more than federal acquiescence in state enforcement of federal standards. Statutes permitting state enforcement only of "identical" standards to the federal standards have the benefit of providing for uniformity of laws.

However, Congress has gone further than simply permitting state enforcement of federal standards. A case that directly illustrates the point is Federal Energy Regulatory Commission v. Mississippi.[71] Here the Supreme Court upheld, in the face of a Tenth Amendment challenge, the provisions of section 210 of the Public Utility Regulatory Policies Act, which mandated that each state regulatory authority enforce ratemaking standards promulgated by the FERC. Certainly, if Congress can mandate state enforcement of federal standards, it can permit state enforcement of federal standards, and to our knowledge there is not a case that forbids an otherwise valid delegation of federal enforcement authority to the states.

It is observed that under our federal scheme there is a wide range of alternative options available to the federal government to undertake coordinate cooperative action with the states to address any particular matter. Federal action does not necessarily have to displace any opportunity for state action, although preemption is one alternative available to achieve uniformity and consistency by a single federal regulator.

(...continued)
certain air emission standards that are "not less stringent" than federally approved standards at 42 U.S. Code § 7416; The Federal Water Pollution Control Act--33 U.S. Code §§ 1251 *et seq*., which permits state enforcement of water pollution "standards of performance for new sources to at least the same extent as. . .." Environmental Protection Agency regulations at 33 U.S. Code § 1316(c); The Noise Control Act--42 U.S. Code §§ 4901 *et seq*., which permits state enforcement of railroad noise emission standards that are "identical to the standard" adopted by the Environmental Protection Agency at 42 U.S. Code §§ 4916(c)(1) and 42 U.S. Code 4917(c)(1); and The National Traffic and Motor Vehicle Safety Act--15 U.S. Code §§ 1381 *et seq*., which permits state enforcement of safety standards that are "identical to a Federal safety standard" at 15 U.S. Code § 1392 (d).

[71] 456 U.S. 742 (1982).

States Rights

It is now axiomatic that under the American system of dual sovereignty between states and the federal government that the states possess sovereignty concurrent with that of the federal government, subject only to the limitations of the Supremacy Clause.[72] As the Supreme Court recently observed:

> This federalist structure of joint sovereigns preserves to the people numerous advantages. It assures a decentralized government that will be

[72] See, Tafflin v. Levitt, 493 U.S. 455, 458, 110 S.Ct. 792, 795 (1990).

> more sensitive to the diverse needs of a heterogenous society; it increases opportunity for citizen involvement in democratic processes; it allows for more innovation and experimentation in government; and it makes government more responsive by putting the states in competition for a mobile citizenry.[73]

The primary locus of recognition of state powers under the Constitution is the reservation of powers under the Tenth Amendment, which provides in its entirety:

> The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people.

The efficacy of the Tenth Amendment in providing a counterpoint to the expansion of federal powers, particularly the Commerce Clause, has been in doubt for over a half century.[74]

However, in the 1977 case National League of Cities v. Usery,[75] the High Court was presented with the question of the constitutionality of the application of the Fair Labor Standards Act to employees of the state. In a five to four decision written by Justice Rehnquist, the Court found that Congress could not exercise Commerce Clause powers to force decisions on the states regarding the conduct of "integral operations in areas of traditional governmental functions." The Court concluded that such an effort constituted an improper intrusion on state sovereignty violative of the Tenth Amendment.

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[73] Gregory v. Ashcroft, ___ U.S. ___, 111 S.Ct. 2395, 2399 (1991). See also, Herbert Wechsler, "The Political Safeguards of Federalism: The Role of the States in the Composition and Selection of the National Government," 54 *Columbia Law Review* 543 (1954); Michael McConnell, "Federalism: Evaluating the Founders' Design," 54 *University of Chicago Law Review* 1484, 1491-1511 (1987); and, Deborah Merritt, "The Guarantee Clause and State Autonomy: Federalism for a Third Century," 88 *Columbia Law Review* 1, 3-10 (1988).

[74] The expansion of Congressional powers under the Commerce Clause is, in part, explainable to the rejection of an emergency powers doctrine during the New Deal. See, Michael Belknap, "The New Deal and the Emergency Powers Doctrine," 62 *Texas Law Review* 67, 108 (1983).

[75] 426 U.S. 833 (1977).

In 1985, in Garcia v. San Antonio Metropolitan Transit Authority,[76] the Court reversed itself, expressly overruling National League of Cities. In a five to four opinion written by Justice Blackmun, the Court held the National League of Cities test of "traditional governmental functions" to be unworkable and inconsistent with principles of federalism. Intervening Commerce Clause cases emphasized the promotion of a national economy and free trade among the states.[77]

Most recently, in Gregory v. Ashcroft,[78] the Supreme Court upheld the mandatory judicial retirement provision of the Missouri Constitution, in the face of a challenge based upon the Age Discrimination in Employment Act (ADEA) and the power of Congress to legislate under section 5 of the Fourteenth Amendment. The Court found the age-seventy mandatory retirement requirement to be within the sovereign powers of the State of Missouri, in light of the absence of clear Congressional intention to preempt the state. Thus, the Court recognized the reservation of power to the states under the Tenth Amendment, which appears to have some remaining vitality.

Just this past term, the Supreme Court of the United States decided a case involving an interstate compact that directly raised a Tenth Amendment question. New York v. United States[79] arose from the interstate compacts approved by Congress that created regional compacts to dispose of low-level radioactive waste. The suit was brought by the State of New York, which is not a party to any of the regional compacts Congress sought to establish on a nationwide basis. New York challenged provisions included in the legislation approving the compacts that required each state to "take title" of the low-level nuclear waste located within its borders in 1996 and

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[76] 469 U.S. 528 (1985).

[77] See, Equal Employment Opportunity Commission v. Wyoming, 460 U.S. 226 (1983) (applying federal age discrimination prohibitions to state employees); Transportation Union v. Long Island Ry. Co., 455 U.S. 678 (1982) (validating Federal railroad labor standards because of their importance to the national economy); Federal Energy Regulatory Commission v. Mississippi, 456 U.S. 742 (1982) (upholding Federal retail ratemaking standards mandated in state proceedings); and Hodel v. Virginia Surface Mining & Reclamation Association, 452 U.S. 264 (1981) (upholding national minimum surface mining standards).

[78] ___ U.S. ___, 111 S.Ct. 2395 (1991).

[79] ___ U.S. ___, 60 U.S.L.W. 4603 (June 19, 1992).

become legally liable for it if it did not become a member of a regional compact or otherwise arrange for proper waste disposal.[80] New York argued that the provision violated the Tenth Amendment and the Supreme Court agreed. The Court held that the "take title" provision amounted to mandated state regulation by the Congress contrary to the Tenth Amendment:

> No matter how powerful the federal interest involved, the Constitution simply does not give Congress the authority to require the states to regulate. The Constitution instead gives Congress the authority to regulate matters directly and to preempt contrary state regulation. Where a federal interest is sufficiently strong to cause Congress to legislate, it must do so directly; it may not conscript the state governments as its agents.[81]

Thus, the Court has recognized an outer boundary to the reach of Congress under the Tenth Amendment. The New York case may actually enhance and encourage the use of interstate and regional compacts as an important alternative to the direct federal dominance through preemption or coercion of state action.

The recognition of vital state interests and sovereign prerogatives is an important element in a healthy system of coordinate federalism. Interstate agreements provide an important alternative form of regulation or programmatic activity to federal action alone.

Finally, it should be observed that interstate agreements often require interaction and mutuality that must be permitted by each participating state under its own sovereign powers. Obviously, agreements must comport with state constitutions and have proper authorization. Reciprocal agreements, the adoption of uniform laws, and other nonregulatory cooperative state actions rely upon the independent and separate actions of each state.

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[80] See, Dan Berkovitz, "Waste Wars: Did Congress `Nuke' State Sovereignty in the Low-Level Radioactive Waste Policy Amendments of 1985?" 11 *Harvard Environmental Law Review* 437 (1987).

[81] New York v. United States, supra, slip opinion at 30.

The creation of interstate regulatory bodies poses potential, although not insurmountable, difficulties through possible regulatory deference to other states.[82] Agreements among states that obligate states to comply with regulatory decisions and to provide funding may raise potential state constitutional and legal difficulties. Thus, there may be important legal limits to the scope and content of interstate agreements that may only be accomplished within the sovereign prerogatives of the individual states.

Even when state constitutional problems are avoided in interstate compacts, significant legal consequences may result depending on the provisions of the Compact. The Supreme Court recently ruled in Port Authority Trans-Hudson Group v. Feeney,[83] that the statutory consent to suit contained in the venue provision of a compact constituted a waiver of sovereign immunity by the participating states.

For all the reasons discussed above, the matter of the rights of states is an important consideration in the establishment and implementation of an interstate agreement.

[82] See, Union Electric Co. v. Illinois Commerce Commission, 77 Ill. 2d 364 (1979) (holding that the Illinois Commerce Commission could not defer to a commission in another state to establish rates, although the Commission could consider rates established in other states in its rate process).

[83] 495 U.S. 299, 110 S.Ct. 1868 (1990).

Summary

A decision to regulate the public utilities at a regional level faces some significant political and legal requirements. Since the matter deals with interstate commerce, the federal government may regulate in a way that precludes explicitly or implicitly state action. Even if the federal government does not act in a particular area, under the Commerce Clause, limits to state action still might prevent regional action.

To avoid federal preemption, a group of states may enter a regional compact. A compact governing utility operations probably requires Congressional approval since the Supreme Court has defined interstate wholesale and transmission of gas and electricity as interstate commerce. Moreover, legal conservatism and history justifies this approach. If a state chooses to form a compact with other states, the problems are more political than legal or constitutional. The Supreme Court has broadly defined the form of the agreement and the kind of approval that the Constitution requires. These legal conditions provide the states with much latitude. On the other hand, the political obstacles to approval may be formidable because states, outside the proposed compact, that may be injured or are uninterested must also approve the agreement. As the discussion concerning club theory suggests, state compacts may also be difficult to sustain over an extended period of time.

Short of regulation, however, a group of states may choose to act cooperatively. Supreme Court decisions suggest that cooperation consistent with traditional federal powers does not trigger a requirement for Congressional approval.

Whatever form of cooperation adopted by a region, federal involvement may continue. The uncertain course of Tenth Amendment litigation does not provide a strong bulwark against federal preemption in areas such as energy or telecommunications with long histories of federal involvement. Although the federal government may defer to state action, it need not. As the case law demonstrates, compacts are subject to federal preemption and oversight, and federal supremacy remains a significant check on other regional activities, as well.

Finally, state law may also restrict state commission action. As is frequently noted, a state commission is a creation of the legislature, and the legislature's delegation of authority may not

permit regional action. There also may be limits to the amount of deference a state gives to the decisions of another state. Nonetheless, many states have specific provisions providing for regional cooperation, and the legislatures have adopted specific legislation when needed.

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CHAPTER 4

TWO MAJOR REGIONAL INITIATIVES AND THE FERC

In this chapter detailed attention is given to two major initiatives that are relevant to regional regulation in the electric sector, the Arkansas Proposal and the Pacific Northwest Electric Power Planning and Conservation Council.

Regional Integrated Resource Planning: The Arkansas Proposal

In September 1991, the Arkansas and New Orleans Commissions and Entergy, a regional holding company, proposed a change in federal law to create regional integrated planning for electric holding companies. The proposal suggested the creation of regional plans that would have binding effect over states and the Federal Energy Regulatory Commission (FERC). There were several alternative mechanisms for the creation of the regional plan, one was the creation of a regional board composed of state commissions which regulate in the jurisdictions served by a regional holding company. Senate Bill 2607 (S. 2607)[1] largely incorporated the Arkansas proposal. Response to the bill was mixed, and during hearings, in May 1992, the original proponents of the legislation (the Commissions and Entergy) circulated a modified proposal that eliminated the option of the regional board. The New England Conference of Public Utility Commissioners (NECPUC) is currently (summer 1992) considering endorsing a version of the Arkansas Plan.

The bill, as originally submitted by Senator Johnston, provided for a basic tradeoff of regional planning for greater certainty in cost recovery. To encourage support for the additional regulation by the states and FERC, holding companies were assured that prudently incurred costs would be recovered. The bill accomplished this tradeoff through several alternatives for planning.

[1] S. 2607, 102 Cong., 2d Sess. (1992).

According to the proposal, the goal of any regional effort is the creation of an integrated resource plan (IRP). The plan will evaluate various resources and actions, including the allocation of existing resources, the construction of new ones, power acquisitions, and conservation.[2] The plan is to set the range of resources at the lowest systemwide costs which balance the interests of shareholders and customers. Further, the plan is to specify which subsidiaries are responsible for purchases, assign risks associated with the acquisitions to customers and shareholders, allocate the costs of resources, and provide a method for periodic updates of the plan at least once every two years.[3] The plan would allow the inclusion of previously included costs, but not those costs associated with preplan disallowances made by states.[4]

The proposal contains several ways in which a regional integrated resource plan (RIRP) may be adopted. These include: (1) adoption through a regional board, (2) petitions by a state commission or the operating subsidiaries subsequently approved by the FERC, and (3) FERC adoption of consistent state plans as a regional plan.

The first alternative is the adoption of a plan by a board pursuant to a multistate compact. The proposal contains Congressional approval to form a regional board from the states whose residents purchase from the subsidiaries of a regional electric holding company.[5] The board would consist of at least one member from each state.[6] The board would determine its own organization and procedures[7] and would be authorized to order the operating subsidiaries to propose an RIRP that the board could approve or modify within twelve months of filing.[8] The

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[2] Id. § 101(1)(A), 102 Cong., 2d Sess. (1992).

[3] Id. § 101(1)(B).

[4] Id. § 101(1)(C). The provision includes a caveat permitting the exclusion of costs that represent excess capacity.

[5] Id. § 102(b)(1).

[6] Id. § 102(b)(2)(A).

[7] Id. § 102(b)(2)(B).

[8] Id. § 102(b)(3)(A)-(B).

board would be required to hold trial-like hearings unless all parties waived the hearing.[9] After the board had approved a plan, the operating subsidiaries would be required to submit the plan to the FERC.[10] The Commission could not modify the plan approved by the regional board.[11]

As an alternative to a regional board, the proposal provides that the subsidiaries or a state commission may initiate a plan with the FERC. The subsidiaries are directed to initiate through a petition accompanied with a proposed plan.[12] If a state commission files a petition, the companies must submit a plan within 60 days;[13] the states then have 120 days to submit an alternative plan.[14] The holding company's right to file a petition with the FERC is conditional upon a filing with the affected state commissions 180 days prior to the FERC petition.[15] If during the 180-day period the states form a regional board, the filing by the subsidiary is suspended for twelve months or until the states certify that they will not complete a plan, whichever is earlier.[16] If the petition is not dismissed within eighteen months of the filing, the FERC may approve the plan if it is not unjust or discriminatory, or it may issue an order explaining why it has not approved the plan.[17] If more than one plan is submitted, the FERC is directed

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[9] Id. § 102(b)(3)(B).

[10] Id. § 102(b)(4).

[11] Id.

[12] Id. § 102(c)(1).

[13] Id.

[14] Id.

[15] Id. § 102(c)(2).

[16] Id.

[17] Id.

to approve the one that is most likely to minimize projected system cost for the operating subsidiaries as a whole.[18] If the FERC finds that no submitted plan is consistent with the statutory requirements, it shall explain its findings and set a time for the submission of revised plans.[19]

The third potential method for approving a plan is listed as an exemption to the regional board approach. If each state commission with authority to set the retail rates of the operating subsidiaries has approved an IRP and filed the plan with the FERC and the other commissions, then the plans would be deemed the regional plan unless the FERC determines, within 180 days, that the plans were not consistent or did not contain the elements of a regional plan.[20]

Once a plan is adopted, it would be binding on the subsidiaries;[21] state commissions likewise would be bound to issue orders consistent with the plan.[22] Finally, the FERC could not approve any action or rate that was inconsistent with the plan.[23] On the other hand, the proposal also seeks to protect existing state and federal authority. It would not change the state's authority to set retail rates or disrupt siting authority,[24] but a siting decision inconsistent with the construction needs established by

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[18] Id. § 102(c)(3).

[19] Id. § 102(c)(4).

[20] Id. § 102(b)(5).

[21] Id. § 103(a)(1).

[22] Id. § 103(a)(2). Enforcement would be accomplished through actions brought in the federal court of the state commission whose actions an affected party sought to enjoin. Id. § 103(b).

[23] Id. § 103(a)(3).

[24] Id. § 104(a)(1) and (2)(A).

the plan would be invalid.[25] Likewise, the FERC's ratemaking authority would not be modified except as expressly contained in the proposal.[26]

Genesis of the Proposal

It is not an accident of history that the Arkansas RIRP Proposal emerged from quite lengthy negotiations between the Arkansas Public Service Commission and the holding company, Entergy (formerly Middle South), that had built the Grand Gulf unit. That unit had become the center of the state/FERC jurisdictional controversy that led to the Supreme Court's decision in Mississippi Power & Light v. State of Mississippi, et al., Moore, 487 U.S. 356 (1988) (MP&L). Those two entities were, of course, lead players in, and perceived victims of, that controversy.

From the "briefing paper" that introduced the Arkansas RIRP proposal in September 1991, it is clear that the proposal overtly purports to deal with "the problem" created by MP&L. The proposal is predicated upon three major assumptions or findings as to the "law today:"

(1) regional holding companies exist and, therefore, regional resource planning is a reality;

(2) after MP&L, state commissions lack clear authority over the retail rates and, therefore, over the resource planning of the holding company operating subsidiaries under their jurisdiction; and

(3) FERC also lacks clear authority to regulate these resource planning decisions because, under the Federal Power Act (FPA), it lacks authority over generating facilities. It also lacks the expertise over local conditions to do so effectively.

[25] Id. § 104(a)(2)(B).

[26] Id. § 104(b).

Hence, the proposal is predicated upon a sort of double-sided "regulatory gap" over regional planning decisions of holding companies, one side caused by FERC's lack of general authority in this area, the other caused by MP&L restricting state commission abilities to review the prudence of such decisions.

The RIRP proposal contemplates the ability of the states who regulate the holding company's subsidiaries to form a regional body, characterized as a "regional regulatory board" (hereinafter "regional board," "board," or "RRB")[27] to regulate regional resource planning. It provides for a wider role and range of options for the state commission concerned.

Hence, the RIRP would permit the RRB to decide the "prudence" and "allocation" issues and a good deal more. Notably, the proposal incorporates a concept similar to the "rolling prudence" concept advanced by some utilities in the 1980s.[28]

In certain circumstances, the RIRP proposal provides an expanded role for the FERC in ruling upon the reasonableness of resource plans, deciding between competing RIRPs or ruling upon the consistency of state or utility resource plans with each other or with the statutory definition of RIRP. This, of course, gives FERC a role in regulating resource planning that it has never had before, although the overall design of the proposal appears to limit this role to that of final review or refereeing, rather than frontline regulation. This feature, which gives the FERC some role in regulating resource planning decisions of regional entities in certain circumstances, is perhaps as significant a change in the status quo as any other feature of the proposal. It is a clear effort to close one side of the regulatory gap as perceived by the framers of the proposal.

Concerns Raised by the Proposal: An Overview

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[27] The term used in the legislative proposal is simply "Board."

[28] The definition of the RIRP also contains a complex provision which appears to be an effort to grandfather preexisting state commission prudence determinations, but without prejudicing the ability of the RIRP to take into account total capacity and total load, whatever the prior prudence determination as to these. This provision was amended in the second legislative version of the proposal, presumably for clarity reasons. See, Section 101(2)(C).

Several concerns are raised by the proposal. First, the program will need support by the FERC for its success, and that support is currently only lukewarm.[29] As an alternative, the FERC would rather see the use of joint conferences to settle regional matters.[30] As suggested in Chapter 6, the FERC's use of that alternative is not extensive.[31] Thus, it appears that the FERC is not strongly committed to sharing its responsibilities over regional matters. That cooperation will be important both for the adoption of the bill and because the legislation creates new administrative responsibilities for the agency.

Another concern was raised about the increased level of regulation. Some complain that this proposal is an additional unnecessary layer.[32] A variation of this idea is that the regional board will present the companies with another forum in which they will have to defend themselves from having to buy unwanted power from new unregulated generation facilities.[33] Both arguments have some merit. On the other hand, since a formalized regional review process does not currently exist, the proposal is filling a gap, and thus, may not actually be an additional layer of regulation. It follows that the holding company subsidiaries also need to be challenged on their decisions not to incorporate new sources of generation. This mechanism would provide a way of doing that on a regionwide basis.

Additionally, there is an argument that there is no need for regional planning statutes

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[29] Testimony of William Scherman, General Counsel, FERC, before the Senate Committee on Energy and Natural Resources (May 14, 1992) (Scherman Testimony); "State Regional Planning Seen Getting Deference, Not Carte Blanche," *Inside FERC* (October 14, 1991), 13. The testimony of the General Counsel and the FERC staff is examined in some detail in the next section of this chapter, 79.

[30] Id.

[31] See, Chapter 6.

[32] Testimony of Allen Franklin before the Senate Committee on Energy and Natural Resources (May 14, 1992); Cano, "Terzic Pans Regional Regulation by States, Advocates Joint Boards," *Inside FERC* (November 18, 1991), 3.

[33] "NARUC Official, FERC Lawyers Differ on Implications of Native-Load Issues," *Electric Utility Weekly* (October 14, 1991), 11.

because a certain amount of regionalism is already working.[34] Opponents argued in Senate hearings that currently there is not any legal barrier to interstate cooperation and that de facto regional regulation is underway.[35] This argument is true to some extent, but it does not answer the broader political and regulatory questions that the bill attempts to address. Proponents argue that the bill is necessary to assure greater certainty in planning and more input into the planning process.[36] They point to a gap in federal and state regulation that compounds the concern: the state may not regulate the interstate companies, the FERC lacks siting and planning authority, and the

Securities and Exchange Commission (SEC) is ineffectual.[37] Additionally, a key to the bill is the sense that regional matters should be decided regionally. Under the current framework, regional problems are presented piecemeal to the states and the FERC. This legislation may offer a stronger voice to the region than would otherwise be possible.

More fundamental and practical concerns also affect the bill. First, there is not an attempt to rationalize the confused roles of the SEC and the FERC.[38] This may cause problems since both

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[34] Cano, "The Federal-State Partnership: Can Collaborative Jurisdiction Work?" *Inside FERC* (October 7, 1991), 10.

[35] Scherman Testimony, 5; Testimony of Thomas G. Robinson, Associate General Counsel, New England Electric System, before the Senate Energy and Natural Resources Committee, 6-7 (May 14, 1992).

[36] Testimony of Kent Foster, Vice President, Entergy Services, Inc., before the Senate Energy and Natural Resources Committee, 5 (May 14, 1992); Testimony of Carl Simpson, Director of Resource Management, Riceland Foods, Inc., before the Senate Energy and Natural Resources Committee, 4 (May 14, 1992).

[37] Testimony of Sam Bratton, Jr., Chairman, Arkansas Public Service Commission, before the Senate Energy and Natural Resources Committee, 4 (May 14, 1992); Testimony of Jim Singleton, Council Member, City of New Orleans, before the Senate Energy and Natural Resources Committee, 13-14 (May 14, 1992). A related problem is the use of forum shopping and creative corporate structuring that arguably results from the perceived gap and differential levels of regulatory effort. Testimony of Ashley Brown, Commissioner, Public Utilities Commission of Ohio, before the Senate Energy and Natural Resources Committee, 6 (May 14, 1992).

[38] Testimony of Larry Frimerman, Federal Liaison, Ohio Office of Consumers' Counsel, before the Senate Energy and Natural Resources Committee, 9-10 (May 14, 1992).

agencies have some control over holding company structures. Without SEC-FERC agreement, the SEC's authority over capital structures may frustrate the goals of the regional authorities and the FERC.

Second, opponents raise questions about the operation of regional planning with other statutes. One concern is the operation of the statute in an environment of increasing reliance on market factors such as the proposed expansion of independent power producers.[39] A second issue raised by the FERC is the effect of the bill on the control of interstate transmission facilities.[40] Issues of coordination among states with different standards for IRP and for holding companies with responsibilities to power pools also were raised during Senate hearings.[41]

Third, opponents challenge the workability of the various approaches to regional regulation contained in the bill. For example, the bill may need better procedural definitions. There are not any descriptions of how the board is formed or the powers of members. Also, there is not a provision concerning the voting power of each state. Nor is there any provision for breaking deadlocks. These deficiencies could be troublesome when concerns of one state conflict with concerns of another. Some also have complained that the process is likely to be inflexible and protracted.[42] Finally, there are no standards for rulemaking or provisions for funding.[43] Thus, it might be appropriate to address the actual structure of the proposed boards before the states

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[39] Scherman Testimony, 10; Testimony of Charles Patrizia before the Senate Energy and Natural Resources Committee, 13-14 (May 14, 1992).

[40] Scherman Testimony, 10.

[41] Testimony of Allen Franklin, President and Chief Executive Officer, Souther Company Services, Inc., before the Senate Energy and Natural Resources Committee, 5 (May 14, 1992); Testimony of Charles Patrizia before the Senate Energy and Natural Resources Committee, 9, 31 (May 14, 1992).

[42] Testimony of Allen Franklin, President and Chief Executive Officer, Southern Company Services, Inc., before the Senate Energy and Natural Resources Committee, 3-5 (May 14, 1992); Testimony of Charles Patrizia before the Senate Energy and Natural Resources Committee, 22, 26 (May 14, 1992).

[43] Testimony of Charles Patrizia before the Senate Energy and Natural Resources Committee, 6, 29 (May 14, 1992).

attempt to adopt this mechanism.

There were some objections to the bill from traditional supporters of regulation. As an example, one concern was that the standards would become too favorable to the utilities. One consumer advocate argued that the bill could preclude review of certain costs through a form of preapproval.[44] Another suggested that the bill might preclude the use of a "used and useful" standard of review (despite a provision in the bill that does not preclude a state from adjusting rates for excess capacity, the common way that the issue is presented).[45] The Louisiana Public Service Commission also raised the concern about the ability of state commissions to participate effectively, because of resource constraints.[46] In a similar vein, the Ohio Consumers' Counsel urged that consumer advocates be given statutory standing in regional planning efforts.[47]

To address some of these concerns, the original proponents of the bill circulated a compromise proposal prior to the May 1992 Senate hearings. The major change in the proposal was the elimination of the regional board as a means for securing an IRP. In testimony to the Senate Energy and Natural Resources Committee, a vice president for Entergy described a two-alternative plan. In the first alternative, each state would adopt a plan and file it with the FERC. The combination of plans would be the regional resource plan unless there was an objection by a state or utility. If there were an objection, the FERC could reject the plan only if it determined that the combination of plans did not meet the definition of an RIRP contained in the statute. The second alternative for approval would permit either a state or utility to file a plan with the FERC. A state could substitute its own plan for that portion of the utility plan affecting it. If the plan failed to meet the definition, the FERC would provide opportunities for the parties to cure the

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[44] Testimony of Larry Frimerman, Federal Liaison, Ohio Office of the Consumers' Counsel, before the Senate Energy and Natural Resources Committee, 7 (May 14, 1992).

[45] Comments of the Louisiana Public Service Commission before the Senate Energy and Natural Resources Committee, 8 (May 14, 1992).

[46] Id., 3.

[47] Testimony of Larry Frimerman, Federal Liaison, Ohio Office of Consumers' Counsel, before the Senate Energy and Natural Resources Committee, 3 (May 14, 1992).

deficiencies and resubmit the plan.[48]

In summary, the Arkansas proposal has developed an interesting life of its own. Early Senate hearings indicate some significant interest in the bill but also demonstrate the need for some revisions.

FERC and the Arkansas Regional Integrated Resource Planning Proposal

Preemption

As noted above, a board or FERC-approved RIRP has preemptive effect, as a contract filed and approved with FERC, on the actions of state commissions. By converting the actions of the board into FERC orders, the proposal would use the direct preemptive effect of FERC authority under the FPA rather than the approach of the broader regional proposals that would utilize federal enabling legislation both to authorize and to give the state compacts the force of federal law that they need to impose preemptive legal discipline on the state agencies. Hence, if the RIRP proposal were enacted, it would probably be an amendment to the FPA. Of course, in enabling (though not requiring) the formation of regional boards, the proposal would introduce a new regional institutional structure into the FPA processes, just as section 209(a) (joint boards) has the potential to do.

The legislative proposal also contains standard language otherwise preserving state commission and FERC authority. The briefing paper notes that FERC retains authority to set wholesale rates which are consistent with the regional plan, and it states that the legislation "would not overturn MP&L."

Technically, this is correct. However, the principal effect of the proposal is to fill the perceived, double-sided regulatory gap created by MP&L and the new authorities of FERC and the regional board, building heavily upon state commissions' IRPs or RIRPs. Hence, the effect is

[48] Testimony of Kent Foster, Vice President, Entergy Services, Inc., before the Senate Energy and Natural Resources Committee, 6-7 (May 14, 1992).

essentially to reverse the impact of MP&L on the state commissions' ability to monitor utility supply planning and, potentially, to subject holding companies and their subsidiaries to considerably more regulation. However, as noted, an approved RIRP also grants the complying operating subsidiary some level of immunity from ex post disallowances, at least in concept.

State Siting Authority and "Regulatory Layering"

A notable additional feature of both legislative versions of the RIRP proposal relates to state energy facility "need" or siting decisions. Generally, the proposal purports not to "affect or modify" state rights to make such decisions.[49] However, a critical exception would apply to a state decision to *disapprove* a facility's construction if based upon a determination of "that state's future responsibility for meeting system needs. . .that is inconsistent with such responsibility assigned by an approved plan."[50] Such a decision is "invalid;" and enforcement is available as above.[51]

This limitation deals with one of the most glaring flaws in the earlier "voluntary" regional supply planning legislative proposals of the mid-1980s that led to legitimate charges of unnecessary "regulatory layering;" specifically, that state "need" certification processes could second-guess the need determinations of the regional body.

Several of the major concerns over "regulatory layering" in earlier regional supply planning proposals are addressed in the RIRP proposal. Most critically, both state commissions and state siting authorities are, in effect, preempted from those actions which are obviously and directly inconsistent with the RIRP. Moreover, neither FERC actions, nor subsequent "update" actions by FERC or regional boards, are permitted to second-guess or undermine utility actions relying on RIRPs.

When the board acts to approve an RIRP, there may be some procedural delay to permit

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[49] Section 104(1)(2).

[50] Id.

[51] Id.

state commission inputs, and some significant delay if the board deliberates but is unable to act. Nonetheless, regulatory layering in the sense of another level of regulatory review is avoided in the second legislative version by the proscription on FERC's ability to amend the plan--probably the very reason for the change from the first version.

However, when FERC is placed in the role of ruling upon or selecting an RIRP from competing plans, or determining the consistency of state IRPs, the proposal clearly adds a major new regulatory role for FERC. FERC referees, with some limits on its discretion, state commission and company-developed plans. Although the proposal technically does not "layer" this regulatory function (FERC makes the final decision in both cases), it does add a new regulatory oversight function and a significant added timeframe.

FERC Staff Testimony

FERC presented written and oral testimony on S. 2607 through its General Counsel, William S. Scherman, accompanied by Associate General Counsel, Cynthia A. Marlette.

In his prepared testimony, Mr. Scherman noted the laudable goals of the bill, "promoting consensual RIRP among members of multistate holding companies." He pointed to the efforts of FERC Chairman Allday to promote these goals through the Commission's June 1991 public conference on electricity issues and the subsequent series of workshops with the National Association of Regulatory Utility Commissioners (NARUC), including the October 17, 1991 workshop on market-based pricing and IRP.[52] However, the balance of the FERC staff's testimony consisted of elaborating upon some major concerns with the bill.

The FERC staff's principal objection to S. 2607 (and to a simplified version of the bill proposed by the Arkansas Public Service Commission and Entergy) was that both would result in states within a region exercising a "joint preemptive authority over matters affecting interstate wholesale rates, corporate transactions affecting interstate commerce, and competition in wholesale electric generation markets."[53]

As to the simplified version of S. 2607, FERC staff concluded that it would be an improvement over S. 2607 because it would allow the operating subsidiaries a federal forum, allow more substantive review by FERC of matters affecting interstate commerce, and eliminate "some of the cumbersome procedural complexities and legal infirmities of S. 2607."[54] However, it would still allow state commissions within a region, absent protest from the operating subsidiaries they regulate, to "preemptively determine matters affecting wholesale electric rates" and FERC's regulation of transmission and corporate activities.

In addition to the two concerns raised, interference with FERC jurisdiction and procedural complexity, Scherman mentioned one other concern which he did not

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[52] Scherman Testimony, 1-2.

[53] Id., 8.

[54] Id., 13.

elaborate on, the concern that S. 2607 appears to "substantially lessen the role of utilities themselves in their own planning."[55]

Analysis of FERC Staff Position on S. 2607

The central FERC staff objection to S. 2607, and the simplified version, was that it provides for situations in which state commissions can make determinations in the IRP context that may basically affect, and, in places, potentially "preempt,"[56] FERC jurisdiction over wholesale power sales, transmission, and corporate matters. Even if this interpretation of S. 2607 is accurate (notwithstanding the savings provision for FERC authority), FERC staff's principal argument against the bill is in reality no more than a legalistically derived conclusion that any diminution of FERC authority is bad policy, because the bill may have these potentially intrusive effects on current FERC jurisdiction, it is objectionable from a policy standpoint. FERC staff's central criterion for acceptability appears to be that FERC retains sufficient authority to review effectively and, presumably, to alter, reverse, or at least remand regional determinations that affect FERC's own broad jurisdiction.

The testimony is almost completely devoid of substantive reasons as to *why* it is in the national interest that FERC retain ultimate decisional authority on all these issues. The one exception is Scherman's striking example of a region's state commissions in effect conspiring to

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[55] Id., 6.

[56] The continued use of the term "preemption" in this context is not technically accurate from a strictly legal viewpoint. The doctrine of preemption developed by the courts applies to situations where Congress, exercising its Commerce Clause powers, evinces an expressed or implied intent to displace state authority. It is not typically applied to situations where Congress recognizes and preserves state authority and limits the jurisdiction of federal agencies. However, broader, looser usage of the term "preemption" was frequently invoked in the late 1980s by those (including many state commissions) criticizing FERC actions in the bulk power markets such as the 1988 electric Notices of Proposed Rulemaking (NOPRs) and other FERC efforts to adjust its rules under Section 210 of PURPA. Hence, a broader usage referring to any adjustment in state-federal jurisdiction or authority has arguably become part of the lexicon of the policy debate, and that is the usage Scherman adopts.

have the holding company block access to its transmission system to bulk power market competitors.[57] It is not clear whether this example is realistic, nor is there any discussion of whether Congress could anticipate and proscribe such conduct in regional regulation legislation. An example would be, imposing the obligation on the regional agency, or on the requirements for validation of a regional IRP, that the IRP cannot have anticompetitive effects[58] or that it be procompetitive in effect.[59] There may, indeed, be sound policy reasons why the retention of nationally exercised regulatory authority should not be devolved to regional authorities but the reasons are not generally set forth in the FERC staff's testimony.[60]

A key adjunct of FERC staff's basic position appears to be a belief that the principal state concerns over loss of control over utility power supply planning can be adequately dealt with under the existing jurisdictional structure. In building this argument, Scherman detailed the facts of the Grand Gulf case (Middle South) that led

[57] The closest any actual FERC decision has come to relying on such reasoning was the Commission's decision to impose a "no fault" or absolute obligation to provide long-term transmission service, and to build capacity to do so, as a condition of a major merger in Utah Power Light Co., 45 FERC ¶ 61,095 (1988).

[58] The courts or FERC itself have read such a mandate into FERC's major FPA authorities. See, for example, Gulf States Utilities v. FPC, 411 U.S. 747, 758-9 (1973); FPC v. Conway Corp., 426 U.S. 271 (1976).

[59] This is a goal the United Kingdom's England & Wales privatization legislation specifically included in the charter of both the regulator and the monopoly National Grid Company.

[60] In fairness to FERC staff, they may have concluded that this elaboration was not necessary or appropriate in the context of a first Congressional hearing on the subject where basic statements of position often suffice. However, in view of the possibility of Congressional consideration of the Arkansas RIRP proposal, such elaboration becomes necessary.

to the MP&L decision.[61] He pointed out that Middle South is the only case "of its kind" in the fifty-seven years since enactment of the FPA, and that it involved "an after-the-fact contentious dispute" in which FERC had to serve the role of "neutral federal arbiter" between the state commissions which could not agree on the cost allocation for the unit.[62] He argued that there is nothing in the current structure to prevent state commissions, which regulate holding company subsidiaries, to work jointly and with their utilities to bring "consensual interstate IRP arrangements" to FERC and, to do so (preferably) before rather than after "IRP actions are taken;" and he asserted that FERC has a long history of promoting and accepting such "consensual arrangements" if FERC concludes that they are in the public interest.[63] However, Scherman later added, that while FERC "ordinarily seeks to give deference to consensual state commission findings" that affect wholesale rates, it also gives utilities and "other affected persons a federal forum to raise issues."[64] He preferred the amended version of to S. 2607 because it gives the operating subsidiaries such a forum.[65]

FERC staff's basic position which was clearly articulated in the staff "Responses to Specific Questions Asked by the Committee,"[66] is that such collective mechanisms for resolving intercommission jurisdictional matters, preferably on a binding ex ante basis, are welcome and can be accommodated under existing law, but with the critical proviso that there must be an "effective federal backstop to protect interstate interests which may be affected by regional resolutions" and "which may be broader than the regional

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[61] Scherman Testimony, 4-6.

[62] Id., 5.

[63] Id., 5-6.

[64] Id., 8-9.

[65] Id., 13.

[66] Id., Appendix C.

interests addressed."[67] Examples of such interests are "anticompetitive efforts, undue burdens on interstate commerce, and undue discrimination."[68]

This suggests a continuation of the model that state commissions have for years viewed as not satisfactory in regulating utility power supply planning when their Pike County review ability is curtailed by federal preemption, *viz* the ability to bring proposals to FERC and to participate in the FERC proceedings that will resolve them. If the matter is remotely contentious, the FERC proceeding will most likely be quasi-judicial in nature.[69] State commissions have argued for years that this ability does not give them adequate control over the planning decisions of the holding companies. If there is no serious contention over a holding company planning decision, either between the states or between state commissions and the operating subsidiaries, then the FERC "deference" to their agreements adds little to their control. Moreover, even that deference is not complete. A discontented consumer or environmental intervenor could conceivably upset a settlement and precipitate a hearing that is in effect quasi-judicial notwithstanding agreement between the commissions and operating subsidiaries.

In the more likely event that there is a contention which leads to a hearing process, this "FERC forum" model in effect dictates that state commissions must participate as a party in often protracted FERC quasi-judicial proceedings for their interests even to be considered, let alone to prevail. Not only does this not give them the authority they perceive that they need, but it also puts a serious strain on their resources and requires that they pursue their regulatory prerogatives in a distant, quasi-judicial, and unfamiliar forum. In short, in the states' view, the FERC forum model is not a substitute for the direct regulatory authority sought. This, in the multistate holding company context, probably requires that such regulatory authority be sanctioned by federal law and, to some degree displace, and not fall under FERC authority (this argument may have had some weight with the states, since the states retreated from their earlier position of needing a

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[67] Id., 1.

[68] Id., 2.

[69] FERC may soon issue a Notice of Proposed Rulemaking on alternative dispute resolution (ADR) which could conceivably change that expectation in the long term.

compact).

Indeed, without some use of federal law to ensure the binding nature of a multicommission or regional decision (that is, to preempt contrary state or local decisions), the model suggested by FERC staff is subject to the same "regulatory layering" concern that was raised against some of the poorly designed regional regulation proposals of the 1980s. Even if a consensual arrangement results from a multicommission mechanism, if commission participants are not bound by force of federal law to honor it, there is nothing to keep them from relegating the matter before the FERC. Indeed, the "federal forum" model seems to invite such a response. The notion that state commissions should simply exercise the self-discipline to abide by an ex ante arrangement is not realistic when critical state interests are involved. That was exactly the problem in Middle South.

FERC staff's implicit suggestion that Middle South was unique, which was more explicitly asserted by other parties at the S. 2607 hearing, does not respond to the states' concern and is misleading. The states' principal current concern is that the holding companies may choose to channel all future generating capacity additions through an independent power producer (IPP) subsidiary and to sell the power back to the operating subsidiaries subject to FERC review of the "justness and reasonableness" of the sales price, but not subject (by virtue of MP&L) to state commission review of the prudence of the acquisition by the operating companies, ex ante or ex post. It is not clear under current law that an ex ante effort by state commissions, either individual or collective, to impose IRP mandates on the subsidiaries would survive application of the MP&L decision.

The federal interests raised by FERC staff as necessary to be protected by the "FERC forum" or "FERC backstop" model are, however, extremely serious interests that cannot necessarily be sufficiently protected by multicommission or other multistate mechanisms. Hence, it is useful to the national debate that federal interests are raised as forcefully as the FERC staff testimony. What it lacks is a demonstrated nexus between regional IRP and the detrimental effects Scherman asserts. By the same token, most of the proposals advanced over the last decade by the National Governors Association, NARUC, and others for the total or almost total devolution of elements of current FERC authority to state commissions have not adequately addressed this crucial concern. In reality, there is an across-the-board and not easily resolved

tension between FERC concerns over the efficiency and competitiveness of the bulk power markets and state jurisdiction over utility supply planning or IRP. As the bulk power markets grow in size, scope, and competitiveness in the 1990s, that tension will become more evident and put even greater strain on the FPA jurisdictional dichotomy, which was designed for the 1930s and had held up remarkably well until the 1980s. Solutions that alter this structure will need to be carefully reviewed. Reaching such solutions and achieving a viable accommodation between state and federal interests will require a far more precise analysis of where state IRP prerogatives and federal interests seriously clash and cannot be accommodated. Any jurisdictional adjustments or solutions need to be tailored precisely to those situations.

Pacific Northwest Electric Power Planning and Conservation Council Compact

One of the most significant experiments in regional regulation occurred in the Pacific Northwest. The four-state region of Washington, Oregon, Idaho, and Montana joined under a federally approved compact to coordinate electric production and conservation.[70] As many who have studied the regional organization have explained, however, this regional compact may not be a model for other regional efforts.[71] In a large part, this limitation is because of the significant role of the federal power authority in the region.[72] On the other hand, it is an example of the flexibility that states might exercise to address a particular mix of regional problems.

Unique Factors Affecting Northwest Power

The Pacific Northwest Electric Power Planning and Conservation Act (Northwest Power

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[70] 16 U.S.C. §§ 839-839h (1988).

[71] Alan Larsen and Frederick Hitz, "Conference Overview," 38 *Administrative Law Review* 315, 319-20 (1986).

[72] Charles G. Stalon, "Regional Supply Planning, Federal Authority, and State Regulation--Thinking Through the Jurisdictional Maze," 38 *Administrative Law Review* 327, 330 (1986).

Act) is largely a compromise concerning several factors affecting the production of power in the Northwest. First, the production in the Northwest is predominantly based on hydroelectricity that is marketed by a federal agency. Roughly three quarters of the capacity is hydro[73] that is generated at 130 dams in the region.[74] Because of the dependence on hydroelectric generation, production varies with the river flow annually and seasonally, and it is affected by decisions concerning other uses, such as recreation, irrigation, fish conservation, and upstream storage.[75]

Especially significant is the role of the Bonneville Power Administration (BPA) in the distribution of power, but significant risks developed in the BPA's execution of its mandate. As the primary marketer of federal electric power, the BPA controls an extremely valuable resource, and over time it augmented its dominant role. While the BPA did not initially have the authority to construct or own power generation facilities, it did develop means of expanding the power generation sources within the region. In recent years this was done through net billing arrangements. Under net billing, the BPA would guarantee to purchase the output of a plant from generation sources and credit its payments against the sources' purchases of power. The first effect was to meld the costs of the cheap hydropower with newer, more expensive thermal generation. Second, it shifted the risk of construction failures to the BPA and its other customers because the net billing contracts guaranteed credits even if the new plant never produced electricity. Thus, BPA went into the construction business with very little control over the product once it agreed to net bill the capacity of a plant.[76]

A second historical factor affecting power production in the region was its base of customers. Because of a statutorily created preference, much of the base of the cheap

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[73] John M. Volkman, "Testing New Forms of River Basin Governance: Implications of the Seattle Builders Case," 17 *Environmental Law* 835, 838 (1987).

[74] Dale D. Goble, "The Compact Clause and Transboundary Problems: A Federal Remedy for the Disease Most Incident to a Federal Government," 17 *Environmental Law* 785, 792 (1987).

[75] Eric Redman, "Nonfirm Energy and BPA's Industrial Customers," 58 *Washington Law Review* 279, 283-87 (1983).

[76] Government Accounting Office, *Impacts and Implications of the Pacific Northwest Power Bill* (Washington, D.C.: GAO Printing Office, 1978), 3-5.

hydropower is directed to public power companies. The Federal Water Power Project Act in 1920 created a preference for the sale of power to public power companies from federal projects.[77] The preference had three purposes. First, it was designed to encourage the rural use of electricity that was a byproduct of the dams that were built to improve irrigation. Second, Congress intended the preference as a device to frustrate the growing power of electric holding companies. Third, the preference was perceived as part of the government's stewardship of public lands.[78]

The early decisions of the BPA reflected the preference goals. Rates were based on postage stamp models of one price for all regardless of transmission costs. Extensive efforts went into the construction of transmission lines to extend the availability of power to more rural areas. Finally, the region encouraged the development of public utility districts to take advantage of the preference.[79]

A third important factor affecting the region (and an extension of the dominant federal role in the area) was the significant growth of interconnection and joint planning. World War II and the thirty years following the war marked an important transition period for regional coordination in the Northwest. Initially, World War II resulted in high levels of regional power coordination. This cooperation translated into relatively high levels of interconnection and the creation of the Northwest Power Pool.[80] Following the war, the region encouraged the introduction of large industrial users to take advantage of the available surpluses that could be easily moved to the end users.[81] At the same time, the Eisenhower administration moved away from the public power

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[77] Michael Blumm, "The Northwest's Hydroelectric Heritage: Prologue to the Pacific Northwest Electric Power Planning and Conservation Act," 58 *Washington Law Review* 175, 187 (1983).

[78] Joseph Mentor and David Jory, "The Preference Clause Revisited: Central Lincoln People's Utility District v. Johnson and the Pacific Northwest Electric Power Planning and Conservation Act," 58 *Washington Law Review* 413, 413-15 (1983).

[79] Blumm, "The Northwest's Hydroelectric Heritage," 201.

[80] Id., 202-04.

[81] Id., 206.

preferences and encouraged joint public-private construction of new generation facilities.[82] In these ventures, public authorities would construct a dam using federal subsidies such as low-interest tax-exempt bonds and enter into long-term contracts to sell the power to private utilities.[83] Finally, after the United States signed a treaty with Canada concerning water storage that could effectively reduce the problems of seasonal variations in hydro availability, the Bonneville Power Administration, the Corps of Engineers, and the utilities signed an operating agreement that provided for managing regional power on a "one utility concept."[84] Thus, the region, dominated by one marketer, also benefited from a highly interconnected structure and a tradition that supported a regional approach.

In this growing market, the industrial customers were a curious benefit and drain on the system. On the one hand, the industrial contracts provided that 25 percent of their power could be interrupted at any time and another 25 percent could be interrupted with notice. Thus, the industrial load could serve as reserve capacity since it could be interrupted. This factor was especially important for the region because of the seasonal fluctuations associated with hydropower production. The terms of the industrial contracts, however, also provided for significant penalties if the loads were interrupted. Thus, BPA would look for power outside the system to serve the industrial load rather than exercise its authority to interrupt.[85] Ultimately, the preference and industrial customers would have to come into conflict when the limited amounts of hydropower became relatively scarce due to the region's growth.

Emerging Problems in the Northwest

During the 1970s, three problems emerged in the regional arrangements of the Northwest. First, the region experienced significant power interruptions and anticipated more of the same.

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[82] Id., 212.

[83] Id.

[84] Id., 217-18.

[85] Government Accounting Office, supra footnote 68, 15.

Second, there was an increased concern that hydropower production had some serious ecological impacts that were not being addressed by the relevant authorities. Finally, many within the region resented the lack of voice that states and local interests had in power production and transmission by the BPA. These concerns coalesced support for adoption of the Northwest Power Act.

During the 1970s, industrial customers had already suffered from curtailments of their interruptible power from BPA due to increased demand from the preference customers and unusually low water levels.[86] In response, BPA attempted to secure additional sources of power through the net billing contracts that encouraged the construction of fossil and nuclear reactors to supplement the hydro sources. When BPA's authority to enter these arrangements was challenged and limited, a shortfall under the existing power arrangements looked probable.[87] These shortages could only

[86] Redman, "Nonfirm Energy and PBA's Industrial Customers," 303.

[87] Blumm, "The Northwest's Hydroelectric Heritage," 221-23; Redman, "Nonfirm Energy and PBA's Industrial Customers," 304.

become exacerbated as preference customers sought to capture additional supplies to the detriment of industrial and private utility customers.[88]

The second major concern raised in this period was the impact of additional damming on the local ecology. Though the number of potential sites for new dams was already small, additional dams were unlikely because of the environmental impact that they threatened. Of particular concern was the impact on anadromous fish whose populations had been significantly lowered by damming on the Columbia River and its tributaries.[89]

Finally, state authorities and other local interests raised concerns about the lack of political accountability for the decisions affecting the region. There was also a perception that problems were not confined to state boundaries, that regional solutions were necessary because of the regional nature of the problems.[90] Thus, from 1978 to 1980, strong political support emerged as the adoption of the Northwest Power Act made its way through the political process. The result was a complex set of provisions to address the problems of the region and a regional organization to serve as a check on federal authority and to provide a regional voice in decisionmaking.

The Northwest Power Act

A remarkable feature of the Northwest Power Act is its complexity. It provides a single plan to deal with several issues.[91] Moreover, it accomplishes this planning by providing a set of market and political incentives.[92] Although these incentives are not necessarily consistent with

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[88] Mentor and Jory, "The Preference Clause Revisited," 419-20.

[89] Blumm, "The Northwest's Hydroelectric Heritage," 219. See, also, Michael Blumm, "Hydropower v. Salmon: The Struggle of the Pacific Northwest's Anadromous Fish Resources for a Peaceful Coexistence with the Federal Columbia River Power System," 11 *Environmental Law* 211 (1981).

[90] Goble, "The Compact Clause and Transboundary Problems," 787.

[91] Larsen and Hitz, "Conference Overview," 321.

[92] Id., 322-23; Kai Lee, "The Path Along the Ridge: Regional Planning in the Face of Uncertainty," 58 *Washington Law Review* 327, 324 (1983).

prior regulation in the region,[93] they do appear consistent in terms of expected problems in the region.

The centerpiece was the creation of the Pacific Northwest Electric Power and Conservation Planning Council (Council).[94] The Council consists of two members from the four states (Washington, Oregon, Idaho, and Montana).[95] The Act directs the Council to develop two regional plans: one for regional conservation and development of power, and one for conservation of fish and wildlife.[96]

Two years after enactment, the Council was required to prepare and adopt a regional conservation and electric plan.[97] The importance of the plan was readily apparent: after the Council adopted the plan, the BPA was required to undertake actions consistent with the plan or secure Congressional approval for a deviation.[98] Under the Act, the Council is required to give priority to cost-effective alternatives with priority given "first, to conservation; second, to renewable resources; third, to generating resources utilizing waste heat or generating resources of high fuel-conversion efficiency; and fourth, to all other resources."[99]

As part of the plan, the Act requires the Council to develop the conservation plan including model conservation standards, recommendations for research and development, a methodology for quantifying environmental costs, and a twenty-year demand forecast that includes regional reliability and reserve requirements, variations caused by conservation measures, an approximation of the purchases that BPA should enter into, and the methodology for any

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[93] David Shapiro, "Policy and Legal Conflicts in the Pacific Northwest Power Act," *Public Utilities Fortnightly* 16 (November 14, 1985).

[94] 16 U.S.C. § 839b(a) (1988).

[95] Id. § 839b(a)(2).

[96] Id. § 839b(a)(1).

[97] Id. § 839b(d)(1).

[98] Id. § 839b(d)(2).

[99] Id. § 839b(e)(1).

recommended surcharges.[100]

The model conservation standards receive special treatment in the Act. The conservation standards would be applicable over the whole range of potential electric transactions including new and existing buildings.[101] Failure to comply with the standards could result in the application of surcharges by the BPA, at the recommendation of the Council, if the Council determined that the failure to implement conservation resulted in net additional costs.[102]

Beyond the substantive responsibilities of the Council, the Act provides for extensive public involvement in the creation of the conservation and electric plan, and the fish and wildlife program. To ensure public participation, the Act generally directs the Council and the BPA to provide information and secure public comments.[103] Prior to adoption of the plan, the Act specifically requires the Council to conduct public hearings in each of the represented states and any other state that may be affected by the regional plan.[104]

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[100] Id. § 839b(e)(3).

[101] Id. § 839b(f)(1).

[102] Id. § 839b(f)(2). In addition to the conservation and electric plan, the Council was directed to prepare a program to protect fish and wildlife. The program was to be consistent with existing conservation programs, scientifically sound, and cost effective. The Act then directs the BPA to use funds in a manner consistent with the execution of the fish and wildlife program (Id. § 839b(h)(10)).

[103] Id. § 839b(g).

[104] Id. § 839b(d)(1).

The remainder of the Act creates the careful balance of federal, state, and customer rules for the purchase and sale of electricity in the region. Complex provisions provide for the BPA to buy and exchange power in such a way as to lower the cost to residential customers while passing the difference on to existing direct industrial service customers. Further, the Act extends the right of the BPA to purchase additional generation resources that are in compliance with the plan adopted by the Council. Additionally, if the BPA seeks to purchase a major resource (over 50 megawatts) or adopt an equivalent conservation measure, it must again proceed through an extended period of notice, public comment, and hearings.[105] Attempts to buy resources inconsistent with the plan must be approved by Congress.[106]

The Act ties the package together with rate provisions that protect the public body, cooperatives, industrials, and federal customers and direct much of the remaining costs on to the direct industrial service customers. In effect, the first group pays the average cost of the BPA system and the industrial customers pay that cost plus the costs of covering the exchange sales made to private utilities.[107] The Act further attempted to assure industrial customers with access to long-term contracts with the BPA.[108] The BPA can further increase rates to customers through the surcharges assessable against entities that fail to comply with conservation standards adopted under the conservation and energy plan.[109] Once again there are detailed provisions for public notice and participation in the ratemaking process.[110] At the final stage the FERC must approve

[105] Id. § 839d(c).

[106] Id. § 839d.

[107] Id. § 839e.

[108] Id. § 839c(d).

[109] Id. § 839e(h).

[110] Id. § 839e(i).

rates.[111] Uniquely, the FERC must convene a joint board if the rates concern the exchange of power by an investor-owned utility (IOU).[112]

Nature of the Political Compromise

The basic compromise concerning the provision of electricity to the region reflected in the Act is straightforward, even if the provisions are complex.[113] First, private utilities that faced likely shortages and the threat of public power authorities, had access to BPA resources at system cost for their residential customers. Industrial customers would pay for that access but in return expected long-term contracts that would not otherwise be available. Preference customers were not in a worse position.[114] Moreover, BPA could expand, but expansion was checked by the plan and the Council's approval.[115] The Act also attempted to improve performance by requiring regional planning and construction and long-range forecasting.[116] Thus, there was a little something for everyone.

While the substantive compromise is important, equally important as conditions changed were the provisions for public participation. As noted in the discussion of the Act, Congress responded to the frequently-voiced concern that the BPA was unchecked. In response, Congress required public participation and gave the newly created Council

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[111] Id.

[112] Id. § 839f(g). A discussion of the process the FERC established is presented below. See, supra, Chapter 6, footnotes 77-84 and accompanying text.

[113] Blumm, "The Northwest's Hydroelectric Heritage," 230-31.

[114] Mentor and Jory, "The Preference Clause Revisited," 424.

[115] Id.

[116] Lee, "The Path Along the Ridge," 325, 336. See, also, Larsen and Hitz, "Conference Overview," 323.

the authority to limit the ability of the BPA to undertake actions inconsistent with the planning documents for the region.[117]

Limitations of the Northwest Power Act as a Model

There are limitations in the application of the Northwest Power Act to other regional problems. First, as discussed previously, the Act did not create a true regional regulatory authority.[118] Its role is largely advisory, but its suggestions can have some impact, as in the provisions for Congressional approval for BPA acquisitions inconsistent with the plan. On the other hand, it does not have ratemaking authority. Those activities are left to the states and the federal authorities. Additionally, the Act addresses a much broader array of issues than energy planning for the region. The uniqueness of the Act, however, should not be overplayed. The Act was a response to a regional set of problems for which the federal solution did not appear to be acceptable. This kind of problem is common to the current demands for greater regional control of resources.

Note too, that the Council may only now be addressing the challenges it was designed to address. The Act's provisions and the ability of the region to cooperate in the Council have not addressed the fundamental problems that led to its adoption. During the first ten years of the Act, the primary rationale for regional planning, energy shortfalls, failed to materialize.[119] Thus, the Council has not faced the need to plan for the acquisition of resources under real stress, nor has it

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[117] David Frohnmayer, "The Compact Clause, The Apportionments Clause and the Cooperative Federalism: The Accommodation of Constitutional Values in the Northwest Power Act," 17 *Environmental Law* 767, 772-73 (1987); Volkman, "Testing New Forms of River Basin Governance," 846-47.

[118] Stalon, "Regional Supply Planning, Federal Authority, and State Regulation," 330.

[119] Frohnmayer, "The Compact Clause, The Apportionments Clause, and the Cooperative Federalism," 772; Larsen and Hitz, "Conference Overview," 324.

had to deal with the problem of its own mistakes in planning.[120] This window may be closing and the Council has already divided on some issues responsive to the shortages, such as the completion of nuclear power construction.[121]

Another concern is organizational constraints. A regional agency creates another potential bureaucracy.[122] This bureaucracy may be a substitute for existing authorities or it may be another layer. In this case, it is another layer. As a result, it imposes its own costs both in additional hearings and review, delay, and the direct costs for funding the agency and its staff.[123]

In a related matter, one must also recognize that the function of the Council is jeopardized by its relatively small size and resources compared to the entities toward which it directs its attention, particularly the BPA.[124] Thus, there is the real danger that it will be reliant on or overwhelmed by the federal agency whose actions the Council is meant to constrain.

Finally, one must also be cognizant of the changes in regulatory approach. As with telecommunications and gas, electricity is facing ever increasing calls for some element of deregulation. The question can be asked as to what role a planning agency should play in a market that is not regulated under the traditional model of monopoly players.[125]

FERC's Authority to "Consult" State Regulators and to Institute a Joint Board in Ratemaking Under the Northwest Power Act

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[120] Roger Mellem, "Darkness and Dawn/Generating and Conserving Electricity in the Pacific Northwest: A Primer on the Northwest Power Act," 58 *Washington Law Review*, 245, 249 (1983); Stalon, "Regional Supply Planning, Federal Authority, and State Regulation," 333.

[121] ENR, November 8, 1990, 34; Loberstein, "Power Council Runs Out of Time," *The Oregonian* (October 22, 1990): E12.

[122] Stalon, "Regional Supply Planning Federal Authority, and State Regulation," 332.

[123] Id.

[124] Volkman, "Testing New Forms of River Basin Governance," 843.

[125] Reinier Lock, "Models for Bulk Power Deregulation: What Promise for the Future," 38 *Administrative Law Review* 349, 357 (1986).

As indicated earlier, while FERC's general oversight of BPA's activities under the Northwest Power Act does not significantly involve it in regional planning issues, there are two discrete authorities in the Act that suggest the potential for regional approaches or, at least, some type of formal multistate/federal mechanism to deal with ratemaking issues under the Act.

One of the central features of the Northwest Power Act, perhaps at least as important for the region as the regional planning aspect itself, was the effort by Congress to deal with certain longstanding grievances concerning perceived inequities in retail rates in the region. One of the most significant of these efforts is embodied in section 5(c), which establishes a power exchange program between BPA and IOUs in the Pacific Northwest to eliminate disparities that had developed between rates paid by residential customers of IOUs and the rates of residential customers of publicly-owned utilities who receive lower-cost federal power from BPA.

This disparity is purportedly eliminated by a subsidy to the IOUs achieved through a fictional exchange.[126] The IOUs sell power to BPA at their "average system cost," and BPA sells it back to the utility at BPA's lower wholesale rate.[127] The determination of "average system cost" (ASC), therefore, is vital to the level of benefits this "exchange" provides to the IOUs.

FERC is required to participate in two parts of this program. BPA actually develops the ASC methodology, and FERC must review and approve it. FERC must also review the wholesale rates, at which the individual IOUs sell their power, based in part on the ASC methodology developed by the BPA.

Two provisions in the Act, taken together, suggest the potential for FERC to utilize or participate in regional or state/federal mechanisms in exercising these responsibilities. First, as noted, BPA is to develop the ASC rates "on the basis of a methodology developed in consultation with the [Power Planning Council]. . .and appropriate state regulatory bodies in the region," (section 5(c)(7)). Although the provision does not specify which body is to undertake the frontline responsibility for developing the ASC methodology, it is to be "subject to review and

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[126] CP Nat. Corp. v. Bonneville Power Admin., 928 F.2d 905, 907 (9th Cir. 1991).

[127] 16 U.S.C. § 839c(c)(1).

approval" by FERC.[128] This suggests the possibility of an obligation for FERC to "consult" state regulatory bodies in the course of reviewing the ASC methodology.

Supplementing this authority is a second provision, embedded in the Act's "administrative provisions." Section 9(g) states, that when reviewing rates for the sale of power by IOUs to BPA under sections 5(c) or 6 (relating to conservation and resource acquisition), FERC shall, in accordance with section 209 of the Federal Power Act:[129]

(1) convene a joint state board, and

(2) invest such board with such duties and authority as will assist the Commission in its review of such rates.

Hence, a possible implication of these provisions is that when FERC reviews rates for IOU sales to BPA under 5(c), and the ASC methodology under those rates, and in other cases of review under section 6, FERC is required to use the joint-board mechanism under section 209 of the Federal Power Act. This interpretation has not prevailed.

In its rulemaking concerning its review of the ASC methodology, FERC concluded that its role was quite limited. The current ASC methodology was adopted by BPA in 1984 after notice and comment procedures, and approved by FERC.[130] FERC found that the necessary consultation with the affected parties occurs on the BPA level and viewed its own "consultation" as limited to written comments. "Before the ASC methodology was submitted to the Commission, it was subject to seven months of BPA proceedings, including on-the-record negotiating sessions, and the opportunity for interested parties to present oral and written comments."[131]

FERC has also concluded that, while there is no requirement under section 9(g) for it to convene a joint state board in reviewing the average cost *methodology*, it is required to convene a

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[128] Id.

[129] 16 U.S.C. 824h.

[130] Methodology for Sales of Electric Power to Bonneville Power Administration, Order No. 400-A, 30 FERC § 61,108 (1985), 18 C.F.R. § 301 (1990).

[131] Id., 31,168.

joint board to review *rates* developed under the methodology.[132] In practice, however, even these rates are not always subject to review by a joint board.

As to the ASC methodology, although FERC is not required to convene a joint board in its review, FERC may decide to do so if "it is consistent with the intent of the Act and will be of substantial assistance to the Commission to receive the comments of the joint state board regarding the proposed methodology."[133]

In reviewing that order, FERC found the earlier Commission's request for "comments" only to be evidence that "any determination by the board" was "far from controlling."[134]

In an earlier rulemaking, FERC declined to convene a joint state board to review the new methodology and saw "no compelling reason to do so," although recognizing its discretion to do so.[135] The necessary consultation with state officials was provided in BPA proceedings. FERC noted that it "appears. . .all affected parties had an opportunity to confer with the Administrator, to make their views known, and to try to affect the nature of the methodology."[136]

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[132] Pacific Northwest Electric Power Planning and Conservation Act, 17 FERC ¶ 61,005, 61,011 (1981).

[133] Id.

[134] Puget Sound Power & Light, 56 FERC, 61,469.

[135] FERC Statutes and Regulations, Regulations and Preambles 1982-1985 ¶ 30,601, 31,168 (1984).

[136] Id., 31,167.

Hence, consultation between state regulatory bodies and FERC concerning the development of the ASC methodology is limited, and FERC usually relies almost exclusively on BPA's "consultation" with the affected parties. FERC does, however, provide opportunity for parties to file comments on proposed methodologies but typically does not require a hearing.

While FERC has found that under section 9(g), "[t]he Commission must convene a joint state board when reviewing sales of power to BPA by an IOU,"[137] it has not considered this to be a mandatory provision and has not consistently invoked the mechanism or applied it.

FERC has generally invoked the mechanism only when it would "assist the Commission in its review" and concluded that this would not be the case if there were not any factual issues in dispute[138] or if the parties agreed upon a rate.[139] In either case, no hearing would be required. Hence, FERC decisions appear to have whittled away the apparently mandatory content of section 9(g), even for rates, and to have concluded that joint state boards are only required when they might contribute to the resolution of factual disputes at a hearing.

In support of its position, FERC has argued that, if the "shall" is interpreted to *require* it to establish a joint state board, the "Commission can never approve an ASC filing, even if there is no contest at all, without prior referral to a board."[140] In this case, FERC ultimately decided the case by deferring to BPA's determination that a joint state board was unnecessary.[141] The "Supreme Court ruled that because of Bonneville's expertise, involvement in drafting of the statute, and the technical complexities of the subject, `it is clear that [Bonneville's] interpretation of the [Northwest Power] Act is to be given great weight' and need only be a reasonable one to be

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[137] FERC Statutes and Regulations, Regulations Preambles 1982-1985 ¶ 30,601, 31,168 (1984).

[138] Pacific Power & Light Co., 28 FERC ¶ 61,143, 61,258 (1984).

[139] Puget Sound Power & Light Co., 55 FERC ¶ 61,075, 61,226 (1991).

[140] Puget Sound Power & Light, 56 FERC, 61,468.

[141] Id.

upheld."[142]

Further support for FERC's position that section 9(g) does not mandate the use of joint boards in all ASC rate cases is found in the legislative history of the Act. The reports of the Senate Committee on Energy and Natural Resources,[143] and the House Committee on Interior and Insular Affairs[144] indicate that FERC should encourage state participation in ASC rate determinations but not be required to convene a joint state board when it does not believe this would provide assistance.

One case in which the FERC did convene a joint state board to review a proposed ASC *methodology*, and then reconvened it to comment on the *rates* produced by the methodology, provides instruction regarding how the mechanism operates.[145] Affected state commissions were permitted to nominate new members to serve on the reconvened joint state board and submit their names to the Chairman.[146] FERC accepted the nominations and appointed the nominated individuals, reappointing an Administrative Law Judge as the Commission's representative on, and presiding federal member of, the board.[147] The board also had alternate members from each state.[148]

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[142] Id.

[143] "The Committee expects the Federal Energy Regulatory Commission to make maximum use of the State board." S. Rep. No. 96-272, 96th Cong., 1st Sess. 34 (1979).

[144] "This provision permits state regulatory participation in the review of rates that would otherwise not be subject to state jurisdiction." H.R. Rep. No. 96-976, Part II, 96th Cong., 2d Sess. 56 (1980).

[145] Portland Gen. Elec. Co., 30 FERC ¶ 61,161, 61,336 (1985).

[146] Id.

[147] Id.

[148] Id., 61,337, n. 2.

A subsequent replacement of one of the representatives required FERC to produce an additional order stating the appointment of a replacement.[149]

An earlier case, however, had revealed a fundamental disagreement within FERC as to how joint state boards should determine their own procedures. The majority, consistent with their view that the board would act as an assistant to the FERC, took a very narrow view of this authority. In consequence, FERC has generally micromanaged the procedure in joint boards. Commissioner Hughes, however, in a concurring opinion advocated "broad delegation" of procedural authority similar to that enjoyed by FERC Administrative Law Judges in order to convey the more pervasive and important role he believed that joint boards should play in FERC's implementation of its responsibilities under the Act.[150]

Also consistent with FERC's view that under the Act the role of the section 9(g) joint board is to aid in the FERC's own review responsibilities, is a clear statement of principle as to the scope of the board's authority. FERC "has reserved its right to set the scope of any joint state board's duties and authority. . .."[151]

However, its decision on this issue has not given much guidance about how this principle is to be applied in practice. FERC's general view is that the joint board's scope should be tailored to FERC's specific, discrete needs for assistance in a case. For instance, FERC has found that the board is not intended to reach extensive factual determinations. "It would be unduly burdensome and inefficient for the board members to be required to preside over several evidentiary hearings."[152] Instead, FERC expected the joint state board "to submit written comments on the record following the recommended decision and briefs on and opposing exceptions."[153]

This rather narrow view of the joint state board's potential function under section 9(g) is at

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[149] Id., 61,209 (1985).

[150] Puget Sound Power & Light Co., 17 FERC ¶ 61,185, 61,355 (1981).

[151] Puget Sound Power & Light Co., 56 FERC ¶ 61,124, 61,469 (1991).

[152] Pacific Power & Light Co., 28 FERC ¶ 61,143, 61,258 (1984).

[153] Id.

odds with the broader notion that arguably underlies the whole notion of the board and the motivation for Congress seeming to mandate or strongly encourage its use in FERC's ratemaking review under the Northwest Power Act. The notion is that the object of the board is to help mitigate any detrimental effects caused by the centralization of regulatory control created by the Northwest Power Act. That view was expressed in Commissioner Hughes' 1981 concurrence: "As the plan of the Pacific Northwest Act unfolds. . .we should seek the board's advice on developments within the region, information specific to individual utilities, and matters within the particular ken of the state regulators."[154] Because section 5(c) increases federal regulatory control, taking this power away from the states, Commissioner Hughes concluded that "we should welcome the continued input of the State Commissioners acting through the joint board."[155]

In summary, then, FERC does not implement the joint state board provision of section 9(g) to review all power sale rates under sections 5(c) and 6, notwithstanding section 9(g)'s apparently mandatory character. It exercises complete discretion in determining when the board will convene, the structure and procedures of the board, and the scope of the board's authority. However, FERC has yet to define the exact role of a board in the review of ASC-based rates beyond that its role is not to make extensive factual determinations.

Summary

Regional regulatory initiatives are not foreign to the electric sector and the FERC. As recently as 1992, a regional IRP initiative was before Congress, in part to address the states' and the Entergy regional holding company's dissatisfaction with the result of MP&L. As noted, this case left a double-edged regulatory gap: the FERC's lack of general authority over regional planning decisions, and the state commissions' position of no longer being able to conduct prudence reviews on the expenditures made pursuant to regional decisions. The Arkansas proposal was an effort to provide for regional planning with the assurance that prudently incurred

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[154] Puget Sound Power & Light Co., 17 FERC ¶ 61,185, 61,355 (1981).

[155] Id.

costs made pursuant to regional plans would be recovered. However, the Arkansas plan did not pass. Instead, the FERC staff suggested that a FERC forum or backstop is necessary to protect federal interests which might be affected by regional resolutions. These federal interests include the avoidance of anticompetitive behavior, undue burdens on interstate commerce, and undue discrimination.

The Northwest Power Planning and Conservation Council, is an example of regional regulation that was enacted and is successfully operating. However, the circumstances leading to the enactment of the Northwest Power Act are unique, resulting from the significant role of the BPA (a federal power authority in the region), the statutorily-created preference sale of cheap hydropower to public power companies, and high levels of regional power coordination. Concerns about power interruptions, ecological impacts of hydropower, and the dominance of the BPA in the 1970s led to a demand for the adoption of the Northwest Power Act. The complex provisions of the Act empower the Council to engage in regional power planning. The remainder of the Act carefully balances federal and state interests in ratemaking. The Act provides for FERC use of joint boards to review all BPA power sales rates. Yet, the FERC has exercised its discretion as to when and under what circumstances a joint board will be convened. Thus, regional initiatives in the electric sector have a mixed record, particularly concerning FERC support.

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CHAPTER 5

OTHER PERTINENT CASE STUDIES

As we have observed in earlier chapters, the American system of coordinate federalism provides a constitutional and legal framework within which many forms of cooperation among the states, as well as with the federal government, are not only possible but in many cases are essential.

The purpose of this chapter is to examine several additional schemes of regional interstate cooperation. The wide latitude of structural and procedural alternatives available for interstate regional cooperative action has resulted in so many permutations of cooperation that any specific example of cooperation is *sui generis*--unique to the circumstances of the subject matter of that particular arrangement and unlike other examples in many of its characteristics.

Categorization of regional arrangements is therefore difficult in the abstract. The discussion of illustrative examples provides a more effective analytical approach from which comparisons and contrasts allow a more meaningful basis for generalization.

Five specific case studies have been selected for examination. These have been chosen in order to demonstrate the breadth of the spectrum of alternatives. This spectrum might be viewed as ranging from the most informal cooperative information-sharing forum to the highly formalized autonomous interstate regulatory institution.

Informal arrangements may involve information sharing or joint study of issues of mutual interest among states, and perhaps the federal government. Persuasion and recommendations serve to stimulate others into action. More formal arrangements often include the ability of structured interstate institutions to legally bind participants through decisionmaking, to affect participants through regulation, and to implement and enforce decisions through the use of sanctions.

Each of the examples illustrates different purposes for cooperation, different relationships among the participating states, different types of relationships with and

roles of the federal government to cooperation, and many other distinguishing characteristics.

The examples chosen also illustrate the point that cooperation can be an evolutionary and dynamic process over time. Arrangements that begin informally may develop into increasingly more structured arrangements. Alternatively, arrangements that are limited in scope may find their purposes achieved, or overtaken by changes, so that they are no longer necessary.

Although the precise locus of each example on the continuum might be debated, they will be considered in the following order (beginning with the informal and moving to the more formal): (1) Chesapeake Bay regional actions, (2) regional telephone regulation, (3) Appalachian Regional Commission, (4) Metropolitan Washington Airports Authority and, (5) low-level radioactive waste compacts.

Following the discussion of each of the case studies, several summary observations will be made.

Chesapeake Bay Regional Actions

A particularly interesting case study is provided by a series of actions and interactions concerning environmental matters between and among the federal government and the states surrounding the Chesapeake Bay. Several regional entities have addressed one aspect or another of matters relating to the environmental status of the Bay. Some of these actions were narrowly-focused single-purpose efforts. Others attempted broader objectives. Despite significant cooperation among the pertinent governmental entities and proposals to create more formal regional entities, a single interstate institution has not emerged as the central forum for regional actions relating to the Bay. Instead, regional actions are characterized by many ad hoc interstate cooperative initiatives and by individual actions of neighboring states and the federal government. Chesapeake Bay regional efforts continue to evolve and thus provide a unique case study.

The environmental status of the Chesapeake Bay has been a concern of the federal government, the surrounding states, and the localities in the region for a long time. Broadly defined environmental interests in the Bay are the subject of at least partial jurisdiction of governmental agencies at the local, state, and federal levels.

As an example, the concern resulted in Congressional approval of the Potomac River Basin Compact in 1940.[1] The purpose of the program was to study pollution and water problems, to cooperate and promote pollution abatement laws among participants, to disseminate information, and to take nonregulatory actions to deal with the pollution problems of the Potomac River Basin.[2] Until the early 1980s, Maryland, Pennsylvania, Virginia, West Virginia, and the District of Columbia participated.[3] At that time, the larger focus on the Bay as a whole overtook the limited mission, budget, and membership of the Commission.[4]

In 1970, Congress directed the Environmental Protection Agency (EPA), in consultation with the Department of Interior, the Army Corps of Engineers, and the Commissioner of the District of Columbia to study and make recommendations concerning the water supply and waste management for the Washington, D.C. metropolitan area.[5] The resulting EPA report[6] recommended that some form of regional entity be established by interstate compact. The report recommended alternative forms of selection of representation from the localities surrounding

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[1] 54 Stat. 751 (1940), 33 U.S.C. § 567b.

[2] See, Article II of the Compact.

[3] The authority for the Compact was found at 31 Purdon's Pennsylvania Statutes § 741. Pennsylvania withdrew in 1981. See, D.C. Code 1981, §§ 7-1301, 7-1302; Virginia Code 1950, §§ 62.1-64 *et seq*.; West Virginia Code §§ 29-1C *et seq*. Maryland repealed its authority under § 8-301 of Annotated Code of Maryland by Acts 1987, ch. 234, effective July 1, 1987.

[4] In its discussion of Bay management options, EPA reviewed the Potomac River Basin Compact, but endorsed other options for regional interaction. See, "Chesapeake Bay: A Framework for Action," Environmental Protection Agency, September 1983, 175-76.

[5] Public Law 91-650, 84 Stat. 1930 (1970).

[6] "National Capital Region Water and Waste Management Report," Environmental Protection Agency, April 1971.

Washington, D.C.[7] Action was not taken to establish such an interstate entity.

In 1975, the EPA was authorized to begin the Chesapeake Bay Program.[8] The Program involved a five-year technical effort to identify and study pollutants and other factors threatening the environmental integrity of the Bay. The technical aspects of the study were completed in 1981 and in 1983 the information was assembled into a three-part EPA study on the Chesapeake Bay.[9]

While the technical study was being conducted, Maryland and Virginia made efforts to establish a tristate agreement which included Pennsylvania, to create the Chesapeake Bay Commission.[10] Pennsylvania did not pass the legislation to join. The Commission would have consisted of twenty-one members, seven from each participating state. Five members of each delegation would have been members of the state legislature. The Commission would have had a broad mandate to address problems of mutual concern relating to the Chesapeake, to promote intergovernmental cooperation, to encourage cooperation planning, and to make recommendations to the legislatures of the participating states.

The EPA study reviewed the proposed tristate agreement and several other possible interstate and regional institutions. The EPA study also examined the following: the Chesapeake Bay Commission, the Bi-State Working Committee for Chesapeake Bay and Coastal Areas of Maryland and Virginia, the Chesapeake Research Consortium, the Chesapeake Bay Research Board and Office of Chesapeake Bay Research Coordination, the Interstate Commission on the Potomac River Basin, the Susquehanna River Basin Commission, the Potomac River Fisheries

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[7] "Multistate Regionalism," report of the Advisory Commission on Intergovernmental Relations, April 1972, 151. An independent study made a similar recommendation. See, Hughes, *An Analysis of Alternative Institutional Arrangements for Implementing an Integrated Water Supply and Waste Management Program in the Washington Metropolitan Area* (Arlington, VA: Institute for Defense Analyses, 1971), 57.

[8] Public Law 94-116, 89 Stat. 581, 588 (1975).

[9] The three-volume EPA study included: "Chesapeake Bay Program: Findings and Recommendations," September 1983; "Chesapeake Bay: A Framework for Action," September 1983; and, "Chesapeake Bay: A Framework for Action--Appendices," September 1983.

[10] Annotated Code of Maryland § 8-302; and Code of Virginia § 62.1-69.5 *et seq*.

Commission, and the Atlantic States Marine Fisheries Commission.[11] The EPA study rejected the use of any of these institutions and recommended, instead, that a "management committee" comprised of two representatives each from Maryland, Pennsylvania, and Virginia and one representative from each federal agency be involved.[12]

Both Congress and the Reagan Administration decided to support the Chesapeake Bay Program's implementation by the EPA, under the Clean Water Act, and provided substantial funding under the Clean Water Act Amendments of 1983.[13]

In December 1983, at a conference on the Chesapeake Bay, an agreement was reached that became known as "The Chesapeake Bay Agreement of 1983." The Agreement began with this predicate:

> We recognize that the findings of the Chesapeake Bay Program have shown an historical decline in the living resources of the Chesapeake Bay and that a cooperative approach is needed among the Environmental Protection Agency (EPA), the State of Maryland, the Commonwealths of Pennsylvania and Virginia, and the District of Columbia (the States) to fully address the extent, complexity, and sources of pollutants entering the

[11] See, Appendix G--Existing Interstate Institutional Arrangements, "Chesapeake Bay: A Framework for Action--Appendices."

[12] "Chesapeake Bay: A Framework for Action," 174.

[13] See, John Warner and John Kindt, "Land-Based Pollution and the Chesapeake Bay," 42 *Washington and Lee Law Review* 1099 (1985): 1121-22.

> Bay. We further recognize that EPA and the States share the responsibility for management decisions and resources regarding the high-priority issues of the Chesapeake Bay.[14]

The Agreement provided for the establishment of a Chesapeake Executive Council to meet twice each year to assess and oversee water quality improvement plans for the Bay. The Council would consist of appropriate cabinet designees of the Governors, the Mayor of the District of Columbia, and the Regional Administrator of the EPA. The Council was directed to establish an implementation committee of state officials, who agreed to establish a liaison office for Bay activities at the EPA's Regional Laboratory in Annapolis, Maryland.[15]

Following the 1983 Agreement, the Executive Council began work on the development of a regional plan. In September 1985, a plan was presented to address the goals and objectives of the Chesapeake Bay restoration and protection effort.[16] The plan comprehensively described the federal and state goals, objectives, and strategies to be implemented. Efforts already underway, such as water quality improvements through sewerage treatment, and new initiatives, such as improved agricultural management practices, were delineated. Detailed elements of the plan included strategies in topical areas, such as nutrients, toxins, living resources, and other related areas. The plan identified both the specific efforts to be undertaken by the participating states, as well as efforts to be undertaken by the federal agencies involved (EPA, the Department of Agriculture, the Department of Defense), and others.

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[14] "Choices for the Chesapeake: An Action Agenda," Chesapeake Bay Conference Report (1983), 17.

[15] Id.

[16] "Chesapeake Bay Restoration and Protection Plan," Chesapeake Executive Council (September 1985).

Since 1985, the implementation of the plan has focused on the individual efforts of the states.[17] Maryland, for example, has passed extensive legislation and has created a state commission, the Chesapeake Bay Critical Area Commission, which has broad powers to establish a regulatory resource-protection program for the Bay and its tributaries.[18]

Cooperative actions relating to various aspects of the environmental status of the Chesapeake Bay have involved the use of several cooperative mechanisms and regional institutions. The EPA's role has been significant, probably because of the federal funding made available through the EPA to the region, and because of the EPA's role in administering several important environmental statutes on behalf of the federal government.

The significant federal interest relating to a wide range of issues affecting the Chesapeake Bay is underscored by at least fifteen major federal statutes addressing aspects of land-based or air-borne pollution affecting the Chesapeake Bay.[19] At the same time, fundamental sovereign state and local interests concerned with property rights, land-use and other matters have also become the focus of Bay clean-up activity. These competing interests have made the use of formal interstate regulatory institutions to deal with the environment of the Chesapeake Bay difficult. Instead, informal approaches relying upon various types of regional interaction and cooperation best-suited to permit the individual sovereign states and the federal government to undertake regulatory actions within their own spheres have been implemented.

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[17] See, Warner and Lee, "Land-Based Pollution and the Chesapeake Bay," 1122-25.

[18] See, Liss and Epstein, "The Chesapeake Bay Critical Area Commission Regulations: Process of Enactment and Effect on Private Property Interests," 16 *Baltimore Law Review* 54 (1986).

[19] See, Warner and Lee, "Land-Based Pollution and the Chesapeake Bay," 1099, 1118.

Activities of the U S WEST Oversight Committee

Regional regulation is an evolving practice of telecommunications oversight. The first-stage version began after the divestiture of AT&T's operating companies and the subsequent formation of seven regional holding companies. Several state commissions formed regional oversight committees. As mentioned earlier, two such committees currently monitor and review the activities of U S WEST and Ameritech local exchange companies. Next some of the activities associated with the operation of the U S WEST Regional Oversight Committee will be examined. Specifically, the committee-supported regulatory impact reviews (RIR) of U S WEST and U S WEST's Advanced Technologies subsidiary will be reviewed.

During the period 1990 to 1991, the U S WEST Regional Oversight Committee discussed the costs and benefits of conducting a review of the policies, procedures, and practices of the management and operation of U S WEST and Advanced Technologies, a U S WEST subsidiary providing research services. As a result of these discussions, Arizona, Iowa, and Oregon formed a steering committee, the Three-State Steering Committee (steering committee) to oversee the conduct of separate regulatory impact reviews (RIRs) for U S WEST and Advanced Technologies.[20] The language in the resulting request for proposals (RFP) clearly indicates that the steering committee believed it had a regulatory responsibility to assess the effectiveness and efficiency of the operation of the parent company that owns the local companies and the operation of unregulated subsidiaries when they provide services and products to the regulated local companies.

[20] The committee will: (a) manage and monitor the RIR; (b) select the consultant for the RIR; (c) define the purpose of RIR; (d) identify the RIR; (e) receive, review, accept and distribute the final RIR; and (f) conduct a post-review assessment.

The steering committee issued two separate RFPs on September 17, 1991 for the two RIRs.[21] These RFPs unequivocally establish that the steering committee intent is to examine the operations of U S WEST and Advanced Technologies for the purpose of establishing net benefits accruing to the customers of U S WEST's local exchange companies.[22] It also establishes that these benefits will be observed in the rate base and revenue requirements of U S WEST's regulated companies. Essentially the RFPs take on rate-case cost-of-service perspectives. Specifically, the steering committee wants to study: (a) the price paid by U S WEST's local exchange companies for the services provided by U S WEST and Advanced Technologies, (b) the need for these services, and (c) the level of managerial control exercised by U S WEST and Advanced Technologies to ensure that prices for their services are appropriate and that services developed and provided are clearly beneficial to the customers of U S WEST's local operating companies.

The RFPs also indicate the desirability of independent examinations and evaluations of U S WEST's and Advanced Technologies' management and operations. The independence of the consultant in these areas was important because the steering committee expected to receive supportable opinions, judgments, and recommendations for cost-effective improvements to U S WEST's and Advanced Technologies' cost-allocation procedures, management policies, and operations practices with respect to the services and products provided to regulated companies. In particular, the committee wanted independent estimates of the cost and savings associated with each recommendation.

These RFPs are examples of regional cooperation in the area of information accumulation

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[21] The Three-State Steering Committee of Arizona, Iowa, and Oregon, Request for Proposal for a Regulatory Impact Review of U S WEST, Inc., September 17, 1991. The Three-State Steering Committee of Arizona, Iowa, and Oregon, Request for Proposal for a Regulatory Impact Review of Advanced Technologies Inc., September 17, 1991.

[22] The steering committee intends to find out about: (a) services received by U S WEST's local exchange companies from U S WEST, Inc. and Advanced Technologies, Inc.; (b) the costs and impacts of these services; and (c) the strengths and weaknesses of U S WEST, Inc.'s and Advanced Technologies, Inc.'s policies, procedures, and practices regarding their cost allocation and operating systems.

and sharing. The preceding descriptions of elements of each RFP indicates that each of the fourteen states comprising the U S WEST Oversight Committee could have undertaken these tasks independently. Each state commission could have engaged the services of a different consultant, and each consultant could have asked different questions and focused on different elements of the relationships between a regulated subsidiary, an unregulated subsidiary, and the parent of both subsidiaries. Each state commission could have obtained different stacks and lists of *quantitative* information that described the cost allocation procedures, management policies, and operating-systems practices of U S WEST and Advanced Technologies, as they affect the individual local exchange companies. Each state commission could have used its independently obtained information for its individual rate-case and cost-of-service purposes. However, these fourteen states decided against this approach.

The costs and benefits of regional information accumulation and sharing are discussed in the RFPs. However, there are some statements in these RFPs that suggest why the regionalization of these efforts represents a sound economic decision. First, the committee realized that these RIRs can disrupt U S WEST's and Advanced Technologies' operations. Therefore, it has indicated in the RFPs that it will take steps to ensure that the consulting firm has devoted sufficient resources to allow the consultant to meet U S WEST's and Advanced Technologies' operating requirements. Second, the steering committee was interested in how costs are allocated between states. It may be that the steering committee's position of regional cooperation will provide better information in this area because having the costs allocated to each state in one place ensures that these costs will equal 100 percent. Third, the committee made decisions suggesting that the organizational and transactions costs associated with regional cooperation are less than the benefits achieved through this procedure. The committee was willing to establish a coordinating committee, comprised of representatives from U S WEST, Advanced Technologies, the steering committee, and the consultants to facilitate the exchange of information in addition to cooperation in the areas of timing and scope of an RIR.

Several firms responded to these RFPs, and the steering committee selected a consultant. The two RIRs were completed in mid-1992, and a final report was sent to the steering committee in August 1992. In this report, the consultant suggested that U S WEST be asked to develop and

submit a plan for implementing the recommendations contained in the report. This suggestion was acted upon, and U S WEST released its implementation plan in November 1992.

The consultant's report contains forty-three findings and conclusions and thirty-two recommendations. This suggests that the information available from U S WEST can be meaningfully interpreted and summarized. It also indicates that the consultant did not have difficulty obtaining the necessary information for its purposes. This observation suggests that U S WEST was cooperative.

We are not concerned with the details of the consultant's report beyond the general observations just made. Our purpose is to examine how regulatory agencies may cooperate with each other as they attempt to deal with the regulatory issues raised by a multistate firm or a regional holding company. The final report, as well as the implementation plan, has little to say in this regard. The report indicates that each state is free to continue its current regulatory policies. A state commission, for example, can interpret the report's findings and conclusions in its own unique regulatory context, and states are not under any obligation to adopt the consultant's recommendations. The latitude with which individual state commissions may use the report indicates that the task of setting regulatory policy is left to the state commissions who may act collectively or individually.

Appalachian Regional Commission

The Appalachian Regional Commission is an important case study because the Commission was the most preeminent of several regional economic-development commissions established by Congress.[23] Although the Commission had a formal existence and structure, its functions were investigatory and advisory. Its relationship with the federal government was largely defined by the special focus given to various program activities authorized and funded for the region by Congress. The Commission did not possess any sovereign regulatory powers and consequently needed no sanctioning authority. Instead the Commission relied upon political

[23] Other economic regional commissions were authorized by Title V of the Public Works and Economic Development Act of 1965, Public Law 89-136, 79 Stat. 551 (1965).

support at federal, state, and local levels.

Created by Congress in 1965,[24] the Appalachian Regional Commission operated until its legal authority expired in 1982.[25] During its existence the Commission's authority and federal programs relating to the Commission's activities were legislatively modified on several occasions.[26]

Early regional informal and cooperative concerns resulted in the creation of the Commission. One discussion of the origin of the Commission is summarized:

> During the fifties, continuing high unemployment existed in various parts of the country and area redevelopment and manpower retraining became the focal points of efforts, aimed chiefly at this chronic condition. The 1960 Presidential contest focused to some degree on these twin issues as well as on the special problems of Appalachia. Separate legislation was enacted in both program areas during the Kennedy Administration with Commerce and Labor administering the redevelopment and manpower programs, respectively.
>
> It required state initiative, however, to bring the multistate regional approach to the forefront. Beginning with efforts in eastern Kentucky in 1957, to a meeting of the Appalachian Governors in 1960, to participation on the President's Appalachian Regional Commission (PARC), the states involved developed and articulated a multistate position on their economic development *viz-a-viz* federal efforts and programs. The legislative proposals emanating from the PARC deliberations reflected this participation and this position.[27]

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[24] See, Appalachian Regional Development Act of 1965, Public Law 89-4, 79 Stat. 5 (1965).

[25] Because the authority of the Commission is now expired, for the purpose of convenience the Commission's authority will be referred to here as it was codified at the time of expiration in 40 U.S.C. App. §§ 1 *et seq*.

[26] For a complete overview of the legislative history see, "Summary and Analysis of the Legislative History of the Appalachian Regional Development Act of 1965 and Subsequent Amendments," Senate Committee on Environment and Public Works, Committee Print S. Prt. 99-14, 99th Cong., 1st Sess. (1985).

[27] "Multistate Regionalism," Report of the Advisory Commission on Inter-governmental Relations (April 1972), 202.

The President's Appalachian Regional Commission recommended a comprehensive approach to economic development in which a federal-state agency would serve as a kind of central clearinghouse.[28]

Thus, the support for the establishment of the Commission came from the participating states. From the federal perspective, the 1965 regional development legislation creating the Commission was viewed as a new experiment in federalism:

> The Appalachian Regional Development Act of 1965 was experimental in several respects. The creation of a federal-state commission to administer the program was an innovation in federalism. The enactment of a comprehensive development program tailored to the peculiar needs of the region was a departure from previous patterns of categorical federal assistance.[29]

The Commission consisted of the Governors of the states involved, eventually including thirteen states in the region, presided over by a federal Co-Chairman, appointed by the President with the advice and consent of the Senate; and a state Co-Chairman, selected by the Governors.[30] For the first two years, the expenses were paid by the federal government, thereafter the expenses were shared (half were paid by the federal government and half were paid by the participating states).[31]

The Commission was authorized to develop and coordinate economic plans, conduct and sponsor investigations, inventory regional resources, sponsor demonstration projects, review and study private programs, formulate and recommend interstate cooperation and compacts, encourage the formation of local development districts, encourage private investment, and serve

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[28] Id., 19-21.

[29] "Appalachian Regional Development Act Amendments of 1967," Report of the House Committee on Public Works, House Report No. 548, 90th Cong., 1st Sess. (1967), 1.

[30] 40 U.S.C. App. § 101.

[31] 40 U.S.C. App. § 105.

as a regional forum.[32] In addition, the Commission was given the express authority concerning the expenditure of funds at all levels, relating to natural resources, agriculture, education, training, health, welfare, and other matters.[33] To carry out these activities, the Commission was given broad administrative powers,[34] and powers to conduct hearings and investigations.[35]

Several federal agencies were given authority and funding to undertake specific activities in the region. The Secretary of Transportation was given authority to fund a "development highway system" on the basis of recommendations forwarded from the Commission.[36] Demonstration health projects were authorized through the Secretary of Health and Human Services.[37] The Secretary of Agriculture was authorized to undertake and fund a program of land stabilization, conservation, and erosion control.[38] In addition, the Department of Agriculture was authorized to assist in certain timber development.[39] The Department of Interior was authorized to assist in mining area restoration.[40] The Secretary of Housing and Urban Development was authorized to provide certain low- and middle-income housing assistance.[41] The Department of Education was authorized to provide financial assistance for vocational education facilities and

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[32] 40 U.S.C. App. § 102.

[33] 40 U.S.C. App. § 103.

[34] 40 U.S.C. App. § 106.

[35] 40 U.S.C. App. § 107.

[36] 40 U.S.C. App. § 201.

[37] 40 U.S.C. App. § 202.

[38] 40 U.S.C. App. § 203.

[39] 40 U.S.C. App. § 204.

[40] 40 U.S.C. App. § 205.

[41] 40 U.S.C. App. § 207.

demonstration projects,[42] and many other activities were authorized.

Through its first ten years, the Commission enjoyed much political support and its many accomplishments were often recounted.[43] By 1979, however, many issues had been raised about the continuing usefulness of the Commission.[44] A General Accounting Office study raised several fundamental questions about the special nature of the regional assistance being provided under the legislation.[45] This study suggested that some urban and metropolitan areas no longer needed special assistance, that state contributions to some activities such as highway funding had been reduced during the period of special federal assistance, and that planning activities on the part of the Commission were not sufficiently comprehensive or specific.[46] In 1982, the Commission's authority was permitted to lapse.

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[42] 40 U.S.C. App. § 211.

[43] See, for example, debate in connection with the Appalachian Regional Developments Act Amendments of 1975 on the House floor, 121 *Congressional Record* 15006 (1975).

[44] See, Osbourn, "Multi-State Economic Development Commissions: History and Background," Congressional Research Service Report to Congress 79-121 GOV (May 21, 1979).

[45] "Should the Appalachian Regional Commission be Used As a Model for the Nation?" U.S. General Accounting Office CED-79-50 (April 27, 1979).

[46] Id.

Nevertheless, the Commission serves as a good case study of an informal approach to regional affairs. The Commission was comprised of Governors who had considerable official authority on behalf of their sovereign states to act independently of the Commission. Their use of the Commission collectively advanced common issues and provided both a forum and a focus for special federal assistance. Although the special regional financial assistance could have been provided without the Commission, its existence undoubtedly provided additional federal focus on regional economic development issues.

Metropolitan Washington Airports Authority

The creation and operation of a single independent governmental authority to operate federally-owned airports in the Washington, D.C. area is an interesting case study in intergovernmental relations that continues to evolve amid much public controversy. In 1986, the Metropolitan Washington Airports Authority (MWAA) was established under federal law,[47] as the governing body over the Washington National Airport, located in Arlington, Virginia, and Dulles International Airport, located in Chantilly, Virginia.

Federal involvement in the Washington National Airport began in 1940 with the Congressional authorization of land acquisition and airport construction.[48] National Airport was owned and operated by the federal government, first by the Civil Aeronautics Agency in the Department of Commerce, and later by the Federal Aviation Administration, presently located in the U.S. Department of Transportation. Various proposals were made to operate the airport as a corporation beginning in the Truman Administration in 1948, and later supported by the Hoover Commission in 1949.[49] These efforts were unsuccessful, largely because of the competitive effect

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[47] Public Law 99-500, 100 Stat. 1783, (1986); and corrected by Public Law 99-591, 100 Stat. 3341 (1986); both of which were codified, 49 U.S.C. App. § 2451 *et seq*.

[48] 54 Stat. 686 (1940).

[49] See, Fischer, "Federal Ownership of National and Dulles Airports: Background, Pro-Con Analysis, and Outlook," Congressional Research Service Report to Congress 85-504 E (January

(continued...)

of Baltimore Friendship Airport (now Baltimore-Washington International Airport) and opposition to incorporation from the airlines and the General Accounting Office.[50] Congress authorized the construction, ownership, and operation of a second commercial airport to serve the region and Dulles International Airport was opened in 1962.[51]

In the mid-1980s, several events converged to create political support for a change in the federal proprietary role over the two airports.[52] In 1983, the President's Private Sector Survey on Cost Control conducted by the so-called "Grace Commission," recommended "defederalizing" Washington National and Dulles Airports through sale by the federal government at the appraised value of the airports. The recommendation was meant to resolve the conflicting role of proprietor and regulator, to reassert a local role in management of the airports, and to provide a more stable financial base of operations.[53]

(...continued)
11, 1985), 4.

[50] Id. See also, U.S. Department of Transportation, Federal Aviation Administration, "History of Past Activity Regarding Organizational and Financial Structure of the Metropolitan Washington Airports" (May 1984), 8.

[51] See, 64 Stat. 770 (1950).

[52] The most comprehensive overview of the background on the Metropolitan Washington Airports Authority is contained in "Proposed Transfer of Washington National and Dulles International Airports to a Regional Airports Authority," Hearing before the Subcommittee on Governmental Efficiency and the District of Columbia of the Senate Committee on Governmental Affairs, 99th Cong., 1st Sess. (1985), hereinafter "Senate Hearings."

[53] Testimony of Mark D. Mishler, Assistant to the President, DuBois Institutional Chemicals, Chemed Corporation and Representative of the Grace Commission, "Hearings," supra, 8-9; and see, excerpts from the Task Force Report on Privatization, "Hearings," supra, 202 *et seq*.

Secretary of Transportation, Elizabeth Dole, concluded that necessary capital improvements could not be financed for either of the airports unless control of the airports were transferred to a regional authority that had the power to provide adequate financing through the sale of tax-exempt bonds.[54] In June 1984, Secretary of Transportation Dole established the Advisory Commission on the Reorganization of the Metropolitan Washington Airports to further the consideration of a regional authority. The Commission was chaired by former Governor of Virginia, Linwood Holton, and became known as the "Holton Commission." After the completion of various studies and public hearings, the Commission issued a brief report in December 1984 that made key recommendations concerning the future control of the airports. It recommended that:

(1) The two airports be transferred to a single independent public authority, jointly created by Virginia and the District of Columbia, with the authority to issue tax-exempt revenue bonds to finance improvements.

(2) The airports be controlled by joint authority by means of a long-term lease with the federal government for nominal consideration.

(3) The governing board of the new authority should be comprised of eleven members serving staggered six year terms. Five members would be appointed by the Governor of Virginia, three by the Mayor of the District of Columbia, two by the Governor of Maryland, and one by the President, with the advice and consent of the Senate.

(4) The employees of the airports would be given pay and benefit protections.[55]

Several regional organizations, already existing and interested in the operation of the airports, became involved in the establishment of a regional authority.

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[54] See, Senate Report No. 99-193 (1985), 2.

[55] Senate Hearings, 317-76.

The Metropolitan Washington Council of Governments (COG), an informal alliance of local governments in the Washington, D.C. area, played an important role in supporting the creation of the new regional authority. The COG, established in 1957, is a joint agency of the District of Columbia and fifteen major local governments within the Maryland and Virginia portions of the Washington metropolitan area. It is administered by a Board of Directors comprised of twenty-two elected officials from local governments and members of the area's delegations to the Maryland and Virginia General Assemblies.

The COG coordinates the activities of the local governments in areas such as public safety, water and air quality, housing, human resources, community and economic development, and transportation. The COG received planning grants from the U.S. Department of Transportation.[56] The COG supported transfer of control over Washington National Airport and Dulles Airport to local control.[57]

The Greater Washington Board of Trade, a private sector organization interested in the economic development of the region, which had been extensively involved in the airport developments from the very beginning,[58] gave its support to the Holton Commission plan.[59] In an initial study prepared for the Holton Commission, a recommendation was made to create a commission using an interstate compact

[56] See, Letter from Secretary of Transportation Elizabeth Hanford Dole to Metropolitan Washington Council of Governments, dated March 26, 1985, reprinted in "Hearings," supra, 151.

[57] See, letter from the Metropolitan Washington Council of Governments to U.S. Senator Charles McC. Mathias, reprinted in "Hearings," supra, 130.

[58] "Hearings," 385-87.

[59] Id., 381-97.

commission, which was patterned after the Port Authority of New York and New Jersey.[60]

Thus, support for Secretary Dole's proposal for a regional commission was provided by several regional institutions interested in the airports.

Finding a workable and acceptable composition for the governing body of the regulatory authority proved, and continues to prove, difficult. The Holton Commission recommended that the members of the Board of Directors of the Authority should not also hold elective or appointive office. The Holton Commission recommendations encountered strong opposition in Congress, where members of Congress were concerned that the surrender of federal control might shift a significant amount of traffic from National Airport to Dulles.[61]

A Board of Directors was created as recommended by the Holton Commission. In order to retain some control, Congress superimposed on the Board of Directors a Board of Review, consisting of nine members of Congress, eight of whom were to be representatives of committees with jurisdiction over transportation and none of whom could be from Maryland, Virginia, or the District of Columbia. The Board of Review had disapproval authority over submitted proposals from the Board of Directors and other final decisionmaking powers.[62]

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[60] See, Report to the Advisory Commission on the Reorganization of the Metropolitan Washington Airports Concerning Financial Aspects of the Transfer of Dulles and National Airports, by Wheat, First Securities, Inc. and Salomon Brothers Inc. (November 29, 1984), reprinted in "Hearings," supra, 256.

[61] See "Hearings on H.R. 2337, H.R. 5040, and S. 1017 before the Subcommittee on Aviation of the House Committee on Public Works and Transportation," 99th Cong., 2d sess. (1986), 1-3, 22.

[62] See, the provisions of the Transfer Act that were codified, 49 U.S.C. App. § 2456(f).

The legislation that emerged from Congress, known as the "Transfer Act,"[63] vested the MWAA with broad powers over the acquisition, maintenance, improvement, operation, and promotion of the airports. Improvements, construction, acquisition of real property, and operating equipment were authorized to be accomplished through the issuance of bonds.[64] Protections for employees at the airports were set forth and authority to enter into labor agreements was provided.[65]

In March 1987, the Secretary of Transportation entered into a fifty-year lease of the two airports to the MWAA in exchange for annual rental payments of $3,000,000. In March 1988, the Board of Directors of the MWAA adopted a plan authorizing major new terminal construction at Washington National Airport which expanded the airport capacity. Shortly thereafter, the Board of Review met and permitted the expansion to become effective.

Concerns regarding the composition of the decisionmaking bodies of the MWAA quickly rose to the constitutional level and many commentators suggested constitutional problems with the legislation. A direct challenge to the constitutionality of the composition was brought to the U.S. Supreme Court in Metropolitan Washington Airports Authority v. Citizens for the Abatement of Aircraft Noise, Inc. by a citizens group supporting the reduction of operations at Washington National Airport and concerned about aircraft noise, air pollution, and airport operational safety.[66]

The Court concluded that the MWAA was sufficiently exercising federal powers, as an agent of the Congress, to require that separation-of-powers scrutiny was applicable. The presence of members of Congress on the Board of Review was found to have two constitutional flaws. First, it was seen as an unconstitutional effort on the part of Congress to exercise powers that were executive in nature; and second, it was found to be an improper effort to empower

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[63] Metropolitan Washington Airports Act of 1986, 100 Stat. 3341, 49 U.S.C. §§ 2451-2461.

[64] 49 U.S.C. § 2456(c).

[65] 49 U.S.C. § 2457.

[66] ___ U.S. ___, 111 S.Ct. 2298 (1991).

agents of Congress in derogation of bicameral and Presidential powers.[67]

In summarizing the significance of the Airports Authority case, one analyst made this observation:

> [The case will]. . .remain as a handy precedent by which future Congressional attempts to utilize state governments and private entities in implementing federal programs may be questioned.[68]

Following the Supreme Court's decision, Congress held hearings in an effort to review the infirmities of the original legislation.[69] Extensive testimony was given regarding corrective alternatives available to Congress. Following the hearings, Congress enacted amendments to the Airport Authority legislation as part of the Surface Transportation Act of 1991.[70] That legislation provided for a new Board of Review comprised of "individuals who have experience in aviation matters and in addressing the needs of airport users and who themselves are frequent users. . ." of the airports.[71] The Board of Review may now make recommendations to the Board of Directors (including negative recommendations on proposals initiated by the Board of Directors). If a recommendation of the Board of Review is not accepted by the Board of Directors, it becomes the subject of Congressional review through a process of joint resolution of disapproval.[72] In effect, the Board of Review remains supreme, subject to Congressional review.

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[67] This case is also analyzed in Chapter 3.

[68] Killian and Rosenberg, "The Airports Authority Case: Separation of Power Revisited," 12 *Congressional Research Service Review* 10 (September 1991), 12.

[69] See, "Amendments to the Metropolitan Washington Airports Authority Act of 1986," Hearing before the Subcommittee on Aviation of the House Committee on Public Works and Transportation, 102d Cong., 1st Sess. (1991).

[70] See, Title VII of Public Law 102-240, 105 Stat. 2197 *et seq*. (1991).

[71] See, 105 Stat. 2198 (1991).

[72] See, 105 Stat. 2198, 2199-2200 (1991).

There is little doubt that the unique proprietary role of the federal government[73] over the two airports, in contrast to local control of most commercial airports, raised many peculiar difficulties in the operation of the airports. The federal government also serves as the regulator of virtually all aspects of the safety of commercial aircraft operations, including air traffic control by the Federal Aviation Administration.

Yet, state and local control of some aspects of airport development and operation remains significant. In the area of airport noise regulation, for example, there has been a significant federal deference to jurisdiction of state and local authority.[74] In addition, federal responsibility for the District of Columbia gives Congress a special role as the regulator of local activity in the Washington area.[75]

National budgetary considerations in the operation of these local airports emphasize the conflict among these various federal responsibilities. An independent regional authority involving the governments of Virginia and the District of Columbia provides the opportunity to reduce the federal involvement. Because Congress is apparently unwilling to divest itself of involvement

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[73] U.S. Constitution, Art. IV, § 3, cl. 2 gives Congress the power ". . .to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States."

[74] See, City of Burbank v. Lockheed Air Terminal, Inc., 411 U.S. 624 (1973); British Airways Board v. Port Authority of New York and New Jersey, 558 F.2d 75 (2d Cir. 1977); British Airways v. Port Authority of New York and New Jersey, 564 F.2d 1002 (2d Cir. 1977); Global International Airways v. Port Authority of New York and New Jersey, 731 F.2d 127 (2d Cir. 1984); Global International Airways v. Port Authority of New York and New Jersey, 731 F.2d 127 (2d Cir. 1984); Arrow Air, Inc. v. Port Authority of New York and New Jersey, 602 F. Supp. (D.C.N.Y. 1985); and, City and County of San Francisco v. Federal Aviation Administration, 942 F.2d 1391 (9th Cir. 1991).

[75] Congress has had some experience in dealing with the local transportation affairs in the metropolitan area surrounding the District of Columbia through the use of interstate compacts. The Washington Metropolitan Area Transit Authority Compact provided for the construction and operation of the metropolitan subway system and the local bus system in Virginia, Maryland, and the District of Columbia. See, Washington Metropolitan Area Transit Commission Compact, Public Law 86-794, 74 Stat. 1031 (1960). For a history of the authorizing legislation see, "Washington Metropolitan Authority Compact Amendments," Hearing before the Subcommittee on Administrative Law and Governmental Relations of the House Judiciary Committee, 100th Cong., 1st Sess. (1988).

entirely, it has attempted to strike a balance in the structure of the decisionmaking authority that will govern the airports by sharing a role with Virginia and the District of Columbia.

The difficulty encountered in setting up the MWAA became a constitutional problem for Congress because of its reluctance to divest itself completely of review authority. Washington, D.C. and Virginia accepted the role of the Board of Review, as originally defined by Congress. The new review role for Congress is an effort to strike a new balance between federal interests on the one hand, and state and local interests on the other.

The scope of the powers of the MWAA does not encompass broad regulatory responsibility, even though the MWAA has broad powers confined to the operation of the two airports involved. The MWAA is not entirely independent owing to the review reserved to Congress.

Thus, the MWAA can be viewed as one important example of interjurisdictional cooperation containing formal, but limited, regulatory authority, subject to review by Congress.

Low-Level Radioactive Waste Compacts

The examination of the regional radioactive waste disposal compact regime offers a final case study that has the characteristics of attempting to use interstate compacts to accomplish regulation on a national basis. The mechanics of the regime involve formalized interstate arrangements for regional regulatory commissions vested with both sovereign powers from the participating states and from the federal government.

There is little doubt that Congress possesses adequate constitutional authority to totally preempt the field and regulate the disposal of radioactive waste throughout the nation under the Commerce Clause of the Constitution. Federal involvement in the licensing and control of nuclear materials is already considerable through the Nuclear Regulatory Commission. It has adopted regulations governing the licensing requirements for land disposal facilities of radioactive waste.[76] High level radioactive waste, the highly radioactive residue from spent nuclear fuel, is subject to

[76] See, 10 C.F.R. Part 61.

much more extensive federal regulation.[77]

In August 1980, the National Governors Association Task Force on Low-Level Radioactive Waste Disposal developed a proposal for the use of interstate compacts and recommended Congressional action.[78] Acting on the recommendation of the National Governors Association, Congress encouraged states to enter into regional compacts for the purpose of assuming the responsibility for the disposal of low-level radioactive waste generated within the regions. In that year, Congress enacted the Low-Level Radioactive Waste Policy Act.[79] The Act set forth a declaration of federal policy regarding the disposal of low-level radioactive waste:

> . . .each state is responsible for providing for the availability of capacity either within or outside the state for the disposal of low-level radioactive waste generated within its borders except for waste generated as the result of defense activities of the Secretary [of Energy] or federal research and development activities. . .and. . .low-level radioactive waste can be most safely and efficiently managed on a regional basis. . .[80]

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[77] See, "Civilian Radioactive Waste Management: Technical and Policy Issues," Congressional Research Service Report to Congress 91-867 ENR (December 10, 1991).

[78] See, 126 *Congressional Record* S. 10057-S. 10059 (Daily ed. July 29, 1980) (remarks of Senator Thurmond).

[79] Public Law 96-573, 94 Stat. 3347 (1980).

[80] Section 4(a) of Public Law 96-573, supra.

In order to facilitate the implementation of this policy, Congress provided in the 1980 Act that the "states may enter into such compacts as may be necessary to provide for the establishment and operation of regional disposal facilities for low-level radioactive waste."[81] The 1980 Act constituted, in legal effect, an invitation to the states to submit interstate compacts to Congress for its approval under the Compact Clause of the U.S. Constitution.[82] It is clear from the legislative history[83] of the 1980 Act that Congress viewed the right of waste exclusion to be an important federally-granted incentive for the states to enter into compacts, because the states could not constitutionally exclude radioactive waste from a region in the absence of federal legislation.

In 1978, the U.S. Supreme Court struck down a New Jersey statue prohibiting the importation into the state of most "solid or liquid waste which originated or was collected

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[81] Section 4(a)(2) of Public Law 96-573, supra.

[82] Article I, Section 10, Clause 3, which provides in pertinent part: ". . .no state shall, without the Consent of Congress. . .enter into any Agreement or Compact with another state. . .." See, Virginia v. Tennessee, 148 U.S. 503 (1893); New York v. O'Neill, 359 U.S. 1 (1959); New Hampshire v. Maine, 425 U.S. 363 (1976); and, United States Steel Corporation v. Multistate Tax Commission, 434 U.S. 452 (1978).

[83] The legislative history of the 1980 Act may be found in Senate Report 96-548, 96th Cong., 2d Sess. (1980); House Report 96-1382, 2 Parts, 96th Cong., 2d Sess. (1980). Debate on the floor of the Senate during original passage may be found at 126 *Congressional Record* S. 9970-S. 9990 (Daily ed. July 28, 1980); 126 *Congressional Record* S. 10000-S. 10010 (Daily ed. July 28, 1980); 126 *Congressional Record* S. 10050-S. 10068 (Daily ed. July 29, 1980); and, 126 *Congressional Record* S. 10239-S. 10273 (Daily ed. July 30, 1980). Debate on the floor of the House of Representatives during original passage may be found at 126 *Congressional Record* H.R. 11747-H.R. 11769 (Daily ed. December 3, 1980). Debate on the floor of the Senate during final passage may be found at 126 *Congressional Record* S. 16539-S. 16546 (Daily ed. December 13, 1980). Debate on the floor of the House of Representatives during final passage may be found at 126 *Congressional Record* H.R. 12494-H.R. 12497 (Daily ed. December 13, 1980).

outside the territorial limits of the state." In City of Philadelphia v. New Jersey,[84] the Court held that the prohibition of waste importation was an unconstitutional intrusion by New Jersey on the power of Congress to regulate interstate commerce. In adhering to a long-standing doctrine, the Court found an undue burden on interstate commerce without legitimate local concerns. Senator Strom Thurmond, leading Congressional proponent of the regional waste disposal compact approach, cited City of Philadelphia as a key obstacle to be overcome through interstate compact. Senator Thurmond reasoned that compacts containing regional waste exclusionary authority approved by Congress would provide the inducement for state participation in the compacts.[85] Following the enactment of the 1980 legislation, two separate U.S. Courts of Appeal applied City of Philadelphia in decisions disallowing exclusion of nuclear waste outside of the compact process.[86]

Clearly, the expectation of the 1980 Act was that the willingness of Congress to give, via interstate compacts, the power of waste exclusion to participating states would serve as an inducement to the states to voluntarily join compacts and accept regulatory responsibility for low-waste disposal. The 1980 Act provided that approved compacts could begin to restrict the use of regional waste facilities to the disposal of waste generated within a region as early as January 1, 1986.[87] The concept of regional compacts began to receive much attention, as several states began to consider legislation

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[84] 437 U.S. 615 (1978).

[85] See, 126 *Congressional Record* S. 10057-S. 10059 (Daily ed. July 29, 1980) (remarks of Senator Thurmond).

[86] Illinois v. General Electric Company, 683 F. 2d 206 (7th Cir. 1982), cert. denied, 461 U.S. 913 (1983); and, Washington State Building and Construction Trades Council v. Spellman, 684 F.2d 627 (9th Cir. 1982), cert. denied, 461 U.S. 913 (1983).

[87] Section 3(b) of Public Law 96-573, supra.

establishing regional compacts and presented these compacts to Congress for approval.[88]

Many issues were raised about compact approval, and Congress held several oversight hearings and many issues emerged around the question of Congressional consent to the compacts that had been submitted by various regions. Three regions, comprising nineteen states, that had submitted compacts for Congressional approval already had operational facilities for the disposal of low-level waste. The Southeast Compact had a facility at Barnwell, South Carolina; the Northwest Compact had a facility at Richland, Washington; and, the Rocky Mountain Compact had a facility at Beatty, Nevada. Not surprisingly, the existence of these sites raised tensions among the various proposed regions. The regions with sites believed that progress had not occurred quickly enough so that they could be relieved of the burdens of disposing of nonregional waste coming into their operational sites.[89] One remaining question is whether noncompacting states ("go-it-alone" states) have the right to exclude waste under the Interstate Commerce Clause.[90]

In 1985, Congress addressed the difficulties by passing legislation that approved the compacts submitted by states in seven regions, subject to several new procedures and conditions.[91] Among the new conditions imposed on the compacts was a series of "milestone"

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[88] See, "An Analysis of Regional Interstate Compacts for the Disposal of Low-Level Radioactive Wastes," 5 *Journal of Energy Law & Policy* 21 (1983); Kearney and Stucker, "Interstate Compacts and the Management of Low-Level Radioactive Waste," 45 *Public Administration Review* 218 (1985); Note, "Glowing Their Own Way: State Embargoes and Exclusive Waste-Disposal Sites Under the Low-Level Radioactive Waste Policy Act of 1980," 53 *George Washington Law Review* 654 (1985); and, Robert Poling, "Regional Perspectives in Energy Regulation," 2 *Bell Atlantic Quarterly* 45 (1984).

[89] See, 131 *Congressional Record* 38421 (December 19, 1985) (remarks of Senator Mitchell).

[90] Campbell, "State Ownership of Hazardous Waste Disposal Sites: A Technique for Excluding Out-of-State Waste?" 14 *Environmental Law* 177 (1983); and, David Condon, "The Never Ending Story: Low-Level Waste and the Exclusionary Authority of Noncompacting States," 30 *Natural Resources Journal* 65 (1990).

[91] Public Law 99-240 (1986), supra.

requirements coupled with an escalating fee system for out-of-region waste.[92] Perhaps most significant was a new so-called "take title" deadline which provided as follows:

> If a state (or, where applicable, a compact region) in which low-level radioactive waste is generated is unable to provide for the disposal of all such waste generated within such state or compact region by January 1, 1996, each state in which such waste is generated, upon the request of the generator or owner of the waste, shall take title to the waste, be obligated to take possession of the waste, and shall be liable for all damages directly or indirectly incurred by such generator or owner as a consequence of the failure of the state to take possession of the waste as soon after January 1, 1996, as the generator or owner notifies the state that the waste is available for shipment.[93]

This provision created much Congressional concern at the time of passage. Congressman Edward Markey specifically raised constitutional concerns about the "take title" provisions of the legislation and the potential imposition of liabilities on the states:

> One of the more controversial provisions in the Senate bill relates to states assuming title and liability for waste in 1996 and to require states to reimburse generators for surcharges. I have requested the Congressional Research Service to study the constitutionality of such a requirement. Their findings, in a study[94] dated December 16, 1985, found that these provisions raise constitutional issues under the 10th and 11th amendments. I agree. I cannot recall any statute which has ever sought to impose such a liability on states. The provision may not pass a constitutional challenge and if it should, I would expect the interpretation of liability to be construed extremely narrowly, and not broadly as some may contend. [Citation not in original.][95]

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[92] See, Section 5(d) of Public Law 99-240, 99 Stat. 1842, 1849-1852 (1986).

[93] Id., 99 Stat. 1891 (1986).

[94] Robert Poling, "Constitutional Issues Raised By the Imposition of Liabilities on the States Under a Proposed Amendment to the Low-Level Radioactive Waste Policy Act of 1980," Congressional Research Service Memorandum (December 16, 1985).

[95] 131 *Congressional Record* 38177 (December 19, 1985) (remarks of Congressman Markey).

The enactment of the legislation marked the abandonment by Congress of the simple incentive of regional exclusivity and the imposition of new federally-sanctioned economic coercion with the ultimate sanction of mandated state liability for waste disposal.

Today, nine regional compacts have been established through the enactment of laws by the participating states adopting the regional compacts, and through Congressional approval.[96]

[96] Unless otherwise indicated, Congressional approval of each compact was provided for under the Low-Level Radioactive Waste Policy Amendments Act of 1985, Public Law 99-240, 99 Stat. 1842 (1986).

The Appalachian regional compact is presently comprised of four states: Delaware, Maryland, Pennsylvania, and West Virginia. The Central regional compact is presently comprised of five states: Arkansas, Kansas, Louisiana, Nebraska, and Oklahoma. The Central Midwest regional compact is presently comprised of two states: Illinois and Kentucky. The Midwest regional compact is presently comprised of six states: Indiana, Iowa, Minnesota, Missouri, Ohio, and Wisconsin. The Northeast regional compact is presently comprised of two states: Connecticut and New Jersey. The Northwest regional compact is presently comprised of eight states: Alaska, Hawaii, Idaho, Montana, Oregon, Utah, Washington, and Wyoming. The Rocky Mountain regional compact is presently comprised of four states: Colorado, Nevada, New Mexico, and Wyoming. The Southeastern regional compact is presently comprised of eight states: Alabama, Florida, Georgia, Mississippi, North Carolina, South Carolina, Tennessee, and Virginia. The Southwestern regional compact is presently comprised of four states: Arizona, California, North Dakota, and South Dakota. Nine states not affiliated with compacts include: District of Columbia, Maine, Massachusetts, Michigan, New Hampshire, New York, Rhode Island, Texas, and Vermont.

Although there are many similarities among the regional compacts, each is unique. All the compacts contain a nonregional waste exclusion provision. The compacts generally establish the procedure for the appointment of the membership of an interstate commission by the participating states and empower the commissions to designate the states in which disposal sites will be located. Participating states are generally bound by the decisions, although a state selected to "host" a site generally retains the ability to regulate site selection and facility construction and operation under its own laws.

The site selection process was difficult and controversial. The progress of the regions and states with operational sites to construct and begin operation of waste disposal facilities remains slow, raising continuing concern about the impending 1996 "take title" deadline.[97] Not surprisingly, the "take title" provisions of the 1985 legislation have become the focus of significant legal controversy.[98]

In a suit brought by the State of New York, a direct constitutional challenge to the "take title" provisions was brought before the Supreme Court.[99] At issue was the question of whether the "take title" provisions of the 1985 legislation constituted an intrusion into the domain of reserved powers of the states under the Tenth Amendment to the Constitution.[100] The Supreme Court held that the "take title" provisions violated the Tenth Amendment. However, it severed the "take title" provisions from the remainder of the legislation and allowed the compacts to stand. The waste exclusionary

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[97] "Nuclear Waste--Slow Progress Developing Low-Level Radioactive Waste Disposal Facilities," U.S. General Accounting Office Report to the Chairman, Committee on Governmental Affairs, U.S. Senate, GAO/RCED-92-61 (January 1992).

[98] Dan Berkovitz, "Waste Wars: Did Congress `Nuke' State Sovereignty in the Low-Level Radioactive Waste Policy Amendments of 1985?" 11 *Harvard Environmental Law Review* 437 (1987).

[99] New York v. United States, ___ U.S. ___, 60 U.S.L.W. 4603 (June 19, 1992).

[100] For a more extensive discussion see Chapter 3.

authority of the compact regions and the economic incentives of the regional scheme remain vital.[101]

Whether the valid residuum of the regional scheme will provide an effective means of inducing a workable regional approach remains to be seen. As originally conceived, the compact process involved the combination of both federal and state sovereign powers in formal regional regulatory bodies able to exercise considerable authority independent of the participating states. As an alternative to the more onerous option of federal preemption of any role of states in the radioactive waste disposal process, the regional scheme implemented on a national basis had much appeal.

Obviously, as with the case of the litigation involving the Metropolitan Washington Airports Authority, a number of remedial alternatives are available to Congress if it should decide that the regional approach has become infirm in the aftermath of New York v. United States.

The difficulties encountered so far in achieving the expectations for the low-level regime point up a fundamental difficulty with regional regimes: the natural inequities of states in resources, needs, and circumstances may be exacerbated at the regional level to such a degree that only national action may permit resolution. Nevertheless, the regional approach to low-level waste serves as an important case study.

Summary

As shown by the example of the Chesapeake Bay Regional actions, the U S WEST Oversight Committee activity, the Appalachian Regional Commission, the Metropolitan Washington Airports Authority, and the Low-Level Radioactive Waste Compacts, regional regulation comes in a variety of forms from less formal to more formal. Further regional regulation can evolve over the continuum as is needed. Regional regulation is an evolutionary and

[101] The value of the waste exclusionary authority to the states was recently enhanced by the Supreme Court in its ratification of the holding of the City of Philadelphia v. New Jersey, 437 U.S. 615 (1978) in two cases involving waste: Chemical Waste Management, Inc. v. Hunt, ___ U.S. ___, 60 U.S.L.W. 4433 (June 1, 1992); and, Fort Gratiot Sanitary Landfill v. Michigan Natural Resources Department, ___ U.S. ___, 60 U.S.L.W. 4438 (June 1, 1992).

dynamic process that can include informal information sharing and planning or formal decisionmaking authorities. A discussion of the continuum of forms that regional regulation might take is discussed later in the report in Part III.

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CHAPTER 6

THE FERC, THE FCC, AND REGIONAL REGULATION

FERC Joint Proceeding Practices

As we have seen, a partial explanation for the lack of regional regulation stems from jurisdictional limitations on state authority. The states alone may not act to regulate the interstate sale and transmission of electricity.[1] Indeed, the states' authority to coordinate construction and price electricity purchased in interstate transactions is highly circumscribed.[2] Thus, formal coordinated efforts have resulted only from extraordinary measures such as interstate compacts.[3] The other part of the explanation, however, is more problematic. The use of extraordinary measures may be necessary in part because of the Federal Energy Regulatory Commission's (FERC) consistent refusal to use the authority provided to it to deal with problems on a regional basis.[4]

Despite repeated requests from the states for FERC to exercise its statutory authority to appoint joint boards or conduct joint hearings, the FERC has claimed interstate matters are solely within its own jurisdiction. Interpretive criticism suggests that the policy is not consistent with the Commission's legislative mandate. However, political considerations may also be relevant to the Commission's approach. The failure of the FERC to use regional boards may reflect some

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[1] Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric Co., 273 U.S. 83 (1927).

[2] Mississippi Power and Light Co. v. Mississippi, ex. rel Moore, 487 U.S. 354 (1988) (state may not review the prudence of the decision to continue construction of nuclear power plant owned by member of interstate holding company); Nantahala Power and Light Co. v. Thornburg, 476 U.S. 953 (1986) (state commission may not reallocate the power sales ordered by the FERC).

[3] Interstate compacts are authorized when approved by Congress. U.S. Const. art. 1, § 10, cl. 3. The Pacific Northwest Planning and Conservation Council is an example of a compact agency. See Chapter 5.

[4] See subsequent footnotes 54-94 and accompanying text.

concerns about the political realities of regional decisionmaking.

The Limits on the States

As a result of Supreme Court decisions limiting state regulation of interstate gas and electricity sales, the power to regulate is limited to some form of federally approved action. The experience with interstate electricity sales is instructive. Part II of the Federal Power Act (FPA) primarily concerns the regulation of interstate transmission and wholesales of electricity. Its adoption in 1935 was responsive to the lack of regulation that would have otherwise occurred because of the Supreme Court's Attleboro decision. In that case, the Rhode Island Commission sought to set the wholesale rates of electricity sold by a Rhode Island electric company to a Massachusetts electric retailer.[5] The Court concluded that the transaction involved interstate commerce, although the title to the electricity was transferred at the state line.[6] This determination precluded state regulation. Thus, "if such regulation [was] required it [could] only be attained by the exercise of power vested in Congress."[7]

At the same time that the states lost their regulatory authority, the perceived need for regulation of interstate sales increased. The legislative history of the 1935 Act in

[5] Attleboro Steam & Elec. Co., 273 U.S. at 84.

[6] Id., 86. ("The transmission of electric current from one state to another, like that of gas, is interstate commerce,. . .and its essential character is not affected by a passing of custody and title at the state boundary, not arresting the continuous transmission to the intended destination.")

[7] Id.

both the Senate and the House noted an increase in interstate sales from 10.7 percent in 1928 to 17.8 percent in 1933.[8]

Congress' decision to enact the Public Utilities Holding Company Act created further impetus for the creation of a federal power authority. Reacting to the perceived ills created by the national holding companies, Congress required that these large corporations divest into smaller, regionally and economically related entities.[9] Though smaller, the remaining holding companies would be multistate entities whose transactions in interstate commerce were outside state regulation.

Part II Regulation

Both the Natural Gas Act and Part II of the FPA filled the gap in regulation caused by the Supreme Court decisions. At the same time, they provided some political participation in the decisionmaking process for the states. Again, federal regulation of electricity is instructive.[10] Part II regulation reflects an interesting compromise. First, the provisions attempt to fill the gap left by the Attleboro decision. Second, they do not require interstate transactions but provide a forum to encourage voluntary regionalization of the electric grid.[11] Finally, the FPA provides for state involvement in federal decisionmaking.

First, Part II assumes a bifurcation of regulatory authority. Section 824(b)(1) of Title XVI

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[8] S. Rep. No. 621, 74th Cong., 1st Sess. 17 (1935); H.R. Rep. No. 1318, 74th Cong., 1st Sess. 7 (1935).

[9] 15 U.S.C. § 79k(b) (1988).

[10] The Federal Power Act and Natural Gas Act contain an identical provision for joint proceedings. For simplicity and clarity, reference is made to the provisions contained in the Federal Power Act.

[11] This position remains essentially accurate even after the adoption of the 1978 amendments found in the Public Utilities Regulatory Policy Act. The wheeling and interconnection requirements are so heavily qualified as to preclude the FERC from directing a program of involuntary national coordination except on an emergency basis. See, Megan A. Wallace, "A Negotiated Alternative to Mandatory Wheeling," 10 *Energy Law Journal* (1989): 99, 100-03.

provides that "Federal regulation. . .extend[s] only to those matters which are not subject to regulation by the states."[12] Section 824(b)(2) states, "The provisions of this Part shall apply to the transmission of electric energy at wholesale in interstate commerce, but shall not apply to any other sale of electrical 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."[13] Thus, the operative language of the statute separates state and federal jurisdiction, leaving to the states the obligation to set local or retail rates.

The legislative history of the FPA reinforced the Congressional goal to retain local control of local rates. The Senate Report, for example, stated that the purpose of the Act was to regulate the increasingly large and important interstate market that the states could not regulate because of constitutional limitations on their powers.[14] Senate revisions of a House proposal aggressively followed that course.[15] The House later agreed and reinforced this message.[16] The section-by-

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[12] 16 U.S.C. § 824(b)1) (1988).

[13] Id. § 824(b)(2).

[14] S. Rep. No. 621, supra note 8, 17.

[15] Id., 18, states:

> The revision has also removed every encroachment upon the authority of the states. The revised bill would impose federal regulation only over those matters which cannot be effectively controlled by the states. The limitation on the Federal Power Commission's jurisdiction in this regard has been inserted in each section in an effort to prevent the expansion of federal authority over state matters.

The sectional analysis of the report further states, "The ratemaking powers of the Commission are confined to those wholesale transactions which the Supreme Court held in [Attleboro] to be beyond the reach of the states." Id., 48.

[16] H.R. Rep. No. 1318, supra note 8, 7-8, states:

> [T]he Commission is given no jurisdiction over local rates even where the electric energy moves in interstate commerce. . .. The bill takes no authority from state commissions. . .. The new parts are so drawn as to be a complement to and in no sense a usurpation of state regulatory authority and contain throughout directions

(continued...)

section analysis of the House committee report stated, "As in the Senate bill no jurisdiction is given over local distribution of electric energy, and the authority of states to fix local rates is not disturbed even in those cases where the energy is brought in from another state."[17]

The bifurcated structure complicated the second goal of the FPA, the encouragement of interconnection. In section 824b, the Commission is authorized to coordinate (but not mandate) interstate sales and transmission.[18] The Senate Report gives an interesting policy justification for structuring the provision this way:

> Under this subsection the Commission would have authority to work out the ideal utility map of the country and supervise the development of the industry toward that ideal. The committee is confident that enlightened self-interest will lead the utilities to cooperate with the Commission and with each other in bringing about the economies which can also be secured through the planned coordination which has long been advocated by the most able and progressive thinkers on this subject.[19]

After a statement of legislative purpose consistent with the Senate Report's stated goal, the section directs the Commission to divide the country into regional districts for the voluntary interconnection and coordination of facilities for the generation, transmission, and sale of electric

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(...continued)

> the Federal Power Commission is to receive and consider the views of state commissions. Probably, no bill in recent years has so recognized the responsibilities of state regulatory commissions as does Title II of the bill.

[17] Id., 27. The Senate Report similarly states, "This subsection leaves to the states the authority to fix local rates even in cases where the energy is brought in from another state." S. Rep. No. 621, supra note 8, 48.

[18] 16 U.S.C. § 824a (1988). As a result of the changes initiated by executive order following the adoption of a reorganization plan, the Commission's authority was transferred to the Department of Energy. See, Charles Stalon, "Regional Supply Planning, Federal Authority and State Regulation--Thinking through the Jurisdictional Maze," 38 *Administrative Law Review* 327, 338 (1986).

[19] S. Rep. No. 621, supra note 9, 49.

energy."[20]

Once interconnected, utilities are subject to numerous provisions for the calculation and implementation of rates that the Commission controls. The primary provisions concern the determination of rates. Section 824d provides that rates must be just and reasonable, that there be no undue preferences, and that rates be filed.[21] Section 824e provides a mechanism for adjusting rates determined to be unjust or discriminatory and refunding overpayments.[22]

Despite the significant federal powers created by the FPA, Congress repeatedly required federal-state coordination. First, the states are given an advisory role in the process of setting the regions for interconnection. The legislative history is clear, "In this subsection, as elsewhere throughout the Title, the Commission is directed to secure and consider the views and recommendations of state commissions before establishing regional districts."[23] Second, Congress directed the Commission to provide assistance to the states for the determination of rates subject to state jurisdiction.[24] As the Senate Report explained, the section was included to assist the

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[20] Id. § 824a(a). The section continues:

> It shall be the duty of the Commission to promote and encourage such interconnection and coordination within each such district and between such districts. Before establishing any such district and fixing or modifying the boundaries thereof the Commission shall give notice to the state commission of each state situated wholly or in part within such district, and shall afford each such state commission reasonable opportunity to present its views and recommendations, and shall receive and consider such views and recommendations.

[21] 16 U.S.C. § 824d (1988). The section further provides that rates may not be changed except upon notice and provides for a suspension period before rates are effective. Id. §§ 824d(d) and (e).

[22] Id. § 824e.

[23] H.R. Rep. No. 1318, supra note 8, 27. See, also, S. Rep. No. 621, supra note 8, 49.

[24] 16 U.S.C. § 824e(d) (1988) provides:

> The Commission upon its own motion, or upon the request of any state

(continued...)

states in making rate determinations in cases in which the property may be in several states.[25] The clear intent appears to be to maintain an effective state ratemaking through federal assistance.

The most dramatic concession to the states was the provision of joint boards under which the federal commission could delegate its authority to the states. The FPA recognizes three forms of joint proceedings. In section 824h(a), the federal commission may delegate its authority to one or more states that are or might be affected by any

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> commission whenever it can do so without prejudice and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction in cases where the Commission has no authority to establish a rate governing the sale of such energy.

[25] S. Rep. No. 621, supra note 8, 51, states:

> Since the ratemaking powers granted to the Commission apply only to the wholesale rates of energy sold in interstate commerce, this last subsection should be of great benefit in removing the practical difficulty which the states may encounter in regulating the interstate distribution rates which are left under their control. Such rate regulation involves the examination and valuation of property outside the state. The task is one requiring an agency with a jurisdiction broader than that of a single state. The authority of the Federal Commission is to render assistance to the state commissions in a way which would preserve and make more effective the jurisdiction which is left to the states.

matter.[26] Under this provision, the board operates as though it were the federal authority. The alternative forms are joint hearings or conferences found in section 824h(b). Under this section, the FERC may confer with the affected states or "hold joint hearings with any state commission in connection with any matter with respect to which the Commission is authorized to act."[27] The first form provides the authority to decide interstate matters and the latter two offer increased coordination of efforts within the jurisdictional authority of each commission.

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[26] 16 U.S.C. § 824h(a) (1988) provides:

> The Commission may refer any matter arising in the administration of this subchapter to a board to be composed of a member or members, as determined by the Commission, from the state or each of the states affected or to be affected by such matter. Any such board shall be vested with the same power and be subject to the same duties and liabilities as in the case of a member of the Commission when designated by the Commission to hold any hearings. The action of such board shall have such force and effect and its proceedings shall be conducted in such manner as the Commission shall by regulations prescribe. The board shall be appointed by the Commission from persons nominated by the state commission of each state affected or by the Governor of such state if there is no state commission. Each state affected shall be entitled to the same number of representatives on the board unless the nominating power of such state waives such right. The Commission shall have discretion to reject the nominee from any state, but shall thereupon invite a new nomination from that state. The members of a board shall receive such allowances for expenses as the Commission shall provide. The Commission may, when in its discretion sufficient reason exists therefore, revoke any reference to such a board.

[27] Id. § 824h(b), in full, provides:

> The Commission may confer with any state commission regarding the relationship between rate structures, costs, accounts, charges, practices, classifications, and regulations of public utilities subject to the jurisdiction of such state commission and of the Commission; and the Commission is authorized, under such rules and regulation as it shall prescribe, to hold joint hearings with any state commission in connection with any matter with respect to which the Commission is authorized in the administration of this chapter to avail itself of such cooperation, services, records, and facilities as may be afforded by any state commission.

The legislative history provides an explanation for these provisions. In the case of subsection (a) of section 824h, the Senate Report states, "This subsection is designed to permit decentralized administration under the general supervision of the Commission by individuals who are acquainted with the situation and the problems of the locality affected by the particular proceeding."[28] Likewise, Congress directed in subsection (b) that the FERC avail itself of the cooperation offered by the states.[29]

The joint proceedings in various forms present a most interesting coordination of federal and state action because they place the parties in direct authoritative relationships with one another. Under a delegation of authority, the state board would act as an agent of the FERC and be subject to its approval.[30] Alternatively, joint hearings provide a forum for coordinated receipt of evidence and the opportunity for coordinated decisionmaking.[31]

FERC Rules and Practice

Despite the Congressional interest in federal-state coordination, the current rules and practice of the FERC do not support the use of joint proceedings. The rules provide significant qualifications. Likewise, the FERC has refused to use the joint board on the many occasions on which states have requested it. The reasons for denying use of the board have been diverse and inconsistent. As a result, the use of authoritative joint boards[32] is nearly nonexistent in practice.

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[28] S. Rep. No. 621, supra note 8, 52.

[29] H.R. Rep. No. 1318, supra note 8, 30.

[30] The FERC may terminate the delegation as a matter within its own discretion. 16 U.S.C. § 824h (1988) (last sentence).

[31] The possibility of parties telling different stories to different regulators obviously would be impossible under this scenario.

[32] The term "authoritative" to qualify this statement is used because the FERC has used boards several times in a recommendatory capacity.

Commission Rules[33]

The FERC has adopted several rules defining its cooperation with the state commissions. In section 1301 of its rules,[34] the Commission, following the legislative mandate, recognized three forms of joint activity: reference to the states, conferences, and joint hearings. The subject matter for these activities could be quite extensive. According to the rule, "[i]t is understood. . .that the Commission or any state commission will freely suggest cooperation with respect to any proceeding or matter affecting any public utility or natural gas company subject to the jurisdiction of the Commission and of a state commission, and concerning which it is believed that cooperation will be in the public interest."[35]

After stating this broad purpose, the rules set out some straightforward notice requirements to initiate a joint proceeding.[36] In any proceeding, the FERC must give notice to the affected states of the filing and provide the states an opportunity to suggest the use of a joint proceeding.[37] If a state suggests a cooperative proceeding, it also must indicate if it has a pending proceeding before it concerning the same matter.[38] The FERC then is authorized to determine if the proceeding should go forward in some sort of cooperative manner.[39] Likewise, the states are directed to notify the FERC of a filing before a state commission that may be of interest to the

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[33] The rules concerning cooperation with the states were adopted without substantive change from the prior rules of the Commission in Order 225, 1981-1982 Util. L. Rep. FERC (CCH) ¶ 5944 (1982).

[34] 18 C.F.R. § 385.1301 (1991).

[35] Id. § 385.1301(b).

[36] Id. § 385.1302 (1991).

[37] Id. § 385.1302(a).

[38] Id. § 385.1302(a)(2).

[39] Id. § 385.1302(a)(3).

FERC.[40] Upon receipt, the FERC can suggest to the state the use of cooperative procedures.[41] If a cooperative proceeding is initiated, then the FERC and states are directed to notify other affected states.[42]

The rules then make a quick turn by stating that authoritative uses are limited. Rule 1303 states the Commission's preference for informal conferences.[43] In a policy statement within the rule, the FERC opines that its experience with informal conferences suggests the benefits of such an approach.[44]

In section 1304, the Commission states that joint state boards are extraordinary proceedings. According to the Commission, "It is believed that the statutory provisions of sections 209 [16 U.S.C. § 824h] and 17 [16 U.S.C. § 717], respectively, of the FPA and Natural Gas Act, for the reference of a proceeding to a board constituted as therein provided, were designed for use in unusual cases, and as a means of relief to the Commission when it might find itself unable to hear and determine cases before it, in the usual course, without delay."[45] Consistent with the statute, the rule concludes that the Commission also retains complete control of the proceedings, their subject matter, and their legal effect.[46]

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[40] Id. § 385.1302(b)(1).

[41] Id. § 385.1302(b)(2).

[42] Id. § 385.1302(c).

[43] Id. § 385.1303 (1991).

[44] Id. The rule is laden with ambiguity. The FERC does not concretely identify the supposed experience it is relying on. It does indicate that it intends the conferences to afford for more consistent regulation and a means for the states to secure the federal assistance promised them in the Natural Gas Act and FPA.

[45] Id. § 385.1304(a) (1991).

[46] Id. § 385.1304(b).

If the FERC ordered the creation of a board, it would issue notice to each state that would be affected by the decision. The notice would specify the number of members to serve on the board with each state being equally represented. The FERC also would specify the functions of the board. Once the states had nominated their representatives, then the Commission would issue an order referring a particular matter to the board and establish the time and place for a hearing. The Commission's rules of practice would govern the hearing.[47]

Finally, section 1305 provides for joint hearings.[48] The rule recognizes two forms of joint hearings. In one kind, state commissions receive information or act in an advisory capacity. In the second, state and federal commissions concurrently hear evidence. In the rule, the Commission states a preference for a concurrent hearing.[49] Consistent with that preference, the independent nature of state and federal commissions in these hearings is well demonstrated in the rule's procedural provisions. For example, each commission retains complete control of its proceeding and the evidence that it will consider in reaching a decision.[50] (Interestingly, the commissions are afforded the opportunity to confer before issuing any orders.[51]) There is a cost for a concurrent hearing, however. If a state agrees to a concurrent hearing, it cannot prosecute its claims in the concurrent federal case as an intervenor.[52]

In general, the FERC rules appear to be skewed against formal authoritative proceedings. Joint boards based on referral of matters to the affected states are deemed an exception. Informal conferences and intervention[53] are the clear favorite of the Commission while it may also consider

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[47] Id. § 385.1304(b).

[48] Id. § 385.1305(a) and (b).

[49] Id. § 385.1305(c).

[50] Id. § 385.1305(c)(2). Likewise, records of the hearing are distinct. Id. § 385.1305(c)(4).

[51] Id. § 385.1305(e).

[52] Id. § 385.1305(g).

[53] The Commission reinforces this policy in two ways in this subsection of the rules. In Section 1306, the Commission reminds the states of their right to intervene in FERC proceedings. Id. §

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joint hearings if supported by administrative convenience. Even so, these regulations might be interpreted to allow a wide range of activities because of the general statement of purpose contained in Rule 1301. In practice, however, the FERC has taken an even narrower view of the role of the states in regional matters.

Commission Practice

Despite the apparent disinclination to use cooperative procedures, many political actors have continued to suggest joint proceedings. Courts have urged the use of boards to deal with antitrust problems resulting from competing state and federal pricing schemes.[54] Likewise, individual FERC and Federal Power commissioners[55] and administrative law judges[56] have suggested the use of joint boards. Most of the requests, however, come from the states on a variety of significant and unusual matters.[57]

(...continued)
385.1306. Second, a state may not serve on a joint board and act as an intervenor to a proceeding even though the apparent jurisdiction of the agencies is separate. Id. § 385.1305(g). See Kansas Gas & Elec. Co., 31 F.E.R.C. (CCH) ¶ 61,379, 61,846 (1985); Attorney General of Massachusetts v. New England Power Co., 27 F.E.R.C. (CCH) ¶ 61029, 61051 (1984).

[54] City of Mishawaka, v. American Elec. Power. Co., 616 F.2d 976, 992 (7th Cir. 1980). See the related discussion of the court of appeals in Conway Corp. v. FPC, 510 F.2d 1264, 1272-73 (D.C. Cir. 1975), aff'd, 426 U.S. 271 (1976).

[55] Notice of Public Conference and Request for Comments on Electricity Issues, 55 F.E.R.C. (CCH) ¶ 61,069, 61,200 (1991) (Charles Trabandt, Commissioner, concurring); American Elec. Power Serv. Corp., 8 F.E.R.C. (CCH) ¶ 61,068 (1979) (Matthew Holden, Commissioner, concurring). See, also, Stalon, "Regional Supply Planning;" and Craig Cano, "Terzic Pans Regional Regulation by States, Advocates Joint Boards," *Inside FERC* (November 18, 1991), 3.

[56] Virginia Elec. and Power Co., 11 F.E.R.C. (CCH) ¶ 63,028, 65,196 (1980) (Isaac Benkin, Administrative Law Judge).

[57] Texas Gas Transmission Corp., 49 F.E.R.C. (CCH) ¶ 61,134 (1989) (authorization for pipeline construction); Kansas Gas and Elec. Co., 31 F.E.R.C. (CCH) ¶ 61,379 (1985) (accounting treatment of nuclear plant construction costs); Stowers Oil and Gas Co., 33 F.E.R.C.
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A survey of the cases indicates four rationales for not initiating joint board procedures. Initially, the FERC has stated that jurisdictional requirements prevent its approval. Second, the Commission has stated that cases were not unusual enough to justify appointment of a joint board. Third, the Commission has argued that its denial is an appropriate use of its administrative discretion. Finally, it has denied requests based on procedural errors by the applicants. Judged by the usual legal arguments of statutory interpretation and consistency with legislative purpose, the reasons offered by the FERC to deny the requests appear questionable. Each is briefly discussed below.

Jurisdictional Barriers

The claim that the jurisdictional provisions prevent joint boards is one of the more common rationales for a denial. The Commission's basic position is that, under either the Federal Power Act or an identical provision in the Natural Gas Act,[58] it has sole jurisdiction over a matter and this authority precludes state involvement. As an example, in a pair of 1974 decisions[59] a state commission asked for a joint review of Eastern Utilities Associates, a multistate holding company. The Commission noted that the applications concerned rates for wholesales from the generating utility, a matter solely within federal authority. They concluded, "The joint board could in no way alter the existing federal state jurisdictional status."[60] The FERC has used the

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(CCH) ¶ 61,207 (1985) (violations of gas pricing rules); Attorney General of Massachusetts v. New England Power Co., 27 F.E.R.C. (CCH) ¶ 61,029 (1984) (treatment of plant outage costs); Kansas State Corp. Comm'n, 25 F.E.R.C. (CCH)
¶ 61,400 (1983) (take or pay contract problems); Northern States Power Co., 10 F.E.R.C. (CCH) ¶ 61,167 (1980) (treatment of plant cancellation costs); Gas Curtailments and Allocations, 54 F.P.C. 2170 (1975).

[58] 15 U.S.C. § 717p (1988).

[59] New England Power Co., 52 F.P.C. 855 (1974); Montaup Elec. Co., 52 F.P.C. 853 (1974).

[60] New England Power Co., 52 F.P.C., 856; Montaup, 52 F.P.C., 854.

same argument to deny state requests for joint boards to investigate gas curtailment plans,[61] construction of portions of interstate pipelines,[62] and the allocation of costs due to plant outages by wholesalers.[63]

The jurisdictional rationale, however, suffers from some obvious flaws. First, the statute authorizing joint boards permits the FERC to delegate its authority over a matter to the states. The regulations contemplate the same result. Therefore, the FERC has the authority to allow the states to consider a matter. Alternatively, the creation of joint conferences or hearings does not contemplate the transfer of any federal authority to the states. Thus, in the latter two instances, there is no jurisdictional issue raised. In short, the assertion that there is a formal jurisdictional barrier to state participation would seem either wrong or irrelevant.

The "Unusual Case" Rationale

The second frequently-cited rationale for denying the use of a joint proceeding is that the case is not "unusual" enough to justify the special procedure. Relying on what is now Rule 1304, the Commission in a 1975 gas curtailment case concluded that use of a joint board was intended for unusual cases that the Commission could not hear and determine in the usual course.[64] Thus, the Commission confined the use of the board to situations in which it could not make timely resolution of a case and left the states to their right to intervene.

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[61] Gas Curtailments and Allocations, 54 F.P.C., 1240, 1242, rehearing denied, 54 F.P.C., 2170, 2171 (1975).

[62] Texas Gas Transmission Corp., 49 F.E.R.C. (CCH) ¶ 61,134 (1989).

[63] Attorney General of Massachusetts v. New England Power Co., 27 F.E.R.C. (CCH) ¶ 61,029, 61,051 (1984).

[64] Investigation of Revised Curtailment Level on the System of Tennessee Gas Pipeline Co., 53 F.P.C., 657, 658 (1975). See, also, Kansas Gas and Elec. Co. 31 F.E.R.C. (CCH) ¶ 61,379, 61,845 (1985) (the procedure is intended "as a means of relief to the Commission when it might find itself unable to hear and determine cases before it, in the usual course, without undue delay").

This interpretive spin is not supported by the statute or the legislative history.[65] Rather, a more consistent reading of the statute and the Congressional reports suggests a Congressional desire to keep the process open to the states and to involve them when their interests were at stake. Importantly, more was intended than intervention alone. Had that been the goal, the provision for joint boards is unnecessary. Likewise, more than service as a spill tank for federal overload must have been intended; such a limited approach would have been stated in the legislation. Instead, the scope of the subject matter both in section 824h and the rules encompasses any matter concerning a regulated utility.[66]

This rationale is especially suspect in what might be considered the ultimate "unusual" matter. In the Kansas State Corporation Commission case,[67] the state commission asked for the creation of a joint body to investigate the problems associated with take-or-pay contracts.[68] The Commission rejected the request on the ground that the case was not sufficiently unique and could be handled in pending rate cases.[69] Any familiarity with the area, however, suggests that this was not a matter that could be handled in the usual course. Between 1985 and 1992, the Commission has issued three rulemakings[70] and suffered repeated defeats in the court of appeals.[71] Indeed, the

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[65] See, supra footnotes 26-31 and accompanying text.

[66] See, supra footnotes 26-31, 34-42, and accompanying text.

[67] 25 F.E.R.C. (CCH) ¶ 61,400 (1983).

[68] In a take-or-pay contract, a buyer is required to pay for a base amount of the product without regard to delivery. During the natural gas shortages, many gas pipelines contracted under multiyear take-or-pay contracts to purchase gas. The contracts, however, became very expensive when gas gluts and low sales resulted in reduced revenues. One pipeline, Columbia Transmission, has filed for bankruptcy protection as a result of take-or-pay contracts. Suein Hwang, "Columbia Gas and its Pipeline Unit File for Chapter 11 after Credit Talks Fail," *Wall Street Journal* (August 1, 1991), A3, col. 1.

[69] Kansas State Corp. Comm'n, 25 F.E.R.C. (CCH), 61,905 (1983).

[70] Order No. 436, 50 Fed. Reg., 42,408 (1985); Order No. 500, 52 Fed. Reg., 30,334 (1987); Order No. 636, 57 Fed. Reg., 13,267 (1992).

[71] American Gas Assoc. v. FERC, 888 F.2d 136 (D.C. Cir. 1989), cert. denied sub nom., (continued...)

complaint from the Court of Appeals for the District of Columbia is that the Commission has failed to address the take-or-pay problems in a coherent manner.[72] Given the complex issues and the delay in resolution, take-or-pay litigation has been an unusual case in any normal sense of the term.

An Exercise of Board Discretion

Although the Commission has sought to justify its decisions within the previous two reasons, several cases also resort to the argument of administrative discretion or convenience. As an example, in the Stowers Oil and Gas Co. case, the Commission noted that the statute provided the Commission with the discretion to authorize a hearing but it declined to exercise its discretion because of the "immediate need to correct ongoing violations."[73] Likewise, the Commission noted the unwieldiness of a joint board to prosecute a hearing on curtailment[74] and concluded that the process would be "probably ineffectual."[75] The Commission has also suggested that the use of joint proceedings would create confusion and duplication.[76]

On the surface, these rationales are a little more difficult to penetrate. The Commission is

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Willcox v. FERC, 111 S. Ct. 957 (1991); Associated Gas Distributors v. FERC, 824 F.2d 981 (D.C. Cir. 1987), cert. denied sub nom., Interstate Natural Gas Assoc. v. FERC, 485 U.S. 1006 (1988).

[72] Id.

[73] Stowers Oil and Gas Co., 33 F.E.R.C. (CCH) ¶ 61,207, 61422 (1985)

[74] Gas Curtailments and Allocations, 54 F.P.C., 2170, 2171 (1975) (denial of request for rehearing).

[75] Investigation of Revised Curtailment Level on the System of Tennessee Gas Pipeline Co., 53 F.P.C., 657, 659 (1975). See, also, Gas Curtailments and Allocations, 54 F.P.C., 1240, 1242 (1975) (initial decision) (motion for states to sit in an advisory role rejected as "unwieldy, procedurally inefficient,. . .inexpedient").

[76] New England Elec. Power Co., 52 F.P.C., 855, 856 (1974); Montaup Elec. Co., 52 F.P.C., 853, 854 (1974).

correct that the statute gives it the discretion to choose the form of the hearing and the level of state participation. This rationale, however, begins to suffer when the Commission asserts the specific problems that it thinks will occur. First, none of the concerns about process is unique to a joint board proceeding. A proceeding that affects all the states such as curtailment will be unwieldy, no matter who is directing the review. Confusion, on the other hand, may be even greater without joint proceedings since the alternatives are multiple state proceedings on the related state matters and separate attempts to integrate the federal and state decisions.

Second, the complaint concerning ineffectual results is also suspect since the process has not been attempted in any regular way. Because there is not extensive experience with joint boards at the FERC, the Commission's assertion that cooperation will be ineffective is a guess at best. What makes the Commission's policy all the more disconcerting is its successful use of the mandated boards under the Pacific Northwest Electric Power Planning and Conservation Act.[77] The Act (discussed in detail in Chapter 5) is a Congressionally-approved compact of several northwestern states for the regional development and distribution of power from public and private utilities.[78] Under the Act, the FERC approves rates suggested to it by the Bonneville Power Administration (BPA), the public power authority in the Northwest.[79] Congress, however, required the creation of joint boards as authorized by the FPA to "assist the Commission in its review of rates."[80] Under this legislative direction, the FERC established a joint board of the

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[77] Pub. L. 96-501, 94 Stat. 2697 (1980), codified, 16 U.S.C. §§ 839-839h (1988).

[78] H.R. Rep. No. 976 (Part I), 96 Cong., 2d Sess. 1 (1980), reprinted in 1980 U.S. Code Cong. & Ad. News, 5989, 5982.

[79] 16 U.S.C. §§ 839e(a)(2) and (i)(6) (1988).

[80] Id. § 839f(g) provides:

> When reviewing rates for the sale of power to the Administrator by an investor-owned utility customer under Section 839c(c) or 839d of this Title, the Federal Energy Regulatory Commission shall, in accordance with Section 824h of this Title:
>
> (1) convene a joint state board, and

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affected states with a federal administrative law judge as the presiding officer.[81] The Commission has placed the board in an essentially advisory role to provide comments concerning rate proposals submitted to the FERC for approval.[82] In practice, the board's role appears to be flexible.[83] The Commission in its order creating the board has limited the delays that might result from the creation of an additional layer of review.[84]

Two important points are evident in the creation of this joint board. First, the FERC can adopt a flexible procedure. In particular, the Commission need not cede its authority in the process of providing the states a mandated voice. Second, the process need not be cumbersome. The Commission can structure the proceedings in a way to avoid delay while providing for higher levels of state participation. Thus, it is difficult to conclude that the Commission's routine dismissals of joint-board and hearing requests are justified by administrative discretion.

Procedural Errors

Finally, the Commission has denied requests for joint proceedings on the basis of procedural flaws in the applications. In the Texas Gas Transmission Corporation case,[85] the Commission found that the request failed to raise an issue of fact justifying appointment of a joint

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(2) invest such board with such duties and authority as will assist the Commission it its review of such rates.

[81] Pacific Northwest Electric Power Planning and Conservation Act, 17 F.E.R.C. (CCH) ¶ 61,005 (1981).

[82] Id., 61,011.

[83] See, for example, Puget Sound Power and Light Co., 26 F.E.R.C. (CCH) ¶ 61,172 (1984).

[84] Pacific Power and Light Co., 28 F.E.R.C. (CCH) ¶ 61,143, 61,258 and 61,260, n.16 (1984) (the board reviews the initial decision of the administrative law judge and must make it recommendations within ninety days of receipt of the initial decision).

[85] 49 F.E.R.C. (CCH) ¶ 61,134 (1989).

board. In the Montaup Electric Co. and New England Power Co. cases,[86] the Commission concluded that the applicant failed to state the issues for review and desired relief with sufficient specificity.

Neither of the procedural questions proves fatal to state involvement. The first rationale concerning the lack of factual issues simply does not make sense. Whether the role of the board is advisory or adjudicative, the board members review facts, disputed or otherwise, and apply the law. The state can serve in that function even if there is no factual issue presented by the pleadings. The second issue is also insignificant and can be remedied by better pleading or amendments to a defective pleading. Thus, these concerns need not be controlling.

Informal Conferences

In its rules, the FERC suggests that it favors the use of informal conferences as a cooperative device.[87] At least in theory, the use of informal conferences would be consistent with lower levels of regional cooperation. On the other hand, the practice obviously would not have the same import as a joint hearing or a referral to the states. Thus, there is some question about the efficacy of the approach even at this level.

Moreover, in practice, the FERC does not appear to use the informal conference as a device to involve the states in a regional decisionmaking process. While there are literally hundreds of cases in which the Commission has ordered or considered the use of an informal conference,[88] a review of the decisions from January 1986 to April 1992 did not reveal any case in which the FERC used an informal conference as a method of regional cooperation.[89] Rather, the

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[86] 52 F.P.C., 853, 854 (1974); 52 F.P.C., 855, 856 (1974), respectively.

[87] See, supra footnotes 43-44 and accompanying text.

[88] A LEXIS search using the term "informal conference" located 460 commission decisions which discussed the term.

[89] Approximately 140 cases identified in the search noted in the prior note were reviewed. A second search using the statement contained in Rule 1303 suggesting the FERC's preference for

(continued...)

FERC normally uses the informal conference as a form of alternative dispute resolution (see Chapter 10). Cases concern the use of conferences to identify issues in filings,[90] to identify issues for hearing,[91] as a settlement device,[92] or to assist in discovery.[93]

An Alternative Basis for Justifying the FERC Policy

Nonetheless, the interpretive problem of the Commission's decisions, is a two-edged sword. By regionalizing decisionmaking through the use of joint boards, hearings, or conferences, the state and federal actors may introduce so much politics into the process as to defeat an economically rational regional decision. The study of one regional agency that joined federal and state officials for environmental planning offers an antidote to an unqualified demand for greater political participation by states in the decisionmaking process.

An analysis of the Delaware River Basin Commission, an interstate compact with the Department of Interior as a voting member, showed that the state and federal actors did not avoid

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informal conferences did not locate a single case.

[90] Paiute Pipeline Co., 55 F.E.R.C. (CCH) ¶ 61,462 (1991); Transcontinental Gas Pipe Line Corp., 53 F.E.R.C. (CCH) ¶ 63,006 (1990); City of Seattle, Washington, 48 F.E.R.C. (CCH) ¶ 61,333 (1989); Southern Natural Gas Co., 45 F.E.R.C. (CCH) ¶ 61,218 (1988); Northern Natural Gas Co., 37 F.E.R.C. (CCH) ¶ 61,343 (1986).

[91] Tennessee Gas Pipeline Co., 50 F.E.R.C. (CCH) ¶ 61, 395 (1990); Panhandle Eastern Pipe Line Co., 48 F.E.R.C. (CCH) ¶ 63,021 (1989); Pacific Gas and Elec. Co., 40 F.E.R.C. (CCH) ¶ 61,068 (1987); ARCO Pipe Line Co., 36 F.E.R.C. (CCH) ¶ 62,212 (1986); Northwest Pipeline Co., 35 F.E.R.C. (CCH) ¶ 61,049 (1986); ANR Pipeline Co., 34 F.E.R.C. (CCH) ¶ 61,114 (1986); Columbia Gas Transmission Co., 34 F.E.R.C. (CCH) ¶ 61,002 (1986).

[92] ANR Pipeline Co., 47 F.E.R.C. (CCH) ¶ 61,113 (1989); Panhandle Eastern Pipe Line Co., 46 F.E.R.C. (CCH) ¶ 61,183 (1989); Tennessee Gas Pipeline Co., 45 F.E.R.C. (CCH) ¶ 61,523 (1988); Great Lakes Transmission Co., 45 F.E.R.C. (CCH) ¶ 61,017 (1988); Equitable Gas Co., 42 F.E.R.C. (CCH) ¶ 61,023 (1988); Great Lakes Transmission Co., 41 F.E.R.C. (CCH) ¶ 61,094 (1988); Algonquin Gas Transmission Co., 35 F.E.R.C. (CCH) ¶ 61,273 (1986).

[93] Trunkline Gas Co., 40 F.E.R.C. (CCH) ¶ 61,203 (1987).

taking what were essentially parochial views based on their federal or state positions.[94] The Commission considered five options developed by a team of federal experts.[95] Despite extensive empirical work that showed one clean-up proposal superior to the others, the state and federal members voted to adopt a more expensive, but questionably more effective, approach based on political factors.[96] In doing so, the actors looked to their own advisors and ignored the experts hired to present regional views.[97] In the end, the institutional incentives to secure authority and the resulting political credit frustrated the attempt at regional decisionmaking.[98]

Clearly, the problems associated with the Delaware River Basin Commission could also affect regional electric regulation. The recent experience with the allocation of costs of completed nuclear plant construction raises the specter of states attempting to shift costs to their neighbors.[99] When the stakes are so large and politically dangerous, one might expect that state officials will protect their own well being.[100] The FERC's decision then can be perceived as an appropriate barrier to the balkanization that might otherwise occur if the states were authorized to plan and price the sale and transmission of electricity within regions.

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[94] Bruce Ackerman et al., *The Uncertain Search for Environmental Quality* (New York: The Free Press, 1974), 165-207.

[95] Id., 14.

[96] Id., 193-200.

[97] Id., 168.

[98] Id., 188-89.

[99] A clear example of this is the New Orleans City Council decision concerning the costs of Grand Gulf I construction. After failing to secure the desired reduction from the FERC, the Council disallowed a portion of the costs on the basis that the utility should have mitigated its expenses by selling a portion of its allocation to another utility. In no small irony, the amount of the disallowance was equivalent to that sought by the Council at the FERC. Petition for Writ of Certiorari, 7, New Orleans Pub. Serv., Inc. v. Council of the City of New Orleans, Case No. 90-1156 (Jan. 1991); New Orleans Pub. Serv., Inc. v. Council of New Orleans, 911 F.2d 993 (5th Cir. 1990), cert. granted, 111 S. Ct. 1617, appeal dismissed, 112 S. Ct. 411 (1991).

[100] See, Frank Darr, Book Review, 10 *Energy Law Journal* 337 (1989) (reviewing M. Chase, *Electric Power: An Industry at a Crossroads* (1988)).

However, by itself, that concern does not justify the Commission's actions. If the Commission's policy is grounded in this political concern, then the federal agency has taken a policy position that does not appear to be supported by the legislation or its legislative history. Congress anticipated a representational model with the states acting for their own regional interests. At the very least, the Commission could strike a better balance than the current policy of uniform denial.

As suggested by the preceding analysis, FERC policy might be modified in two respects. First, the Commission should amend its rules to expand the conditions under which it will authorize the use of joint boards. The Commission should consider their use in two situations. Initially, the boards would be appropriate in those situations in which the Commission needs assistance because its current workload is too large. There is nothing inconsistent with the states' assistance, but it is hardly the sole reason for joint boards as suggested by the Commission's current interpretation. Additionally, the Commission should consider using a joint board or hearings in those circumstances that are associated with essentially planning activities, such as those for interconnection.[101] At this stage in the development, the parties most directly affected could raise and decide issues of local interest. As the process moves toward determination of the costs of final construction, the FERC may well be best-suited for the decision. Past experience

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[101] The scope of the FERC's jurisdictional authority presents something of a problem here. Because the Commission lacks siting authority and generally cannot order interconnection, there are some practical limits to what it and the states might do under § 824h. On the other hand, the FERC authority has broadened apparently from recent Supreme Court decisions to include important power to allocate costs of construction. Likewise, Energy Department authority to review interconnections presumably will be returned to the FERC.

The model offered by the Pacific Northwest Electric Power Planning and Conservation Act is particularly compelling at this stage of the process. The Act provides for the states' council to prepare a plan for the development of new facilities and alternatives. Unlike the Planning and Conservation Act, the FPA does not require joint action. Additionally, there is a potential conflict between 16 U.S.C. § 824b and § 824h. The former directs that the states must have the right to present their views if affected by an interconnection plan, primarily a right to intervene. The latter section gives the states the right to sit on a board with the authority to decide the adequacy of such a plan. Presumably, if a state were appointed to such a board, it would lose its right to intervene. 18 C.F.R. § 385.1305(g) (1991). The problem could be resolved by the creation of joint hearings or conferences or amendment of the statute to clear up the latent ambiguity.

suggests that the political interests of the states can be especially difficult to corral and the representational interests may well need to be diluted through a federal arbiter acting alone.

Second, the Commission should discard the almost whimsical justifications for its current policy of denying requests for joint boards or hearings. On one level, most are logical nonsense and therefore not worth retaining. At another level, they distort the important policy considerations that should and can be reflected in the Commission's determinations. Fairly presented, more realistic rationales concerning the political

constraints on cooperative action should withstand judicial review since they comport with the interests that the Commission should consider under the statute.[102]

FERC Pronouncements on Regional Regulation

As there is not a national regime for regional regulation of power-supply planning in operation in the United States, the FERC has very little, if any, formal authority in the area of regional regulation. Hence, FERC has not issued any formal pronouncements (for example, orders, rulemakings) relating to it. The closest that FERC regulation might come to touching upon regional regulation issues would be in exercising those authorities contained in section 209 of the FPA relating to joint boards, hearings, and conferences of or with state public utility commissions; and provisions in other statutes authorizing use of such mechanisms. However, these might better be characterized as formal mechanisms, sanctified by Congress, for FERC to take into account the views of the state commissions to enhance the quality of FERC regulation on matters that affect the interests of the states concerned, rather than as a form of regional regulation. These mechanisms are discussed elsewhere in this report and, as noted there, they are in fact rarely utilized by FERC.

Another area in which FERC regulation could potentially have an impact upon regional regulation is by virtue of its direct regulatory oversight of aspects of the activities of the Bonneville Power Administration (BPA), whose actions, since 1980, are partly constrained by the Pacific Northwest Electric Power Planning and Conservation Act (the "Northwest Power Act"). That Act, of course, has a significant regional planning component, largely carried out by the Planning Council created by the statute; and, to some extent, that planning function directs BPA's actions. However, FERC's oversight of BPA activities is not directly related to that area of BPA's endeavors. Indeed, in the 1980s, the Northwest Planning Council made various informal efforts

[102] Whether the administrative law model is traditional or representational, the revised policy would withstand review. Under the former, the decision comports with the legislative directive to involve the states in decisions which affect them. Under the latter, the representational interest is clearly satisfied by direct participation.

to persuade FERC to agree to restrain some aspects of its general regulation that are not related to BPA (for example, hydropower licensing) that might indirectly overlap with its regional planning function. The Council was seeking greater latitude to plan for the region exclusively, unfettered even by FERC need determinations in issuing hydropower licenses.[103] No formal agreements emanated from the effort. Nevertheless it is fair to say that, even exercised fully, neither FERC's quite limited authority to regulate BPA, nor its exercise of more general authorities such as hydropower licensing, place FERC in a position where it either becomes significantly involved in or develops positions towards regional regulation or regional supply planning in that region.

Therefore, this section will not discuss FERC's general oversight of BPA under the Northwest Power Act, a topic better dealt with in the context of the general analysis of the Act elsewhere in this report.[104] However, this section will analyze two discrete authorities in the Northwest Power Act that suggest that the FERC might utilize a regional or formal state-federal mechanism in carrying out its ratemaking responsibilities under that Act.[105]

Other than in this discrete area relating to the Northwest Power Act, there is no history of FERC actions or pronouncements on regional regulation in the course of FERC's general exercise of its regulatory functions.[106] However, because a number of

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[103] Most of these relate to general oversight of BPA's ability to repay its debt to the U.S. Government; and to oversight of specific ratemaking requirements imposed directly on BPA by the Northwest Power Act.

[104] See, Chapter 4.

[105] See, Subpart I.4 of this Part.

[106] Indeed, the only use of the term "regional regulation" discovered in FERC jurisprudence occurs in a footnote in an FPC decision, which refers to "regulations of land use." South Carolina Gas and Electric Co., 54 F.P.C., 1642, 1668, n.17. (1975).

major regional regulation proposals have been considered in the U.S. Congress, there have been two occasions on which the FERC, through its Chairman or its staff, has testified before Congress on specific legislative proposals for regional power supply planning. These statements reflect positions of the Chairman and FERC staff,[107] and not necessarily the other Commissioners or the Commission as a body. They will now be analyzed in the context of the proposed legislation which they are related to.

Before examining these statements of position, it is useful to distinguish between two broad types of regional regulation and power-supply planning proposals that emerged in the 1980s:

(1) macroregionalism: those proposals that called for a major restructuring of the state-federal jurisdictional alignment and a devolution of authority from FERC and (at least implicitly) from state commissions to newly created regional regulatory entities. The prime example is the 1983 National Governors' Association (NGA) proposal and its legislative progeny. Infra, section 1.2.1.

(2) microregionalism: those proposals that sought only the minimum restructuring and devolution authority necessary to correct a discrete but contentious problem in the existing state-federal jurisdictional alignment. The prime example is the 1992 Arkansas-sponsored regional integrated resource planning (RIRP) legislation designed to deal, inter alia, with the "MP&L problem" infra, section 1.2.2.

FERC Chairman Raymond O'Connor testified in 1984 as to the former and FERC General Counsel William Scherman testified as to the latter in 1992. The Arkansas Plan was treated in detail in Chapter 4.

[107] Under the Department of Energy Organization Act of 1977, the Chairman of FERC is given specific authority to direct the activities of the staff. Section 401(c), 42 U.S.C. § 7171.

FERC Testimony on the National Governors' Association-Sponsored Regional Supply Planning Bills in Congress

The National Governors' Association Proposal and Its Legislative Progeny

In March 1983 the National Governors' Association Committee on Energy and Environment adopted as NGA policy a set of recommendations based in large part on a report of the NGA Task Force on Electric Utility Regulation issued in January 1983[108] ("NGA Proposal" or "Proposal"). The Proposal called upon the federal government to adopt general legislation that would permit the voluntary formation of compacts of states to engage in a menu of regional regulatory activities ranging from power supply planning to full-blown regional rate, certification, and siting regulation of both generation and transmission facilities.[109] The NGA Proposal clearly envisaged an evolutionary process whereby states could, on a voluntary basis, probe the efficacy of regional arrangements over more limited elements of authority (for example, over planning) and, if satisfied with the results, progressively expand the menu of authorities covered by the regional arrangement without having to go back to Congress to legitimize each expansion.[110]

The other major element of the NGA proposal[111] was that FERC jurisdiction over *intrastate* wholesale transactions should be transferred to states, or, where one existed, to a regional body at the option of the states concerned; and, that FERC jurisdiction over *interstate* wholesale transactions should be transferred to such a regional body when it existed and wanted

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[108] National Governors' Association, Committee on Energy and Environment, "An Analysis of Options for Structural Reform in Electric Utility Regulation," Report of the NGA Task Force on Electric Utility Regulation, January 1983.

[109] NGA Proposal, 23-24.

[110] Id.

[111] A third element that seemed significant at the time, but was largely a response to regulatory reform proposals in the early 1980s that did not survive that era, was the NGA's opposing any efforts to reform PUHCA or the FPA to make it easier for utilities to organize as regional holding companies as a means of escaping state regulation.

to assume the authority.[112] The Proposal was silent as to whether any devolution of state authority was intended. However, because of the "voluntary" nature of the states' scheme, it can be assumed that state authority was not intended.

Significant attention was given to the Proposal, especially after its recommendations were adopted essentially intact by the NGA's Committee on Energy and Environment and were incorporated into NGA policy with the imprimatur of the nation's fifty Governors. However, the expected substantive response from the Reagan Administration was not forthcoming (other than some general criticisms that it might lead to "regulatory layering"). Instead, the proposal was taken up by the Subcommittee on Energy Conservation and Power, of the House Committee on Energy and Commerce, and introduced by its Chairman, Richard Ottinger, as H.R. 5766. House Bill 5766 comprised an ambitious and quite detailed effort to implement the key elements of the NGA proposal. It was supplemented by certain concepts, apparently adopted from the Northwest Power Act. It also included efforts to give regional agencies authorities to seek mandatory wheeling and to price transmission service.

Title I of H.R. 5766 would have given generic Congressional consent to compacts between two or more states that conform to the requirement of the Title and implement two basic functions:

> (1) to develop, adopt, and publish standards, methodologies, and plans to mitigate the adverse effect of unforecasted, emergency power outages or shortages; and
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> (2) to develop, adopt, and publish "long-run conservation and electric power plans. . .and to encourage acquisitions of resources in accordance with such plans."[113]

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[112] Id.

[113] H.R. 5766, Sections 101, 102.

The compacts required voluntary and unanimous consent of each state's membership and were to exist for five years unless renewed. They were to establish a "compact governing agency" (hereinafter "regional agency"), with membership equal as to and appointed by each state; with authority to carry out whichever of the menu of potential functions that the compact chose to undertake.[114] This menu included:

(1) develop and impose on electric utilities standards for ratemaking treatment for costs related to resource acquisitions (for example, abandoned resources, research and development, nuclear fuel disposal, or plant decommissioning costs, and so on);

(2) develop and impose methodologies to assess the cost effectiveness of resources to meet demand; and

(3) develop and impose plans to mitigate emergency supply interruptions.[115]

However, none of these authorities were to grant the regional agency the right "to regulate directly the establishment of either retail or wholesale electricity rates;" nor could they be exercised if inconsistent with the compact or "with law."[116]

Perhaps the central feature of Title I was the authorization (and, under certain conditions, requirement) that the regional agency develop (with public, industry, stakeholder, and government agency input) a long-run conservation and electric power plan for resource acquisition to meet the total demand for electric energy service in the geographic region covered by the compact at least system cost.[117] The plan was to "reflect a detailed and systematic assessment of system costs associated with "a variety of resource options listed in approximately the same order as the resource acquisition priorities set forth in the Northwest Power Act. These included conservation

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[114] Id., Section 103. This Section contains detailed requirements relating to membership, compensation, conflicts of interest, reporting and providing information to Congress, funding, and so on.

[115] Id., Section 104

[116] Id.

[117] Id., Section 105.

and load management, cogeneration, renewable and waste, supply efficiency improvements (including pooling) and, finally, central station power plants.[118] Although the acquisition priorities required in the Northwest Power Act were not obligatory in Title I, they were strongly suggested.

Section 106 of Title I gave the regional agency a variety of options, after public comment and review, for encouraging utilities and their customers to acquire resources in accordance with the plan.[119] These include "need" certifications of demand or supply side resources, conservation programs, rate incentives, programs to encourage pooling or transmission and coordination services, electricity imports, and rate and other disincentives for resources inconsistent with the plan.[120] Again, the regional agency was not given authority to regulate wholesale or retail rates directly or to engage in activities inconsistent with the compact or "with law."[121]

The second key element of Title I was a provision that would give the regional agency, if permitted by the compact, the ability to apply to FERC for a mandatory wheeling order under section 211 of the FPA; and it would require FERC to issue such an order unless FERC found that it would impair reliability or the utility's ability to "render adequate service" to its customers.[122] FERC was to order reasonable recovery of costs for the service.[123] The application requirements were a certification that the requested order would be "appropriate" for implementing the regional plan and the concurrence of the Governor (or other regional agency) of the state not within the compact whose electric utility may be "significantly affect[ed]" by the plan.

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[118] Id.

[119] Use of any of these means, logically, renders development of the plan mandatory.

[120] H.R. 5766, Section 106.

[121] Id.

[122] Id.

[123] Id., Section 106(e).

Title I also permitted the regional agency to intervene as a matter of right in FERC proceedings to advocate positions consistent with those adopted in developing and implementing resource acquisition plans or its other authorities (relating to nonresource acquisition ratemaking, and so on) under section 104. It also contained detailed provisions for judicial review.[124] The Northwest Power Act, and the powers of the Council under it, were left unaffected by Title I.[125]

In a separate, apparently self-contained part (Title II), H.R. 5766 would have sought to implement the other principal component of the NGA proposal, devolution of certain FERC wholesale ratemaking authorities to state commissions.

Title II would have given state commissions the authority (with the approval of their Governor and after public hearings) to submit to FERC a plan (reviewable by FERC every ten years) for devolution of some or all of the authority to regulate entirely intrastate wholesale power sales rates of any utility whose retail sales it regulates.[126] For a plan to be accepted, Title II required that the commission have the requisite retail regulatory authority, that its devolved wholesale authority would not create "undue discrimination" between retail and wholesale rates (that is, "price squeeze"), and that it would provide for an "orderly transition" that left no regulatory gap.[127]

Under Title II, FERC had 180 days to approve or disapprove the plan (or approve it by nonaction). However, FERC could only disapprove the plan if the above showings were not made or if it found that the devolution of authority would have "a significant adverse impact" upon "competition in electricity supply markets" or on "benefits to consumers resulting from the operation of power pools and other interutility coordination."[128] In light of FERC's subsequent decisions in the 1980s relating to holding company power pools and to utility mergers and

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[124] Id., Section 107.

[125] Id., Section 108.

[126] Id., Section 202.

[127] Id.

[128] Id.

market-based pricing for wholesale power sales, had H.R. 5766 been enacted, these findings would probably have played a major and potentially very controversial role in FERC devolution decisions. Notably, however, Title II applied only to power sales, not to transmission transactions.

House Bill 5766 comprised perhaps the most ambitious proposal for restructuring the state-federal regulatory relationship considered by Congress since enactment of Part II of the FPA. If enacted in full, it would have given states substantial authority to guide and control utility power-supply planning through regional compacts "voluntarily" formed by states, and to influence other aspects of utility ratemaking and procedures. It would have enabled a potentially significant devolution of FERC wholesale ratemaking authority to state commissions. It also would have given compact regional agencies a powerful ability to request FERC-ordered mandatory access without meeting the most restrictive conditions for such an order that existed in section 211 of the FPA.

FERC Reaction to H.R. 5766

On June 26, 1984, Chairman Ottinger's Subcommittee held a hearing on H.R. 5766. Both government witnesses (including a Department of Energy official and the FERC Chairman) and private sector stakeholder witnesses testified. These were apparently the only major hearings on the bill. In the next session of Congress, the bill was reintroduced in essentially identical form in the Subcommittee (Rep. Markey, Chairman) by Rep. Jeffords as H.R. 3074. However, little action was taken and it was not enacted.

Regional Regulation Proposal

When testifying on H.R. 5766 in 1984 before the Ottinger Subcommittee, FERC Chairman, Raymond J. O'Connor, issued a short but pointed statement in which he criticized fundamental features of Title I of the bill. Noting that there were "similarities" between some of the provisions of Title I and those in section 4 of the Northwest Power Act, Chairman O'Connor

also identified "major differences between the two legislative approaches." These, he asserted, "create serious concerns about the feasibility of the regional scheme proposed in H.R. 5766."

The Northwest Power Planning Council, he pointed out, covers a "fixed, distinct geographic region that was established by Congress for specific purposes," including the task to "facilitate cooperation" between the BPA and the four states involved.[129] In contrast, O'Connor noted, "H.R. 5766 would permit any two or more states to declare themselves to be a geographic region for whatever reasons they find to be appropriate."[130]

Chairman O'Connor also focused on a feature of H.R. 5766 which stated that membership was "voluntary for any state and that, once a member of a compact, a state could withdraw after five years and could, potentially, join another compact. Moreover, he asserted, part of a state could join one compact, part another under H.R. 5766."[131]

These features, Chairman O'Connor concluded, would lead to "a number of difficulties. . .if no guidance is provided to govern the creation and realignment of geographic planning regions."[132] Such regions might not coincide with the service areas of multistate power systems which plan on a systemwide basis (for example, American Electric Power, which operates in seven states). This could subject them to numerous, possibly conflicting regional plans (each of them possibly subject to substitution every five years) or to conflicting ratemaking standards and, hence, to possible penalization by those states relying on those results in their own planning or ratemaking regulation.[133]

Chairman O'Connor also asserted that the lack of standards in H.R. 5766 for determining what constitutes a "region" would allow two states to discriminatorily exclude a third when all

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[129] Report on Hearings, 63.

[130] Id.

[131] Id.

[132] Id.

[133] Id.

three states regulate a common utility, if, for example, their regulatory philosophies differed.[134] Hence, he asserted, rather than resolving conflicts among states, H.R. 5766 could exacerbate them and could adversely affect interstate commerce and FERC's regulation of power pools and coordination.[135]

Reiterating a common Reagan Administration criticism of the bill, O'Connor asserted that it would add "another layer of regulation" between FERC and state commission authority, which would "not be sufficiently accountable to either."[136] Because regional plans could be ignored by a state commission "disadvantaged" by them, the result could be "a patchwork of state, regional, and federal regulation. . .more cumbersome than the system we have now."[137]

A final concern expressed by Chairman O'Connor was whether "increasing and potentially conflicting regulatory oversight" may lead to inefficiencies in the energy markets which should "operate on their own wherever possible."[138]

Hence, in testifying on H.R. 5766, Chairman O'Connor avoided addressing frontally most of the major policy issues involved in deciding upon the desirability and efficacy of the basic concept of regional regulation and regional power-supply planning. Rather, he focused on what he saw to be certain specific but crucial weaknesses in the NGA Proposal and in the Ottinger-Markey Subcommittee bill.

In contrast, in probably the only other major FERC pronouncement on the proposal, Commissioner Charles G. Stalon, while criticizing the Ottinger-Markey bill on

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[134] Id., 64.

[135] Id.

[136] Id., 64-65.

[137] Id.

[138] Id.

similar grounds, noted the potential advantages of a well-conceived regional scheme, if fully and effectively implemented.[139] He commented:

> Like so many of the broad-brushed solutions for the future of electricity supply in this country, the regional regulation scenario looks very attractive in its final, complete form. Regional regulation would, as the NGA report points out, put regulation geographically more in line with the way large segments of the industry have in fact developed--through the formation of regional holding companies, power pools, power broker arrangements, and a burgeoning growth in simple coordination sales across state lines. The emphasis in the industry is on restructuring regulation to match the structure of the industry rather than restructuring the industry to match the federal-system structure of regulation.
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> Regional regulation, it is assumed, would bypass the obvious inefficiencies of planning and regulating electricity supply on a utility-specific or state-specific basis, which tends to perpetuate insular thinking. Regional regulation would also, presumably, bypass the present awkward dichotomy between federal wholesale and state retail regulatory jurisdiction, described in the NGA report as a "jurisdictional mismatch." Full-scale regional regulation should also promote a level of comprehensiveness in planning that the current federal-state jurisdictional dichotomy renders unnecessarily difficult and should encourage planning that is geographically more suited to the economics of supply and demand in this industry. This suggests a number of obvious advantages:
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> - Both utility and regionwide reserve margins could be reduced, assuming adequate transmission. With the relatively high cost of new capacity today that alone could produce major long-term savings.
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> - Insofar as economies of scale are still a factor in planning major baseload capacity, the sheer size of the regional market permits planning such capacity with greater ease to achieve a least-cost generation mix. It also reduces the "lumpiness" problem that such additions often create on individual systems, causing the utility to

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[139] Charles G. Stalon, "Regional Supply Planning, Federal Authority and State Regulations--Thinking Through the Jurisdictional Maze", presented at the Conference on Regional Regulation of Electric Utilities: Northwest Power Act--Model or Mistake? sponsored by the American Bar Association, Portland, Oregon, October 10-11, 1985.

periodically carry costly excess capacity that is significant in relation to its rate base.

- Very much for these reasons, planning major expansions on a regional rather than a utility-specific basis should reduce the risk to the individual utility concerned. By the same token, any "rate shock" associated with new units will be more palatably spread over a region's ratepayers. [citation omitted]

Changes in FERC Authority

FERC Chairman O'Connor also testified at the Ottinger Subcommittee hearing on the provisions of H.R. 5766 that would devolve FERC wholesale ratemaking authority to state commissions (Part II) and that would give regional agencies access to a liberalized FERC mandatory wheeling regime (section 106(e) and Title III). While lengthier than his comments on regional regulation, these comments went to less basic issues; and, once again, he avoided the broad policy issues underlying each proposal.

Regarding Part II of the bill, he raised a number of procedural concerns. He also raised a number of technical problems, pertinent especially to wholesale requirements ratemaking, as to the adequacy of the condition in Part II that sought to avoid undue discrimination in rates. He asserted that the ability of a state to pick and choose which wholesale transactions to regulate would exacerbate undue discrimination problems. He further noted the potential for duplication of effort and inconsistent results between FERC and different states when each regulated part of the wholesale transaction of a utility. In particular, he noted the present potential for inconsistencies in cost allocations between different jurisdictions that could cause costs to "fall through the cracks" would be exacerbated. A briefer discussion of the experience at the Federal Communications Commission (FCC) with cooperative activities will be addressed next.

FCC Joint Proceeding Practices

The Communications Act of 1934, as amended, is still the most significant piece of communications legislation in the United States. In addition to clearly separating the

regulation of radio and other broadcast media from the regulation of common carriers via Titles II and III, the Act, in Title I, codified the simultaneous federal and state regulation of the telecommunications industry. In order to unify the regulation of telecommunications services, the Act empowered the FCC to regulate the interstate products and services of common carriers. In an effort to avoid the jurisdictional conflict that arose pursuant to the Interstate Commerce Commission's ratemaking authority under the Shreveport Doctrine in the transportation sector,[140] the Act also reserved the authority to regulate intrastate products and services for the individual states.[141] The Act, however, did not anticipate or envision regional regulation.

Although the Communications Act drew a distinct line between the regulatory authority of the federal and state commissions, its legislative history contains the reason that this line quickly became blurred. During Senator William Clark's successful attempt to amend S. 3285 to reserve ratemaking rights for state commissions, he noted that it was inappropriate for the FCC to regulate intrastate rates merely because a local-exchange line was physically connected to a long-distance line.[142] However, the policymaking power of the location of the physical interconnection was soon eroded in Smith v. Illinois (1935). In deciding this case, the court chose to reject the geographic aspects of the physical interconnection (the so-called board-to-board approach) and

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[140] Under the Shreveport Doctrine, intrastate rates (for freight services provided by railroad companies) are preempted and set aside by the Interstate Commerce Commission when they are found to discriminate against the conduct of interstate commerce.

[141] Neither S. 2910 nor H.R. 8301 contain specific language that carved out the jurisdiction of state public utilities commissions over telecommunications services. Prepared statements for each bill by Mssers. K. F. Clardy, A. R. McDonald, and J. E. Benton of the National Association of Railroad and Utilities Commissioners pointed out this omission, and the states' representatives suggested that language to this effect be inserted in the bill. In a prepared statement on H.R. 8301, P. Walker of the Corporation Commission of Oklahoma echoed the suggestions of Mssers. Clardy, McDonald, and Benton. Their call was not heeded as reflected in the original version of S. 3285, which was a substitute for S. 2910. However, Senator William Clark of Missouri offered an amendment during the Senate debate on S. 3285. The amendment was adopted without dissenting discussion. See, M. D. Paglin, *A Legislative History of the Communications Act of 1934* (New York: Oxford University Press, 1989).

[142] Paglin, *A Legislative History*, 857. Senator James Dill of Washington said that he did not think that the amendment would do any harm.

adopt the station-to-station approach for determining the jurisdictional costs of telecommunications services. As a result, a portion of the cost of a local-exchange line was subject to the FCC's jurisdiction.

Senate Bill 3285 eventually became the Communications Act of 1934. Titles IV, V, and VI contain the pure mechanics of implementing the authority granted to the FCC by Titles II and III. Titles IV and V describe the review, enforcement, and penal processes contained within the Act, while Title IV lists and explains ancillary issues.[143] The interest here lies within Title IV, which provides, among other things, administrative procedures for dealing with jurisdictional issues associated with the regulation of the telecommunications industry. These procedures are described in sections 410(a), (b), and (c) of Title IV.

Section 410 authorizes the FCC to create joint boards and conferences for the purpose of dealing with those regulatory issues that cannot be isolated and restricted to the federal or state jurisdictions. Section 410(a) contains the authority to form joint boards at its discretion. Three legal requirements define their structure. First, only the FCC has the legal authority to convene a 410(a) joint board. This requirement, of course, does not stop state commissions from requesting 410(a) joint boards to resolve issues crossing federal and state jurisdictional lines. Second, this type of joint board draws its nonfederal commissioners from the states affected by the interjurisdictional issue. This requirement can be used to create joint boards with dominant regional perspectives. Third, a 410(a) joint board "resolves" an interjurisdictional issue by agreeing to the contents of a recommended order. This order is passed on to the FCC, which is empowered to accept or reject the recommendation. Hence, this type of joint board does not actually resolve an issue. Instead, it suggests a course of action to the FCC. In practice however, recommended orders from 410(a) joint boards are rarely rejected.

Section 410(b) provides the FCC with the power to convene a joint conference. A joint conference is similar in its organization to a 410(a) joint board. A joint conference is convened at the discretion of the FCC, and it is comprised of commissioners from states affected by the

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[143] R. A. Cass, "Review, Enforcement, and Power Under the Communications Act of 1934: Choice and Chance in Institutional Design," in *A Legislative History of the Communications Act of 1934*, M. D. Paglin, ed. (New York: Oxford University Press, 1989), 79-96.

interjurisdictional issue. However, there are two important differences between 410(b) joint conferences and 410(a) joint boards. Joint boards always issue recommended orders to resolve issues, and they tend to stay in existence until the issues are resolved. Obligations or expectations are not placed on joint conferences. As a result, joint conferences can be dissolved without suggesting a way to avoid an interjurisdictional dispute. This characteristic of joint conferences is consistent with the mechanics of section 410(b), which indicates that the strongest interactions between the FCC and the state commissions occur when the FCC decides to hold joint hearings even though the FCC is authorized to act independently.

Section 410(c), an amendment to the Act passed in 1971, requires the FCC to form a joint board to examine issues surrounding the separation of a regulated company's total costs into interstate and intrastate cost pools. Identical to 410(a) joint boards, a 410(c) joint board "resolves" issues by forwarding recommended orders to the FCC for its consideration. Also identical to 410(a) joint boards, these proposed solutions for interjurisdictional problems are rarely rejected by the FCC. But despite these facts, a 410(c) joint board is contextually different from any 410(a) joint board. A 410(c) joint board is not convened at the discretion of the FCC. Instead, it is convened because of a mandate from Congress that instructs the FCC to deal with interjurisdictional cost-separation issues in a collaborative fashion.

There also are procedural differences between 410(a) and 410(c) joint boards. First, there is neither a maximum number nor minimum number of state commissioners who may sit on a 410(a) joint board. A 410(c) joint board, however, is required to have three FCC commissioners and four state commissioners. Second, 410(a) joint boards dissolve once they have forwarded recommended orders to the FCC, addressing the interjurisdictional issues that caused their formation. The practice is to place new jurisdictional cost separation issues in the existing 410(c) joint board and to assign new commissioners to this joint board to replace the departing commissioners.

There have been more 410(a) joint boards than joint conferences. Within the past ten years, four joint boards were convened to address interjurisdictional issues unrelated to the jurisdictional separation of costs. First, there was a joint board to resolve the issue of rate integration for Hawaii, Puerto Rico, the Virgin Islands, and Alaska. Second, the FCC put

together a Uniform System of Accounts joint board, which functioned for many years. Third, a joint board was created to examine measurement problems associated with the use of feature group A and B access services by other common carriers.[144] Fourth, a joint board was convened to address telecommunication issues affecting service in Alaska. Each of the first three joint boards dissolved with the issuance of a recommended order that was accepted by the FCC. The fourth 410(a) joint board is still in session.

Since 1980, a "mandatory" joint board has been in existence. As suggested by the language of section 410(c), this board tends to focus on regulatory issues associated with the separation of total costs into intrastate and interstate components. Over the years, this joint board, with varying membership, has solved some of the more complicated cost separation problems that have arisen as a result of the implementation of interstate access charges for interexchange carriers. For example, the separation joint board has produced recommended orders on the appropriate use and level of the subscriber plant factor, the subscriber line charge, and the gross allocator. It also has recommended an order describing the jurisdictional cost separation of central office equipment. Currently, this joint board is working on a comprehensive review of access charges for the purpose of suggesting changes to the cost-separation process to accommodate the implementation of open network architecture (ONA) on a dual jurisdictional basis.

Thus far, one joint conference has been convened by the FCC. Convened in 1989, it addresses selected jurisdictional issues arising from ONA implementation. When fully staffed, the ONA joint conference has three FCC commissioners and thirteen state public utilities

[144] Without going into technical detail, feature group A and B access services are commonly referred to as inferior access. Feature group A access requires the subscriber to dial a personal identification number of up to twenty-one digits before a call can be placed or a message sent. Feature group B access, also known as "10XXX" access, requires the subscriber to dial five numbers before a toll call or data message can be sent. Feature group C and D access, also known as equal access, requires only the dialing of a "1" before a call can be placed or a message sent.

commissioners as participants.[145] The state members are appointed by the National Association of Regulatory Utility Commissioners. Acceptance of the appointment, however, is voluntary from the states' perspective.

Following are some of the issues examined by the ONA joint conference. First, it analyzed a short report, which investigated some of the interjurisdictional cost-separation effects expected as a result of ONA implementation. Second, the joint conference staff gathered data relating to the increase in common channel signalling investment attributable to ONA implementation and prepared a memorandum for consideration by the joint conference. Third, joint conference members reviewed a report that concluded that a distinction between core and noncore ONA services is not required at this time. Finally, the joint conference has considered a comprehensive report on the appropriate level of national uniformity with respect to the delivery of ONA services.

The National Uniformity Report was released to the general public for comment. Announced as an example of interjurisdictional voluntary cooperation, it is expected that this report and comments will be part of the record that the FCC will rely on when it promulgates rules on national uniformity with respect to ONA implementation and the supply and production of ONA services. As for the other reports and memoranda, only the Separation Issues Report has served as a catalyst for current "mandatory" joint board activity. It examines, among other things, whether it is appropriate for minutes-of-use to dominate the separation of costs into interstate and intrastate components.[146]

As indicated by the joint conference success stories, the value of the joint conference is derived from its information-exchange function. Joint conference procedures and guidelines are compatible with an effective organization for information gathering and exchange. Because a joint conference is sanctioned by the FCC and includes the implied authority of numerous state utility commissioners, its request for information carries considerable weight. Moreover,

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[145] There are two commissioners associated with six of the seven regions served by holding companies. The seventh region is represented by one state commissioner.

[146] The primary finding of the Joint Conference report was that minutes-of-use were suspect as the dominant cost-allocation factor after ONA implementation.

regulated and unregulated telecommunications companies have responded favorably to requests to participate in panel discussions held for the benefit of the joint conference members and staff.

Still, there are some reasons to believe that few joint conferences will be convened in the future. It is difficult to maintain interest in a process that has less implied authority than an advisory council. It is also difficult to maintain interest in a body that is not empowered to issue a recommended order that the full FCC must consider. Without this authority, a joint conferences' discussion of public policy issues is extremely informal and completely nonbinding. For example, a "legitimate outcome" of a joint conference could be a decision by federal and state regulatory authorities to continue to disagree.[147]

Summary

The preceding discussion of the FCC yields two conclusions. First, the predominant function of the joint conference, as employed in the telecommunication industry, has been the exchange of information. This information exchange has in two instances resulted in concrete action by the FCC. Second, "discretionary" and "mandatory" joint boards focus on cost allocation, identification, and classification issues. Three of the four joint boards discussed in this section have some aspect of cost at their center. Thus, the story of federal-state cooperation is a mixed one at the FCC.

[147] This outcome occurred on the question of who had regulatory jurisdiction over ONA services.

On the other hand, the use of joint boards by the FERC has been particularly sparse. Other than in the discrete area related to the Northwest Power Act, there is not a history of FERC actions or pronouncements on regional regulation in the general exercise of its regulatory functions. Until its recent Notice for Comments on Regional Transmission Groups, the FERC had a history of opposing regional regulatory proposals. It should also be noted that the regional transmission groups as proposed do not have an explicit role for active state participation, with the state commissions possessing only a "group veto" over the formation of such regional transmission groups.

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PART III

AN ECONOMIC AND POLICY ANALYSIS: OPPORTUNITIES AND OBSTACLES

CHAPTER 7

CLUBS, SPILLOVER EFFECTS, AND REGIONAL REGULATION

Introduction

The organizational character of the public utilities market has markedly changed over the last ten years. Merged companies, holding companies, and multistate firms are becoming more and more common place. The analyses in Chapters 1 through 3 of this report describe how these circumstances can affect state commission regulation of public utilities and how they can encourage these commissions to use cooperative procedures to cope with the new industrial structure.[1] The analyses in Chapters 5 and 6 contain concrete examples of how state commissions have organized to deal with an increasingly regionalized marketplace. Each example, not surprisingly, suggests that efficient regulation of regionalized firms and effective resolution of regionalized issues may require each state commission to cede some authority in the interests of collaborative policymaking and implementation.

For purposes of Part III of this report, regional regulation is defined as ". . .two or more state commissions acting together in carrying out their regulatory responsibilities."[2] The focal points of this definition, as made clear in Chapters 1 and 2, are that regional regulation works best when: (a) regulatory authority is being threatened, (b) state boundaries do not conform to the operational boundaries of the firm, and (c) collaboration yields efficient policymaking and implementation.[3]

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[1] See Chapter 2 (pages 1-15) for a summary of factors contributing to the viability of regional regulation.

[2] See Chapter 1 (page 3).

[3] See Chapter 1 (pages 13-15) and Chapter 2 (pages 26-30) for discussions of potential gains to state commissions as a result of regional regulation.

In this chapter and its complement, Appendix B, the criteria for efficient regional regulation is determined in the context of the economics of clubs and alliances.[4] The primary objective is to establish the viability of regulation by regional organizations

[4] For an uncluttered discussion of the economics of clubs, see James M. Buchanan, "An Economic Theory of Clubs," *Economica* 32 (1965): 1-14. For a lucid discussion of the economics of alliances, see, Todd Sandler, "The Economic Theory of Alliances: Realigned," in *Comparative Public Policy: Issues, Theories and Methods*, Craig Liske, William Loehr, and John McCamant, eds. (New York: Wiley and Sons, 1975).

The following observations provide a brief summary of the differences between a club and an alliance. An economic club is most often formed for the purpose of consuming an impure public good that usually is not produced by the club members. An impure public good is characterized by congestion costs, which means that the value of the good to potential consumers decreases as more consumers actually use the good. A useful exemplar in this context is the use of a golf course by the general public. All golf playing members of the general public make up the pool from which club members are chosen; however, the general public does not own and operate the golf course.

An economic alliance is usually formed for the purpose of producing and consuming a pure public good. Pure public goods are not subject to congestion costs. The production aspects of an economic alliance is important because it is the source of positive spillover benefits. Positive spillover benefits tend to preidentify potential alliance members, and as a result, the pool of potential alliance members tends to be smaller than the pool of potential club members. Instructive examples of alliances are national defense organizations, such as the North Atlantic Treaty Organization and economic development organizations, such as the Common Market. Smaller and poorer members of alliances tend to benefit through the shifting of their scarce resources from the production of public goods to private goods. The larger and richer members tend to benefit from the enhanced political and economic security of having adjacent sovereign states as part of the fold. The regional clubs discussed in this and subsequent chapters are mixtures of the attributes of idealized economic clubs and alliances. Members of a regional club consume impure public goods, which means that congestion is a factor. However, these members also are producing an impure public good such as information transfer, which opens the door to positive spillover benefits among club members.

containing only state commissions as members.[5] Specifically, this chapter shows how such an organization can help minimize the costs of producing public utility services through collaborating on the construction and use of public utilities' infrastructure. This cost reduction is made possible by positive spillover benefits. These benefits are created whenever two or more firms jointly produce and optimally share the same infrastructure.[6] A subsequent section of this chapter, will further discuss the characteristics of positive spillovers.

The secondary objective of this chapter is to analyze the requirements for forming and sustaining a regional regulation organization or a regional club. The shared construction of the public utilities' infrastructure is again used to tie this analysis together.[7] This chapter shows how

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[5] A regional club also may include a federal regulatory agency. However, clubs of this type may have substantially different operating characteristics as compared to state-only clubs. Consider a situation where the federal agency does not relinquish either its preemption or jurisdictional rights when becoming a member of the regional club. Then the organizational power of the federal agency is significantly greater than the power of any state member of the club or any combination of state members. In effect, the federal agency has veto power, and hence, it is a dominant club member. This dominance is exercised by overturning club decisions that go against the wants and needs of the federal agency. Consequently, it would appear that a state agency would join such a club only if it believed that "second-class" membership in a federal-state club is preferable to going it alone outside of the club. However, in this instance, it is clear that the state agency is subservient. Such subservience is not possible in a state-only club because a state does not have preemption or jurisdictional rights over the activities of another state. These observations suggest that federal-state regional clubs are more likely to emerge when the federal agency gives up its veto power simultaneously with its entry into the club.

[6] Todd Sandler has shown that it is possible to obtain additional benefits measured in terms of regional costs by sharing national defense consumption opportunities among adjacent nations. See, Todd Sandler, "Pareto Optimality, Pure Public Goods, Impure Public Goods and Multiregional Spillovers," *Scottish Journal of Political Economy* 22 (1975): 25-38. Still, there are times when it is advantageous not to be party to a regional organization promoting and implementing a policy of regional defense. Because the regional benefits of defense cannot be denied to any nation within the region after the level of defense has been established, nonmembers can benefit without contributing money and other resources to defray its costs. Such free-rider behavior reduces the economic efficiency of the regional organization because not enough money or other resources are committed to the production of defense. See, Vito Tanzi, "A Note on Exclusion, Pure Public Goods, and Pareto Optimality," *Public Finance*, 27 (1972): 75-8.

[7] The joint production of infrastructure seems to be an increasingly necessary aspect of the

(continued...)

increases in the fixed and variable costs of operating a club reduce the number of regulatory agencies that can effectively cooperate in the course of their efforts to optimally construct and share a predetermined amount of infrastructure. This chapter interprets fixed and variable costs broadly to include transaction costs as well as labor, assets, and financial costs. As the following brief discussion will show, transaction costs can be thought of as "monetized" add-ons to labor and financial costs.

Typically, transaction costs are nonmonetized costs incurred as information is gathered and processed and incomplete contracts are managed. These costs are usually observed as organizational turmoil. Transaction costs, as a result, are not totally accounted for by measuring the resources used to make decisions or by observing wage rates within the organization. We attempt to monetize transaction costs by treating them as additional resources that would be required to reduce existing turmoil. Transaction costs, as defined, can arise within a regional club in the course of performing regulatory activities to promote and implement any regional policy. A typical transaction cost in the context of the shared use of infrastructure is the expenditure of additional dollars required to formally reconcile differing positions within the club concerning technical standards for the sharing of infrastructure.

The next section describes some operational and economic characteristics of shared infrastructure. The following sections review the economics of intraregional spillovers. The optimal size of a regional club is discussed in the third section.[8] The fourth section shows why some members of a regional club will devote more resources to regional activities than other club members. Some factors affecting the finances of a regional club are examined in the following sections. Then, the relationship between dispute resolution processes and regional regulation is investigated. The next-to-last section briefly discusses resource allocation within a regional club. Conclusions are presented in the final section.

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utilities' planning processes as construction costs continue to climb and as new regulations and technologies place a premium on reliable interoperability of public utilities' networks.

[8] The theory of clubs is used in Appendix B to solve the problem of optimal club size for a predetermined amount of shared infrastructure.

Some Operational and Economic Characteristics of Shared Infrastructure

In this section, the economic and operational characteristics of the shared infrastructure are described. The discussion starts with the operational characteristics.

Effective interoperability across state boundaries is a standard requirement of shared infrastructure. Common channel signalling, a telecommunications infrastructure technology, is most efficiently shared when there are not signal transfer points and service control points in each state. However, interstate interoperability is a prerequisite for such a configuration. High-voltage transmission is an electricity infrastructure technology that is efficiently shared when the geographic configuration of a transmission grid is optimal. However, once again, interstate interoperability is a prerequisite for efficient sharing.

Whenever optimal interoperability is a necessary characteristic of shared infrastructure, capacity limitations in one state affect the overall economic value of the shared technologies. Consider what happens when a capacity limitation causes the failure of shared common channel signalling or high-voltage transmission. When either of the associated technologies fail, the otherwise orderly operation of shared infrastructure is thrown into turmoil as each firm attempts to ensure its operational viability by exercising the maximum level of control over the infrastructure physically located in its state.

Economically speaking, shared infrastructure is an impure public good. Content-wise, an impure public good has some characteristics of a pure public good and some characteristics of a pure private good. Therefore, to understand shared infrastructure in

economic terms, it is necessary to first describe the characteristics of pure public and private goods.

National defense is the example most often used to explain the pure public good phenomenon.[9] National defense is a pure public good because once produced, all consumers can benefit from the same unit of national defense at the same time in the same amount. This is possible because national defense cannot be divided-up between consumers, individual consumers cannot be excluded from its use once it is produced, a consumer does not compete with other consumers for the benefits of national defense, and national defense is not used-up regardless of how many consumers take advantage of it. Technically speaking, these characteristics are known as indivisibility, nonexclusion, nonrivalry, and noncrowding, respectively. A pure private good, on the other hand, is something that cannot be shared at the same time. A pair of shoes can be used to explain the aforementioned attribute of this type of good.[10]

As might be expected from the label, an impure public good is more like a pure public good than a pure private good.[11] In particular, an impure public good is semi-indivisible and subject to crowding-out effect. With respect to divisibility, this means that the cost of producing one unit of this good, which in our example is shared infrastructure, is too expensive for a single consumer to bear. In terms of crowding, consumers of an impure public good experience congestion costs.[12] This means, for example, that current consumers of shared infrastructure

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[9] For detailed discussions of the characteristics of pure public goods, see, Paul A. Samuelson, "A Pure Theory of Public Expenditure," *Review of Economics and Statistics*, 36 (1954): 387-89; and Paul A. Samuelson, "A Diagrammatic Exposition of a Theory of Public Expenditure," *Review of Economics and Statistics*, 37 (1955): 350-56.

[10] Crowding is not a characteristic of pure private goods because the nature of pure private goods is exclusion. Only one consumer can consume a pure private good at any point in time. Therefore, it is not possible for crowding to occur since crowding is an economic phenomenon that arises when more than one and less than an infinite number of consumers can consume the same unit of the good at the same time.

[11] See, James M. Buchanan, *The Demand and Supply of Public Goods* (Chicago: Rand McNally, 1968).

[12] For discussions of congestion costs, see, Jerome Rothenberg, "The Economics of

(continued...)

receive fewer benefits as additional consumers attempt to use this infrastructure. Eventually in fact, current users may drop off of the infrastructure because congestion costs become too high and other potential users may not be able to access the infrastructure. Traffic overload on a common shared channel signalling system is a typical example of the crowding-out effect and congestion costs. However, fortunately, analyses presented in the next section of this chapter and Appendix B show that shared infrastructures can yield positive spillover benefits to regional club members.

Two practical regional objectives are suggested by the fact that shared infrastructure generates positive spillover benefits to offset congestion costs. Because of the ill effects of crowding-out, a regional club must take measures to ensure the availability of sufficient amounts of shared infrastructure. Because a shared infrastructure that produces spillover benefits is semidivisible, a regional club has to identify the competing economic needs of its members. Consequently, regional regulation, with respect to shared infrastructure, is a process of give-and-take between regulatory agencies and groups of affected individuals. It is noted that the process may be formal, informal, or anywhere in between.

State commissions will have to dedicate monetary and nonmonetary resources to create a regulatory process that will identify economic needs and ensure that shared infrastructures are in place to meet those needs. These expenditures must be distributed among states. What is unclear, however, is the amount of resources that each state commission should devote to the formation and maintenance of a regional club. It is not surprising that some state commissions, within a geographic region, will choose not to share in the expenses of regional regulation if they feel that it is more economical to retain decisionmaking autonomy. This "hold-out" possibility implies that regional clubs will form around some regulatory issues and not around other issues.

This section is concluded with the observation that the sharing of infrastructure should spawn a regional club to capture positive spillover benefits as long as there are net benefits from

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Congestion and Pollution: An Integrated View," *American Economic Review*, 60 (1970): 114-21; William H. Oakland, "Congestion, Public Goods and Welfare," *Journal of Political Economy*, 1 (1972): 339-57; and Robert H. Haveman, "Common Property, Congestion, and Environmental Pollution," *Quarterly Journal of Economics*, 87 (1973): 278-87.

regional regulation. In fact, it is believed that state commissions will find it difficult to share infrastructures in any other fashion. Noncooperative use of shared facilities by public utilities is apt to create operational turmoil; operational turmoil causes economic turmoil. Economic turmoil adversely affects the workload of state commissions and the economic performance of public utilities. In an effort to minimize workload and to avoid unintended economic outcomes, it is anticipated that state commissions will find it to be in their interest to cooperate with each other and to make joint decisions concerning the deployment and use of shared infrastructure. It does not particularly matter whether these cooperative activities among states amount to irregular consultation between adjacent states, confederations of states engaging in regularized cooperation and coordination, or interstate compacts with national coverage.

Regional Clubs and Intraregional Spillovers

Loosely speaking, cooperative behavior yields positive spillover benefits as economic bonuses. Consider what happens when two state commissions coordinate the construction and use of public utilities' infrastructure. Properly done, such coordination reduces the expenditures for physical facilities which are required to ensure a predetermined network reliability level. Reduced expenditures for physical facilities means lower costs for prespecified levels of access to and availability of productive facilities. The common channel signalling technology is a classic example of this relationship. An efficient regional common channel signalling network does not require a telecommunications holding company to deploy signal transfer points and service control points in each distinct geographic area of the region.

Regional regulation organizations, consisting of only state commissions, can be formed to make shared public utilities' infrastructure a reality.[13] Tables 7-1, 7-2, and 7-3 describe how sharing infrastructure can be economically rational. Table 7-1 shows the infrastructure positions of two hypothetical states before the formation of a regional club. The regulated firms of State A have produced infrastructure valued at fifteen units of consumption, while ten units are being used by its consumers. Therefore, State A has five units of excess capacity as a result of errant demand forecasts in the past. State B's regulated firms, on the other hand, have produced infrastructure valued at ten units of consumption, and all units are in use. Clearly, there are not any unused units of infrastructure in State B.

Although it is apparent that pent-up demand cannot exist in State A because there is excess capacity, pent-up demand might exist for the consumers in State B. This

TABLE 7-1

ISOLATED PRODUCTION AND USE OF INFRASTRUCTURE

State	Infrastructure Value	Infrastructure Use
A	15	10
B	10	10

[13] Because policymaking and implementation occur jointly, all members of a regional club share equally in the responsibility for any decision even though each member may not have expended the same amount of resources in the decisionmaking effort. This suggests that a decision is reached by a regional club only if no member is diametrically opposed to that decision. When diametric opposition surfaces, either the decision is modified or a decision is not reached by the existing members of the organization.

potential pent-up demand could be served if more units of infrastructure became available. Because more units of infrastructure do become available after the regional club is formed, consumers in State B have an opportunity to expand their usage of infrastructure. Specifically, consumers in State B have access to five additional units of infrastructure if State A's consumers continue their preclub usage of infrastructure. As a result, the total use of infrastructure across both states can increase from twenty units to twenty-five units. This is shown in Table 7-2.

Direct examination of Table 7-2 yields the mutual gain from sharing the costs and use of infrastructure. Under conventional regulation, consumers in State A may experience lower per-unit prices as the five additional units of infrastructure begin to generate revenue. Meanwhile, State B's consumers have access to five units of

TABLE 7-2

POST-ORGANIZATION PRODUCTION AND USE OF INFRASTRUCTURE

State	Infrastructure Value	Infrastructure Use
A	15	10
B	10	15

infrastructure that the regulated firms in their regulated utilities did not build. Consequently, regional regulation has the potential to produce gains for both states.[14]

The spillover benefit for each state can be calculated from information in the two tables.[15] The results of the calculations are shown in Table 7-3. State A has a positive spillover equal to five additional units of infrastructure use. State B has gained five additional units of the private good use.

TABLE 7-3

EXTENDED POST-ORGANIZATION SPILLOVER BENEFITS

State	Infrastructure Spillover	Other Good Spillover	Total Spillover
A	5	0	5
B	0	5	5

[14] The equilibrium described in Table 7-2 will continue to exist until consumers in either state decide to change their usage of infrastructure. There are, however, limits on how much the infrastructure can be altered in response to changes in state-specific usage. No state commission is willing to reduce its infrastructure below its full utilization level. Meanwhile, no state agency is willing to put its utilities under financial pressure to meet the infrastructure needs of other utilities outside of the state.

[15] It is not claimed that the spillover benefits derived from the assumed production mixes are optimal. The claim is that the process described by Tables 7-1 and 7-2 is feasible. That is, a regional regulation organization, consisting of States A and B, could be in equilibrium at these production mixes.

The preceding example outlines the economics of a regional club when positive spillover benefits exist and congestion is not a factor. This type of organization also can form to avoid the negative effects of congestion. Reflect for a moment on the costs incurred when infrastructure becomes crowded and creates congestion costs. Once these facilities reach their capacity, consumers are randomly prevented from, say, making some calls or transporting some electricity. As a result, each consumer receives less and less net benefit over time as consumers' needs continue to rise. Eventually, some consumers will become disillusioned with the shared use of infrastructure. This will cause the members of a regional club to supplement the shared infrastructure with nonshared infrastructure.[16]

Commissions within a regional club can reduce the congestion costs experienced by consumers within their respective states by requiring club members to pay buy-in fees and usage charges.[17] This tactic reduces the number of club members and consumers because fewer states are willing to share the use of their facilities. Still, there are complications associated with price-based rationing of memberships. Fewer club members mean smaller amounts of shared infrastructure (all other things equal). Consequently, congestion may not be substantially reduced. This clearly unintended result of buy-in fees and usage charges can be mitigated by taking actions to establish uniform usage of the shared infrastructure across states. As will be shown subsequently, uniform usage across state makes it easier to compare the cost of additional shared infrastructure to relieve congestion of current congestion costs. However, different prices for different members are required to induce uniform usage of shared infrastructure if, as expected, each club member has a different congestion function. In other words, price discrimination among club members would be necessary to induce the uniform usage of shared infrastructure. It is to be expected that each member state has a different congestion function, and hence, different prices for different members would be required to produce the same change in usage whenever and wherever uniform usage of the infrastructure is desired.

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[16] Oakland, "Congestion, Public Goods and Welfare," 350; and Sandler, "The Economic Theory of Alliances: Realigned," 230.

[17] See, Stephen C. Littlechild, "Common Costs, Fixed Charges, Clubs and Games," *Review of Economic Studies*, 42 (1975): 117-24.

Prior economic analysis of price discriminating clubs yields several insights with respect to the optimal production and rationing of shared infrastructure. First, it is not enough for two (or more) states to agree on the deployment of infrastructure and the expected production of positive spillovers. In addition, each state must be concerned about how its citizens and the citizens of other states feel about crowded infrastructure and the potential for congestion costs.[18] When the second factor is taken into account, members feeling strongly about crowded facilities will pressure their regional club to authorize or support the construction of more infrastructure. Meanwhile, other members may oppose this proposal.

Second, members' attitudes toward relief from congestion are important because each member evaluates crowding-out effects differently. In practice there are two ways for the regional club to deal with these differences of opinion. One option is for the club to choose to honor these different attitudes and attempt to accommodate this heterogeneity through a system of differential membership fees and usage-sensitive rates. For example, members with low tolerances for congestion may be charged high membership fees and usage rates. In return, they might be granted priority status with respect to the receipt of information and preferential status with respect to the club's decisionmaking process. Meanwhile, members with high tolerances for congestion may be assessed low membership fees and enjoy reduced usage rates. Of course, these club members may be denied a significant role in certain club decisions and may have to wait some time for information produced by the club. Alternatively, the club may decide to reconcile the members' different attitudes. For example, dispute resolution mechanisms may be used to bring club members' attitudes toward congestion into equilibrium so that the cost of congestion to each club member is equal, or approximately equal. When such an equilibrium is reached, it is meaningful to compare the cost of congestion to the additional cost of constructing more shared infrastructure. However, the proposed homogenization requirement, the equilibration of cost congestions across club members, is strict because it must acknowledge the attitudes of each club

[18] See, Mark V. Pauly, "Optimality, `Public' Goods, and Local Governments: A General Theoretical Analysis," *Journal of Political Economy*, 78 (1970): 572-85.

member, as well as each member's reaction to a change in congestion costs.[19]

Third and finally, the regional club has to ensure that its revenues are sufficiently large to oversee the optimal construction of shared infrastructure. Suppose, for example, that the regional club has approximately reconciled the members' different attitudes toward congestion, and suppose as a result that the club membership has agreed to the construction of additional shared infrastructure. Unavoidably, the construction of shared infrastructure will give rise to regulatory and economic issues that cross state boundaries. Decisions have to be made as to where to locate the shared infrastructure and how the costs of constructing the infrastructure will be allocated among the ratepayers of the respective regulatory jurisdictions. If the club's membership fees and usage-sensitive rates, measured in either dollars or personnel, are not large enough to accommodate the additional costs incurred to oversee the construction of additional infrastructure, then the club either will have to agree upon a new schedule of membership fees and usage rates or attempt to raise the additional funds from outside the club through a schedule of taxes on nonmembers and grants from parties interested in the promotion of shared infrastructure within the region. Choosing either route creates economic and political difficulties for the club membership. Taxes on nonmembers are difficult to enforce, although they may be easy to pass. Grants from interested parties are problematic because these parties are usually looking to shared infrastructure for cost reduction and not as another short-term drain on their budgets or bottom lines. Unfortunately, theoretical analyses of efficient systems of membership and usage-sensitive fees indicate that any price discrimination to accommodate any residual difference of attitudes toward congestion creates the presumption that the optimal level of infrastructure will not be constructed because the regional club is not capable of effectively overseeing this activity.[20]

Clearly then, the practices and procedures that the regional club employs to oversee the

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[19] For example, each state has to consider the value of the average utilization rate of transmission facilities summed over all club members when congestion is a factor versus the average utilization rate of the summed facilities after congestion is no longer a factor. See, Sandler, "Pareto Optimality, Pure Public Goods, Impure Public Goods and Multiregional Spillovers," 31.

[20] See, Todd Sandler and John T. Tschirhart, "The Economic Theory of Clubs: An Evaluative Survey," *Journal of Economic Literature*, 18 (1980): 1481-1521.

construction of shared infrastructure and those practices and procedures employed to decide on its use are affected by the cooperative relationships within the club and the relationship of the club to the outside world. Additionally, it is now clear that a regional club is economically rational when no state commission is worse off after joining the club. A remaining question is how large should the regional club be.

Optimal Size for a Regional Club

The optimum size for a regional club is determined by the benefits received by members, the fees paid by members, and the costs incurred to form and maintain the organization. Optimality means that the reduction in costs per member caused by the addition of another member is exactly offset by the reduction in existing per-member benefits. That is, the club continues to grow until the decrease in costs per member is less than the reduction in per-member benefits.

In most instances, a club's optimal size is less than the total number of state commissions that could be members.[21] In our example, this occurs because of the eventual negative effect on direct member benefits caused by the sharing of infrastructure. The negative effect is congestion costs, which are a universal attribute of the consumption of all impure public goods. However, optimal size increases when the effects of intraregional spillovers are accounted for. This occurs because every member contributes positively to the production of shared infrastructure, thereby increasing the benefits received by members.[22]

In addition to congestion costs, administrators and members have to deal with the fixed and variable costs of forming, operating, and maintaining a regional organization to oversee the construction and use of shared infrastructure. Both costs in general and the variable costs in particular tend to rise on a per-member basis as club size increases because larger organizations

[21] Optimal size is finite whenever impure public goods are produced. See, Buchanan, "An Economic Theory of Clubs," 1.

[22] Sandler, "The Economic Theory of Alliances: Realigned," 235.

are more complex and their memberships tend to be more diverse. Consequently, the optimal size of a regional club decreases as the importance and relevance of these costs increases.

The point made by this brief discussion is that the optimal size of a regional club is not a predetermined number. It depends on the issues being addressed, and how the resolution of these issues affects the costs and benefits experienced by the club's members. Therefore, an optimally sized club arises when market forces cause regulatory agencies to cooperate in numbers that represent the most desirable sharing group for a particular policy and its implementation.[23] However, under these conditions, each member is forced to relinquish some of its autonomy. This means that each member is subject to explicit "rules of behavior" defining the limits of its autonomy and the structure of its interactions with other members.

Forming a Regional Regulation Organization

Whatever the actual size of a regional regulation organization, its formation establishes some loss of autonomy by individual regulatory agencies. Hence, an effective organization does not form because regulatory agencies want company. When self

[23] How individual regulatory agencies go about maximizing this satisfaction is not germane to the process of club formation. It is sufficient that regulatory agencies maximize satisfaction and recognize that this process is dependent on the formation of regional organizations.

interest is at stake, the tendency is to choose a pure "go it alone" approach, unless cooperation with others is expected to yield a more desirable result. A regional regulation organization then emerges whenever there is a belief among regulatory agencies that more is to be gained from coordinated decisionmaking.

Behavioral rules defining collaborative efforts have two functions. The first function is to help determine what regional decisions are made. Rules in this area are meant to avoid decisions that create excessive congestion costs for the consumers of member states. They recognize that collaboration necessarily decreases the rapidity and autonomy of decisionmaking. The second function is to establish the rules of voting as they apply to decisionmaking by the club. Rules in this area represent minimally intrusive dispute resolution processes. This requirement recognizes the importance of self interest during the formative stages of a regional club. The following example describes how self interest affects an organization that must face congestion created by the shared use of infrastructure.

In this example, upstream users of a gas pipeline create congestion costs for downstream users of the same pipeline. For example, natural gas producers near a pipeline's "head end" may crowd out other gas producers' access to "nondedicated" pipeline capacity; that is, pipeline capacity purchased on an "on-demand" basis.[24] These costs typically take the form of higher transportation costs for both the upstream and downstream producers of natural gas.

At issue is whether the upstream producers gain more from creating the congestion than the cost they incur as a result of the congestion that they have created by not cooperating with the downstream producers. Using what may be termed a
"revelation principle," it is concluded that the noncooperating upstream producers obtain net benefits because if they did not they would not congest the pipeline. It might be the case that downstream congestion is the price these producers pay for more employment opportunities within the region and higher regional incomes.

[24] Crowding of on-demand capacity by upstream natural gas producers is conceptually similar to the crowding out that occurs when upstream producers of goods may load barges that eventually cause congested river conditions for downstream producers of goods that also transport their products by barge.

However, what might happen if the downstream natural gas producers experience fewer employment opportunities, lower incomes, and lower profits? It may be that the downstream producers might petition regulatory commissions in their region to form a regional club. The purpose of this regulatory club would be to persuade upstream commissions to join with them to encourage the pipeline provider not to allow congestion in any segment of the pipeline. This leads to the question of whether the upstream commissions have any incentives to be part of such an organization.

Once again, it may be concluded that upstream commissions will be part of this regulatory club only when the net benefits they receive after joining the club are greater than the net benefits they receive by abstaining from membership in a club consisting of upstream and downstream commissions. This implies that upstream commissions will join the club only when organized downstream commissions can push through legislation or regulations that have adverse economic effects on the upstream producers of natural gas. For example, the downstream commissions may convince Congress to pass a tax on upstream producers that do not cooperate with downstream producers with respect to sharing access to nondedicated pipeline capacity.

It should be clear at this point that upstream commissions have an alternative either to take independent action offset the activities of a downstream club, or to join with the downstream commissions in the exercise of cooperative procedures for resolving congestion issues. The upstream commissions can choose to form their own regional club for the purpose of responding jointly to the legislative and regulatory activities of the club consisting of downstream members. This second regional club is economically rational when it can create net benefits for the upstream commissions in excess of what would be available to them as part of the regional club consisting of upstream and downstream commissions.

In this instance, competing regional clubs are optimal in terms of congestion control and economic development from the perspective of the upstream producers. However, it also is obvious that competing regional clubs are not optimal from the perspective of the downstream commissions, who would benefit more from the formation of a regional club consisting of upstream and downstream commissions.

Why is it that the upstream commissions may benefit more from two competing regional clubs? The answer lies in the different degrees of membership diversity that characterize the two competing clubs versus a combined club of upstream and downstream commissions. By the construction of this example, it is apparent that the combined regional club has a more diverse membership than either the upstream or downstream clubs taken in isolation. And it is equally apparent that diverse membership complicates the formation and maintenance of a regional club.

Any club decisions perceived as favoring a particular type of member adversely affects the stability of the organization. There are various ways to overcome this complication but some ways are more restrictive than others. For example, a unanimity voting rule paralyzes the decisionmaking process. Consensus building, while recognizing the diversity within a regional club can be manipulated through the formation of coalitions. Therefore, member safeguards are necessary. Mediation and arbitration are obvious candidates.

Interacting in Regional Clubs

We can infer the degree of interaction between state commissions within a regional club, and perhaps their commitment to the organization by examining the interaction rates of each member. The interaction rate that is proposed for this purpose may be defined by the number of person hours spent by a state commission in regional regulation activities divided by the number of person hours spent by all members of the club in regional activities.[25] It is not possible to use the more customary definition of

[25] This measure, in principle, may be adjusted by weighting each state commission hour by the salary of the individual participating in regional activities. Such weights could be interpreted as a quality adjustment. The proposed measure, of course, is not the only possible measure of degree of interaction in a regulatory club. Another possible measure is the number of regional regulation meetings attended by state commissions divided by the number of regional regulation meetings held during a specific period of time. This second measure, however, is more difficult to adjust for quality because it is not easily modified to capture the number and the composition of the state commission personnel attending the meetings. For example, one state commission could send two inexperienced analysts to a meeting and another state commission could send five experienced managers to the same meeting. On the other hand, the second measure does not penalize a small commission for its inability to send a large number of personnel to a regional meeting.

the number of person hours spent in regional regulatory activities divided by the number of person hours reasonably available for these activities because we do not know the number of person hours reasonably available at any point in time. For example, we do not know and cannot know if the number of person hours spent in regional regulation by a state commission represents all of the resources that the commission potentially has available for this purpose or only a proportion of the potentially available hours.

It is important then to note two important characteristics of the participation rate that is proposed. First, the participation rates of all club members, when added together, equal one. Hence, a rate of .5 means that one club member has contributed 50 percent of the person hours of activity recorded by the regional club. Second, higher degrees of interaction are assumed to be associated with larger values of the ratio because the club member has been present more often. This is evident when participation rates of .3 and .1 are compared to each other. The state commission with a participation rate of .3 has been present three times more than the commission with the .1 participation rate.

The second characteristic, just described, enables one to identify which state commissions are devoting more resources to regional regulation activities. If we assume that resources devoted to regional activities are positively correlated with commitment to regional regulation, then the proposed interaction rate may be used to infer which state commissions are participating more in regional regulation. Here participation means more than just hours spent in an activity. It means, in addition, the commitment to that activity and its successful completion.

Of course, there are not any guarantees that the amount of resources spent in regional activities is positively correlated with a commitment to regional regulation. Some state personnel may be there merely to observe the process and report back to their home commissions regarding emerging consensus. Other state commission personnel may be there to ensure that regional activities do not negate any state prerogatives. Both of these functions are legitimate and necessary in the context of regional regulation. But it is readily apparent that they are not necessarily consistent with a commitment to a regional regulatory process. These observations establish that any inference of commitment based on the proposed interaction rate cannot be absolute in the sense that a higher interaction rate always means a stronger commitment to the

success of regional regulation. At best, all that one can infer absolutely is that a higher interaction rate means that a specific state commission has more opportunity to interact with other state commissions on issues identified as potentially suitable for resolution through regional regulation.

Much of one's inability to infer commitment to regional regulation is caused by the fact that an analytical measure of full participation in regional regulation has not been proposed. That is, at present, it is not known what constitutes the minimum level of participation that represents full participation in the regulatory club.[26] Because of this limitation, the best that one can do is to examine the full set of interaction rates in an effort to uncover a "cluster" of relatively high interaction rates. For example, suppose one finds that two members of a regulatory club have interaction rates of .35 and the other three members have rates of .05, .1, and .15. If it is believed that an interaction rate of .35 is substantially different from all other observed rates, then in this instance it could be concluded that two members are providing themselves with more regional regulation opportunities than the other three members of the regulatory club.

It is readily apparent that searching for clusters of relatively high interaction rates is consistent with some a priori reasonable relationships between commitment to regional regulation and the optimal size of a regional club. For example, it is reasonable to expect that a regional organization where all members are fully committed will be smaller than an organization with some doubters. It is also reasonable to expect that high entry fees and low usage charges will encourage the formation of a regional club with a relatively large number of fully committed members. High entry fees are expected to discourage doubters from joining the club and low usage charges are expected to encourage members to use the regional process. Finally, it is

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[26] The greatest lower bound is a mathematical concept that is useful in situations where there are open subsets of elements within a larger set of elements. For the purposes of this report, one may think of the larger set of elements as including the interaction rate of each member of the regulatory club. The objective is to divide this larger set into two subsets, where the first subset contains all club members who are partially committed and the second subset contains all members who are fully committed. However, because each subset is open, there is not a means to analytically determine the criteria that can be used to identify the members of these subsets without error. That is, the boundary between the two subsets cannot be located. This means that the minimum interaction rate that establishes a state commission as fully committed to a regional club is not absolutely known.

reasonable to expect that the commitment characteristics of club members will follow the club's voting rule. All club members are likely to be fully committed when unanimity is the club's voting rule. Remember, one "no vote" scuttles a regional policy. Hence, fully committed voters are not likely to accept such a voting rule when there are any doubters in the club. On the other hand, some club members are likely to be partially committed when the voting rule is consensus building.

Financing a Regional Club

The commitment levels of club members, however measured, affect the organization's finances. Obviously, fully committed members will contribute more to the support of the organization than partially committed members, if for no other reason than full commitment implies that these members receive more total value than the partially committed members. These contributions, taking on various forms of time and money allocations, comprise the majority of the club's finances. Supplementing members' contributions are contributions of nonmembers, such as regulated firms, who are asked to devote resources to help defray the club's total operating costs.[27]

It is useful for expository purposes to divide the total contributions to a regional club into two nonoverlapping (separable) categories. The first category contains all of the time and money spent in the policymaking activity. The amount of ex post, labor-related resources in this category may be approximated by the sum of the costs of the personnel that each member and nonmember has allocated to a regulatory club during the time that policy was being made. The second category contains all of the resources that members and nonmembers contribute to implement the policy. It would seem that the size of the second category of contributions is influenced by the size of a state's interest in the regional policy. For example, suppose that the regional policy is to promote the use of shared infrastructure by producers and consumers of electricity and telecommunications services. It would then seem likely that an individual state's

[27] Total operating costs are defined to include the costs of making regional policy and the costs of implementing that policy.

contribution to implement this policy would be approximately proportional to that state's volume of traffic carried over shared infrastructure.

Outlining the general nature of what is required to finance the policymaking and implementation activities of a regional club is one thing; determining from whence these resources will come is quite another thing. Looking at the second issue broadly, several pools of resources will be tapped to pay for the separable costs of making and implementing regional regulatory policy. First, any club member or nonmember can contribute generalist or specialist personnel to support the organization's policymaking or implementation activities.[28] Second, a regional club can be financed through the practice of bartering; that is, members and nonmembers alike can offer resources in their areas of expertise as pay for access to policy directives and implementation procedures associated with areas outside of their expertise. Third, monetary fees can be paid directly by members and nonmembers to the club for the purpose of supporting policymaking and implementation activities.

The direct payment of fees raises the issue of the structure of the optimal fee for each member and assisting nonmember. In theory, this fee can be assessed either through a single or multipart tariff, depending on the composition of the total operating costs incurred by the organization.[29] A two-part fee structure, for example, is optimal when policymaking and implementation activities are associated with common and variable costs.[30] Conversely, a single-

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[28] When specialists are assigned to the regional club, it is expected that each member and nonmember will make commitments that favor their areas of relative efficiency. A member, for example, may focus on the implementation of cost allocation decisions and a nonmember may concentrate on the formation of regional policy to limit congestion on shared infrastructure.

[29] Whatever the actual fee structure, it should allocate resources efficiently between state-specific and regional policymaking and policy implementation.

[30] When the benefits for each member of an optimal regional club are maximized it has been proven that a fixed and variable fee structure exists such that the fixed charge is maximized for that organization. Moreover, this fixed charge does not exceed the common costs of the organization's policymaking and implementation processes, and additionally, this fixed charge does not exceed the consumption benefit of implementing this policy less the variable costs incurred during the making and implementation of the policy. See, Stephen C. Littlechild, "Common Costs, Fixed Charges, Clubs and Games," 24.

part tariff is optimal when only variable costs are incurred during policymaking and policy implementation activities.

Thus far, our discussion of club finances has covered issues when it is acceptable to lump together the costs of making regional policy and implementing that policy. Next is the discussion of some financing issues that requires separating the costs of making policy from the costs of implementing policy. Looking first at the costs of making policy, we are interested in how these costs should be allocated to each member of the regional club and each nonmember who chooses to assist in the formation of regional policy. The most simple cost-sharing arrangement is for each member and assisting nonmember to share equally in the cost of making a policy decision. A useful assumption for motivating this symmetrical sharing arrangement is that members and assisting nonmembers are functionally identical to each other.[31] This establishes that each policymaking participant is willing to share the costs equally because each participant has the same marginal rate of substitution between the value of the policy decision and the numeraire.[32]

[31] This point is central to the formation of clubs as described by Buchanan in his 1965 article, "The Economic Theory of Clubs."

[32] The marginal rate of substitution measures the rate at which a club member or assisting nonmember is willing to give up regional policymaking authority for more of the numeraire. If the numeraire is control over state-specific revenue requirements, then the marginal rate of substitution measures the rate at which a state commission is willing to give up regional policymaking authority for more control over state-specific revenue requirements.

The assumption underlying symmetrical cost sharing, however, is quite restrictive and somewhat unreasonable. This observation leads us to consider cost-sharing arrangements that are not symmetric, where some club members and assisting nonmembers will pay more in support of the regional policymaking activities. The literature on club finances indicates that unequal cost shares are required for optimum economic stability when all members and assisting nonmembers are not always required to be party to every club activity.[33] More to the point, issue-directed participants expect to pay less than process-directed participants because the latter are likely to have more control over the policies reported out of the regional club. Meanwhile, process-directed participants expect issue-directed participants to pay something in support of the club's policymaking functions because the latter do contribute to the formation of the policy and presumably benefit directly or indirectly from efforts in this area.[34]

The problem with all regulatory clubs financed by unequal cost shares is that such organizations are likely to be plagued with allegations by both types of participants that the other type of participants are paying too little in support of the club's policymaking activities. When these allegations reach some threshold level, they will transform unavoidably into financing disputes that could threaten the continued viability of the policymaking function. If this should occur, that is, the regional club is no longer capable of making policy, then the implementation function would disappear and in all likelihood the club would disband. The explanation for these results is that each member and nonmember assisting in policymaking activities is concerned about its fee and charges *vis-a-vis* the fees and charges of others, because control of the club's policymaking function is not uniformly distributed across all club members. That is, issue-directed participants do not have the same number of opportunities to influence

[33] See, for example, Allan C. De Serpa, "A Theory of Discriminatory Clubs," *Scottish Journal of Political Economy*, 24 (1977): 33-41.

[34] Sandler and Tschirhart, "The Economic Theory of Clubs: An Evaluative Survey," 1489.

the structure and content of the regional policy, and hence do not have the same opportunities to ensure that they receive the maximum benefits from the regional policy.

Implementation issues arise and affect the finances of a regional club when there are differences between what the club expects to achieve by the implementation of regional policy and what each member and assisting nonmember privately expects to achieve by implementing the regional policy. This suggests that disagreements over implementation practices and procedures can destroy a regional club as easily as disagreements over policy decisions.[35] While there is not a readily apparent way to construct club financing arrangements that ensures the absence of disagreements over implementation practices and procedures, it seems prudent to tie, under perfect conditions, the members' and assisting nonmembers' contribution in support of policy implementation to the compatibility of their private implementation objectives with the club's implementation objectives. This fee structure will produce fewer threats of withdrawal from the club over disagreements about implementation.

The problem, as expected, is that conditions are never perfect. There are few incentives for club members and nonmembers to reveal private implementation objectives that are compatible with the organization's implementation objectives because doing so would increase the members and assisting nonmembers fees and charges in support of implementation. This possibility suggests that a better fee structure in support of policy implementation is equal cost shares. This fee structure does away with the need to report private implementation objectives, but it does so at the cost of a rising expectation that some club members and assisting nonmembers will withdraw from implementation activities for reasons to follow.

There is no a priori reason to believe that the intensity of a member's preferences for or against a particular implementation objective is correlated with the fees and charges paid to a regional club. In fact, it may be that a process-directed participant, making a large contribution in support of the club, is strongly opposed to one or more of the implementation objectives. If this opposition reaches a certain threshold level, this member will withdraw from the club regardless

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[35] See, Allan C. De Serpa and Stephen K. Happel, "The Economics of the Olympic Games: An Application of the Economic Theory of Clubs," in *Public Goods and Public Policy*, William Loehr and Todd Sandler, eds. (Beverly Hills, CA: Sage Publications, 1978).

of the fees and charges it pays for the opportunity to be continuously involved in the policymaking process. Although contrary to notions of fair representation, this result creates situations where the remaining members will have private implementation objectives that are more attuned with the club's implementation objectives.

Stabilizing a Regional Club

Many different forms of resolving disputes could apply to a regional club.[36] The most familiar form makes use of notice-and-comment rulemaking and an adjudicatory, trial-like procedure followed by straight voting by the decisionmakers. Notice-and-comment consists of issuing a proposed policy with an opportunity for interested parties to file comments. However, it is unlikely that this form will be useful whenever there is diversity among some club members. Instead, what is needed are dispute resolution procedures that are compatible with consensus building within the regional club.

The following is an example that highlights the issues that have to be considered in the course of resolving disputes within a regional organization.[37] Suppose a diverse regulatory group wants to form a regional club. However, suppose that market forces create big winners, small winners, and losers among the potential members. Suppose further that the complete club does not form because the losers are unwilling to invest the required resources; however, a club of regional winners does form. Then suppose that a club of regional losers forms in response.

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[36] Administrative procedures, such as negotiated rulemaking, the use of task forces, and joint problem-solving workshops serve these purposes. For a detailed description of these and other innovative administrative procedures, see Burns, *Administrative Procedures for Proactive Regulation*.

[37] As the example unfolds, it will become apparent that a consensus-building process with safeguards is the preferred decisionmaking process because it provides club members with a means to offset the winners versus losers effect. That is, there are no losers only winners in varying degrees. The prerequisite for efficient consensus building, however, is that its implementation costs are less than the costs of implementing super-majority or unanimity processes. Only then would members have to bring fewer resources to the table to finance the regional club.

Finally, suppose that the decisions made by the winners' club are better than any other possible set of club decisions.

Let the competition between the winners' and losers' clubs affect the content and structure of the decisions made by the winners' clubs. Suppose the effect is to make the final decisions less beneficial to some members of the winners' club, and suppose that these club members withdraw from the organization in response. This adjustment could start a chain reaction that ultimately destroys the winners' club. Therefore, it behooves potential members of the winners' club to negotiate a regional structure up front that provides for an equitable sharing of benefits and costs by winners and losers.[38]

A way to accomplish this objective is to adopt procedures for organizing and maintaining a regional club, where no member finds it advantageous to "go it alone." In other words, the benefit and cost-allocation rules for the organization are structured such that every member finds that it is better off belonging to the club and sharing in the costs and benefits than they would be if they took a stand-alone stance.

Operating a Regional Club

Once a regional club is formed, its decisions are made by using pooled resources, that is, commission resources devoted to regional activities. A club member can hedge against an unwanted club decision by retaining some resources to make its own decision. This hedge can be a state-specific policy that is more or less stringent than the regional policy. Or, the hedge can have a quality dimension such that the state-specific policy complements and improves the regional policy.

There are, however, some conditions that have to be met before regional and state-specific policies can be formed by using combinations of pooled and segregated resources. First, each club member must be able to freely transfer a unit of productive resources between the production

[38] The benefits of a complete regional club are more certain because this organization does not have to contend with the actions of a losers' club. Consequently, members are more willing to invest resources to support the organization. Hence, this type of club is more stable.

of regional and state-specific policies.[39] Second, each member has to select the combination of state-specific and regional policies that maximizes its net benefits.[40] Third, any spillover benefits emanate solely from the policies formed at the regional level. Fourth, state-specific benefits accrue only to the state that produces the state-specific policy. Under these conditions, a member of a regional club is in the position to choose from a continuum of resource combinations available for making a specific overall (state plus regional) policy. The continuum begins with the use of only state-specific resources for the express purpose of producing only state-specific policy. At this end of the continuum, there is no regional policy agreeable to the club. The continuum ends with a production technology that uses only pooled resources to produce only regional policy. At this end of the continuum, a state has no need for a separate state-specific policy to offset or complement the regional policy. The point selected on this continuum by the organization member is the point that minimizes the member's cost of producing an acceptable overall decision.[41]

[39] It is interesting to note what happens when the amount of resources that can be transferred between state-specific and regional decisionmaking is limited, and as a result, it is not possible to equalize the prices of state-specific and club resources. If the price of a unit of club resources is greater than the price of a unit of state-specific resources because the club resource faces higher transaction costs than the state-specific resource, then efficient decisionmaking requires that the marginal productivity of the club resource is greater than the marginal productivity of the state-specific resource.

[40] If each member is identical, then they would maximize the same average net benefit.

[41] Efficient decisionmaking takes place where the marginal productivity of the pooled resources divided by the marginal productivity of the state-specific resources equals the price of the pooled resources divided by the price of state-specific resources. The lower boundary of efficiency is associated with the minimum level of acceptable quality.

Conclusions

The essence of a regional club is that decisions are reached by a collaborative process that is made possible by resource contributions from individual members. Its optimal size depends on the decisions being made, the costs incurred to form and maintain the organization, and the direct and spillover benefits received by club members. It was suggested that optimal size increases as a club's membership becomes more diverse and spillover benefits increase. However, optimal size decreases as formation and maintenance costs become more important and relevant to the administration of the club. It also has been argued that it is more efficient to organize membership only once and to permit members to vary their interaction rates when resources are not perfectly mobile between decisionmaking contexts and transaction costs are repeatedly incurred each time a new club is formed.

The factors influencing size also affect the financing of a regional club. In general, club finance is less difficult when each member pays the same amount, assuming each member benefits from the organization equally. However, there are instances where equal prices provide incentives for some members to threaten to withdraw from the club for valid reasons such as divergent objectives. When this is the case, it is efficient to charge a two-part fee, where the fixed component recovers the common and fixed costs of the club and the variable component recovers the remaining usage-based costs.

The evolving character of regional regulation suggests that dispute resolution mechanisms are needed to hold a regional club together. These mechanisms are most valuable when market forces generate winners and losers within the club. A mechanism that looks promising in this regard is consensus building with joint problem solving and safeguards. It supplies opportunities to craft win-win decisions. Potential members, as a result, are more willing to invest resources in the formation of the club because the expected net benefits are on average greater and more certain. This outcome, in turn,

should make either a unanimity or super-majority voting rule less onerous in terms of obligating the member to the costs necessary to maintain the regional organization.

The selection of a decisionmaking mechanism depends on how a member intends to join its state-specific objectives with the club's objectives. The same decisionmaking mechanism can be used to combine state-specific and club resources when the state-specific objectives complement the club's objectives. Otherwise, the decisionmaking process of the regional club will be different than the processes used by the individual states.

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CHAPTER 8

REGIONAL COOPERATION AND THE POLICY PROCESS

The task of this chapter is to analyze regional issues requiring collaboration by state commissions. The discussion will examine factors affecting the value of cooperation, cooperative structures, and the amount of collaboration required to implement regulatory policies successfully. Regional cooperation is deemed beneficial whenever it captures economies of scale and scope, internalizes externalities, or recognizes policy interdependencies among state commissions. Whether collaboration is economical depends upon the costs of institutional arrangements useful to reach consensual policies and harmonize state commission activities.

This chapter begins with a discussion of the interdependency between industrial structure and the economic value of regional cooperation. It is argued that an integrated and coordinated industrial structure increases the value of regional cooperation because it creates a source of interdependency among state commissions. This is followed by a discussion on the importance of developing points of mutual advantage during the policy process. Consensus building delineates the structure of interdependencies linking state commissions and discovers points of mutual advantage. The resulting policy codifies mutual advantages into a workable agreement. However, the economic value of regional cooperation comes from the presence of interdependencies among state commissions; otherwise, independent regulatory behavior could achieve the same policy outcomes more economically by avoiding the costs of cooperation.

Industrial Organization and Regional Interdependency

The manner and extent to which state commissions are interdependent determines whether regional cooperation is beneficial, and if so, how it should be structured. An interdependency occurs whenever policy decisions by one state commission spill over and affect the outcomes of policy initiatives within other states. Whenever these spillover effects are adverse and consequential, interjurisdictional disputes typically arise signalling a need for cooperation. The

fundamental source of state commission interdependency is the interjurisdictional nature of utility activities. Although this process can give rise to many operational efficiencies and economies, it also creates situations where a commission's policy affecting the activities of its utilities alters the performance of those connected to it and ultimately the value of commission policies in other states. As industrial interdependencies become more interjurisdictional through mergers, regional holding companies, or increased physical interconnections, it becomes imperative for regional efficiency for state commissions to proceed jointly rather than independently.

A simple duopoly model illustrates the consequences of behaving independently within an interdependent system. A duopoly involves just two firms supplying an identical product to the same consumer market. The consumer market is the source of interdependencies between the firms; that is, changes in one firm's policies can evoke a market response that lowers the economic value of the other firm's policies. As an example, one firm can cause a change in market price by altering its production level. The new price provokes a response from the other firm, especially when profits decline as a result of the new price. The response may be an increase or decrease in production, depending on the characteristics of the market place. However, merely by responding, the second firm will cause the market price to change again, which thrusts both firms into another round of production changes. Although this independent stimulus-response path almost always reaches an equilibrium, the profitability of the two firms at the new equilibrium is below the level attainable if both had decided to collaboration and determine output jointly. That is, individual profitability but not social welfare would have increased had the firms recognized their dependency and turned it to their advantage by behaving collaboratively.

Of course, when firms collaborate to restrict supply and raise price, it is not in the public interest. Cooperation among duopolist results in allocative inefficiency, a social welfare loss, and decreased consumer welfare. However, the duopoly model does illustrate an important economic principle: independent actions by interdependent agents

lowers their economic welfare. In other words, failing to cooperate is costly in an interdependent system.

The same rationale applies to regional cooperation in the regulatory arena. State commissions charged with oversight responsibilities for a multistate utility or regional holding company may have to recognize that there will be instances when they would be better off by behaving collaboratively. For example, consider the situation created by a multistate merger of utilities. Because several firms have been combined under a common management, any change in state commission policy will elicit a response that is in the best interest of the utility's entire organization. Consequently, one state's regulatory decisions will affect the regulatory policies of other states. The recovery of common costs serves as an example of this phenomenon. In the course of independently determining a set of intrastate revenue requirements, state commissions may inadvertently create outcomes that are neither efficient nor equitable to ratepayers nor financially sound for the utility. A state commission, by placing its ratepayers first, may want to minimize its contribution to the multistate utility's common costs. Unfortunately, if all commissions in the multistate region act in this manner, cost minimization becomes regionally suboptimal. The multistate utility could face higher long-term capital and operating costs, causing an inability to service debt or offer investors a fair rate of return. These outcomes could encourage the multistate utility to remove its operations from state commission oversight and purposely increase the role of federal authorities such as the Federal Energy Regulatory Commission or the Federal Communications Commission to obtain the consistency offered by a single regulating body.

State commissions, in this example, are akin to firms independently operating within a common consumer market (in this case, the multistate utility). Decisions by one state commission elicit a utility response affecting the outcomes of other policy decisions. This back-and-forth motion is both costly and unproductive. A more rational approach would be to develop cooperative agreements to structure the interdependency to be mutually beneficial. In this circumstance state commissions should, through consensus building, form consistent and efficient regional policies that are in the best interests of

ratepayers, investors, creditors, and utilities. Consistent policies across state commissions send clear messages to the regulated firms and reduce the costs on regional issues.

In short, the economic value of regional cooperation depends on the extent of industrial interdependencies. These interdependencies naturally interlink the policy outcomes of one state to policy decisions made in other states. Industrial interdependencies underlie state commission interdependencies, which if ignored, can lead to suboptimal policies in the states and the region. By forming cooperative organizations to recognize and structure interdependencies, state commissions can enhance their policy's effectiveness and better attain state goals.

Mutual Advantage and Regional Cooperation

A common belief is that cooperation, regional or otherwise, requires the presence of mutual goals. This belief, however, is true only to a degree. Cooperation should be considered whenever independently designed commission policies lead to suboptimal outcomes regionally. In determining the need for cooperation, state commissions should consider whether their policy decisions will affect utility operations in other states and vice versa. If so, they will need to consider whether consensus building can craft points of mutual advantage. Mutual goals and points of mutual advantage are distinct but related concepts. The former typically implies the latter but the reverse does not necessarily follow. It is quite possible to develop points of mutual advantage without agreement on a common goal.[1] Simple capacity-expansion and transmission-expansion examples are used below to illustrate the importance of this point.

[1] This distinction underlies the difference between "regional regulation" versus "regional cooperation" as discussed by state utility commissioners. Regional regulation generally connotes the formation of mutual goals under the auspices of a quasi-autonomous regional authority as organized by state commissions. Regional cooperation relies on points of mutual advantage developed within a more sovereign institutional framework.

Another common belief is that the presence of mutual goals facilitates the formation of regional organizations. Commonness of purpose does in fact facilitate group interaction, generally lowering the costs of reaching an agreement by making mutual points of advantage more clearly. However, the existence of mutual goals is neither a necessary nor sufficient condition for regional cooperation. By themselves, mutual goals are not sufficient to warrant regional cooperation because these goals may be met more economically by independent actions at the state level. A simplified regional holding company example illustrates a situation in which regional cooperation is not required to obtain a mutual goal held by all state commissions.

Turning to the capacity-expansion example, suppose utilities operating in three states, A, B, and C, share a transmission network. Suppose further a utility in State A is required to expand its generation or switching capabilities in response to load growth whereas utilities in States B and C are not.[2] Finally, suppose the utility in State A has developed an independent least-cost plan that ties the new generation or switching facility into the regional transmission network for the purpose of moving power or messages to various intrastate load centers. Although this plan is economical from State A's perspective, it may adversely affect utilities operating in States B and C. Once brought on-line, the new facility could create loop flows or traffic overflows, and force utilities in States B and C to upgrade their transmission networks to maintain service reliability within their respective states. Furthermore, these loop flows or traffic overflows could congest the interstate transmission corridors and cause the rerouting of interstate telecommunication messages or a reduction in interstate economy transactions. The basic problem, an externality (loop flow) embedded within State A's least-cost plan, was overlooked during the planning process. The plan is least-cost for State A but is suboptimal at the regional level because the economic costs caused by loop flows were been imposed upon States B and C which may not benefit from State A's plan. Even though the states do not directly share a common goal, the need to cooperate and resolve the loop flow externality is clear. As explained further in the subsequent chapter, cooperative policies to internalize externalities involves some type of exchange. In the above example, utility A is unlikely to internalize loop flow costs within its least-cost plan unless

[2] Notice, only one state has the goal of capacity expansion.

it receives some benefit in return from utilities in States B and C.

Not all externalities impose costs upon others. Sometimes externalities permit others to enjoy benefits. A simple transmission-expansion example illustrates this point. Suppose the utility in State A decides the best approach to lower statewide costs is to upgrade its transmission network. Perhaps, additional transmission facilities would allow an electricity firm to pursue extra economy purchases and delay construction of generation facilities or allow a telecommunications firm to improve the call-set time on intrastate toll messages. Clearly, the addition of transmission facilities in State A benefits utilities in States B and C. Telecommunications firms in these states will find it easier to complete interstate messages and while electricity firms outside State A could more easily pursue economic and other wholesale transactions. Investment efficiency requires the inclusion of these benefits in the least-cost plan although this will not occur without some type of compensation for the utility in State A. Of course, in this instance, the objective of regional cooperation is to provide a means for the utility in State A to be compensated by the utilities in States B and C. However, to be viable, the agreement must be mutually acceptable to all state commissions. This is a formidable challenge because regional efficiency requires those receiving a "free" benefit to be willingly to pay a price.

It is now time to turn to the issue of whether mutual goals are a necessary and sufficient condition for regional cooperation. In the two preceding examples presence is not a necessary condition. The following example shows presence of mutual goals is not a sufficient condition either. Suppose the three states, now serviced by a regional holding company, want to subsidize low-income households. Suppose further the regional holding company wants to be part of this effort but regulatory practices prevent it from pooling low-income customers from different states into one customer class. It is obvious that under these conditions assistance to low-income households occurs within a service territory and not across service territories. Consequently, a tax-subsidy program implemented by State A could be effective without adversely affecting State B or C. As a result, the programs can be formed independently and without collaboration. In fact, regional cooperation would likely be inefficient particularly if a uniform tax-subsidy program is developed for states with dissimilar characteristics. State A, for example, might have strong industrial or large volume sectors best suited to finance the subsidy, whereas in States B and C the

commercial or alternative access sectors might be most appropriate. In this case, separately designed tax-subsidy programs would be superior because they would better allocate the tax burden within a service territory and allow state commissions full discretion to set the subsidy.[3]

Regional Interdependency and State Commission Cooperation

What is necessary for regional cooperation is interdependency among commissions' regulatory policies and decisions. The economic value of regional cooperation comes from the better management of consequential interdependencies, which, in turn, is dependent on the characteristics of regulatory issues facing individual state commissions. Consider the following multistate utility example as an illustration of this relationship.

Unlike a regional holding company structure with its individual operating companies, a multistate utility is in the position to pool its customers into multistate customer classes. This pooling arrangement can subvert the individual efforts of state commissions as they attempt to form regulatory policies. Consider once again the desire to assist low-income customers.

Suppose the multistate utility has pooled its low-income customers and charges them the same price regardless of the state they reside in. Suppose it does likewise within each class of nonlow-income customers. Finally, suppose States A, B, and C develop their respective tax-subsidy programs independently of each other. Without regional cooperation, the state commissions may each consider the utility's entire nonlow-income customers as the appropriate tax base for their purposes. This decision is individually rational because it allows each state to minimize the tax burden upon its nonlow-income ratepayers for a given subsidy amount. However, an overly high subsidy to low-income households, and consequently, an overly high tax

[3] Independently designed tax-subsidy schemes would not be appropriate should the operating companies be highly involved in interutility power transactions. This is particularly important should total system demand fall due to independently designed tax-subsidy schemes. Lower total demand raises price when economies of scale are lost. Furthermore, operating companies counting upon revenue from wholesale power sales would be adversely affected. The spillover effects from independent behavior, particularly when consequential, must be a part of the design process. State commissions, therefore, should jointly design a tax-subsidy scheme when spillovers are consequential.

burden will result.

By not sharing initiatives and coordinating activities, such state commissions tax their nonlow-income customers, as well as those of other states. Nonlow-income customers are taxed three times: once by each state commission. By failing to consider one another's tax-subsidy schemes, each fails to incorporate the tax burden imposed by the other upon nonlow-income customers. As a result, they each overestimate the optimal subsidy amount to their low-income customers. An overly high tax on nonlow-income customers can create additional problems as well, which could undermine assistance to low income customers. For example, higher taxes raise retail prices and could significantly reduce the demand of nonlow-income customers. A smaller demand could lower operational efficiencies[4] as well as raise capacity charges to all customers, including low-income customers. However, by recognizing their interdependency, state commissions could cooperatively design an optimal tax-subsidy scheme and address all relevant variables simultaneously.

Sometimes regulatory policies seemingly implementable without regional cooperation are quite interdependent nevertheless. Returning to the regional holding company example, suppose the states are served primarily by autonomous in-state utilities having a modest amount of physical interstate ties. Suppose further that each state commission has developed an economic development rate program for business customers. The competition for customers serves to increase the degree of interdependency between commission decisions. This interdependency can be exploited by the business customers who can play the states off against each other. This approach, if successful, can drive business rates to marginal operating cost. This means that business customers would not contribute to the recovery of the utility's investment.[5] This outcome is entirely unintended when the reason for the incentive rates is to attract new business customers to the state at the minimum cost necessary.[6]

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[4] Lower operational efficiencies would result from a lower level of capital utilization.

[5] J. Stephen Henderson and Robert E. Burns, *An Economic and Legal Analysis of Undue Price Discrimination* (Columbus, OH: The National Regulatory Research Institute, 1989).

[6] Some would claim the development rate should be set equal to marginal cost. This claim is (continued...)

It is now instructive to consider a situation in which state commissions attempt to implement two objectives simultaneously, such as economic development rates and low-income subsidies. Recall that it is optimal to implement the tax-subsidy programs independently when the industrial organization is loosely interdependent. The issue, therefore, is whether the independent implementation of an economic development rate program affects the optimality of independent tax-subsidy programs. Suppose the economic development rates are in equilibrium at a price equal to marginal operating cost. Furthermore, suppose the economic development incentive is successful in attracting new business customers and has reduced excess capacity in these states. Because excess capacity has been reduced, the pace of new investment will be quickened. Since new business customers do not make a contribution to the recovery of new investment, the recovery burden naturally shifts entirely to core customers, including low-

(...continued)
mistaken however. In this example, the states are the consumers trying to purchase industrial activity through development rates. Setting the rate equal to marginal cost is equivalent to paying the maximum feasible price for industrial activity. Paying a price higher than necessary reduces consumer welfare. The collaboration among state commissions, in this case, is equivalent to forming a consumer co-opt.

income households. This outcome challenges the viability of the tax-subsidy program.[7] Even though the tax-subsidy programs may be independent, their success depends upon the collective treatment by the state commissions of the interdependency between these programs and economic-development programs. Should they collaborate and keep development rates above marginal operating costs, they could place some of the burden of new investment upon new customers. This outcome removes the bias against core customers and maintains the subsidy to low-income households, while minimizing incentives necessary to reach economic development goals.

Regional Cooperative Structures

For our purposes, collaboration can be refined into three types: irregular, regular and structured. Irregular collaboration involves incidental or episodic interaction among participants. Regular collaboration is sequential and characterized by orderly interaction adhering to agreed upon procedures or guidelines. Structured collaboration involves the coordinated interaction of participants deemed "equal" in importance.

Three regional cooperative structures, embodying the three collaborative processes, are introduced in this section. First, there are "episodic clubs."[8] They structure irregular collaboration. Their distinguishing characteristic is the club disbands once the regional policy is developed and implemented. Episodic clubs, therefore, are used to facilitate temporary and inclusive interaction. The term inclusive implies that the club has no further need nor use to reconvene once the policy is implemented. Generally, episodic clubs deal with specific and singular utility issues, such as the exploitation of economies of scale.

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[7] This two-objective example can be posed in a variety of ways and still achieve the same outcome. Consider the following variant. If any one state successfully implements an economic development program, this would undermine the future integrity of another state's subsidy program by lowering the growth of its taxable base.

[8] The terminology "club" is used as a sort of shorthand to assist in the description of these structures.

Second, there are "sequential clubs," which structure regular collaboration. These clubs become dormant quite often but are designed to reconvene whenever necessary to make policy adjustments. The more restrictive requirement of natural coordination is not involved, but there are procedures designed to reconcile equity and efficiency imbalances when circumstances change. Sequential clubs, therefore, require a more permanent institutional structure than episodic clubs. They can address specific issues, such as a subsidy for low-income households or more general ones such as externalities. They become relevant when the underlying regulatory issue is too volatile and unpredictable to enable a one-time comprehensive agreement.

Third, there are "coordination clubs," codifying structured interaction. Commissions are asked to coordinate their policies continuously over time in order to obtain efficient and equitable outcomes. Coordination clubs are more holistic in approach, and form to better organize and implement interrelated regulatory issues, such as simultaneously implementing a tax-subsidy and economic-development program. Furthermore, they can be used to structure the formation of episodic and sequential clubs.

These observations indicate that the formation of regional policies and cooperative structures occur simultaneously. What precedes this outcome is the selection of the regional issues to be addressed either independently or jointly by the affected state commissions. Once this is done, the regional policy and cooperative structure can be developed together. As an example, suppose the States A, B and C, all served by a common regional holding company, attempt to implement an economic development program. One option is to resolve this issue within the context of an episodic club. If this were to occur, the resulting policy would be highly detailed contractually with preagreed solutions to all possible contingencies. As an example, suppose it is expected that the policy will increase the regional demand for electricity or telecommunications services with the result that transactions costs and market prices are increased. The higher prices, in turn, would affect the welfare of some customers in some states. This sequential effect must be fully anticipated and addressed by the episodic club's policy; otherwise, regional inequities and inefficiencies may arise and undermine cooperation. If not, commissions from states adversely affected have an incentive to leave the club, break the terms of the agreement, and "go it alone." This outcome naturally undermines future attempts to cooperate because it undermines the

original policy's economic value to remaining members. Hence, the choice of an episodic club to resolve a regional economic development issue is a risky choice unless the original policy correctly forecasts future circumstances or has built-in solutions sufficiently capable of controlling equity imbalances fairly. Perhaps a better selection is a sequential club. This cooperative structure develops dispute resolution procedures to adjust the policy or resolve disagreements on a real time basis rather than relying upon accurate forecasts or preconceived solutions. As such, the original policy is deemed the first in a likely sequence of policies; each one is a redress of previous ones as changing circumstances warrant.

A coordination club, on the other hand, is best-suited for resolving regulatory issues that are themselves interdependent. Consider, in this regard, the situation created when each state independently couples a tax-subsidy program with an economic development program. Strong cross-effects emerge whenever one state's success in luring business investment to its area increases its demand for purchased power from other states. These effects become adverse when the increased demand for purchased power raises average system operating costs or lowers reliability for ratepayers in states supplying that power. Specifically, the tax-subsidy programs are compromised in the selling states because their tax and subsidy levels must rise to keep pace with their higher average costs.[9]

[9] The analysis applies with some modifications to the situation where economic-development rates in a purchasing state lures businesses away from selling states. In this case, the incentive rates do not necessarily increase total electricity consumption across the selling and buying states. However, it is certain that this outcome will redistribute existing activity in this area. Selling states that lose business will experience losses of economic welfare whenever purchased power rates do not recover any of the fixed costs of production. In this instance, the fixed costs of firms in selling states are recovered from a smaller customer base. Of course, the losing states respond by increasing the level of competition among states for new and existing businesses. This makes business customers extremely happy but everyone else unhappy as they are responsible for increasing shares of the firm's fixed costs.

More specifically, under a regional holding company regime, the member utilities are compelled in principle to interact with each other to minimize overall costs. This implies that commissions should not develop an economic development program that raises retail rates to another state's ratepayers without reciprocal compensation. With this observation in hand, what remains is to create an environment in which no state commission has such an incentive. This environment can exist when state commissions coordinate their economic development activities on a more continuous basis.

It is important to reiterate significant structural differences among the cooperative clubs. Members of episodic and sequential clubs are asked to design regional policies capable of enhancing efficiency yet without unnecessarily impinging upon a member's sovereignty. They both support state commission flexibility and independence while recognizing the role of regional interdependency and the importance of developing mutual advantages. Consequently, they both encourage what might be called "quasi-free or "conditional" decisionmaking. That is, the regional policies must structure the interdependencies from the viewpoint of the regulatory issue so commissions can benefit themselves and the region overall without creating regional committees to govern or monitor independent decisionmaking. The club policy is supposed to mitigate inconsistency due to industry interdependency.

Coordination clubs, on the other hand, involve more complex decisionmaking over time because multiple regulatory issues are resolved together. Coordination clubs, although more complex, should not remove state sovereignty. Instead, the club should help characterize the regionally efficient set of options available to state commissions when exercising their independence. In order to minimize confusion and assist independent decisions, coordination clubs may require lasting investments in regional committees, such as advisory or technical committees to ensure consistency between intrastate decisions and regional objectives. Coordination requires this characteristic because the social contract under discussion is not ultimately enforceable except through self-enforcement. Consequently, the club, whose economic value comes from better managing regional interdependency, is viable only as long as each member commission benefits.

The simultaneity of the policy and club formation process is one characteristic which

distinguishes cooperative clubs from consolidated clubs. Another distinction concerns the role of power and authority. Consolidated clubs institutionalize power and authority. In the context of regional regulation, a quasi-autonomous regional regulatory council serves as an example. Policy formation is subsequent to a consolidated club's institutional formation. Cooperative clubs do not institutionalize power nor authority. Their structure is endogenously determined within the policy formation process. The regional policies are, in essence, unenforceable social contracts built upon points of mutual advantage.

The cooperative structure introduced in this chapter helps to fill a gap in current regulatory models. Many models treat the state commission as the primary decisionmaking unit with collaboration treated as an afterthought. Naturally, this approach implicitly emphasizes state sovereignty. At the other extreme, models regarding regional regulation usually discuss collaboration in a highly institutionalized and consolidated context. Most discussions focus on the internal processes required within the regional organization to overcome the natural tendency states have against relinquishing sovereignty. The cooperative structures presented here lie in between the extremes. By contrast, they embed state sovereignty within a collaborative process built upon points of mutual advantage to better structure regional interdependencies.

Conclusions

The simultaneous formation of regional cooperative structures and regional policies is meant to improve both regulatory and industrial efficiency. The cooperative structure required to implement a regional policy depends upon the policy's characteristics, which depends upon the characteristics of the regulatory issue. Also relevant is the degree of commission interdependency and the benefits from points of mutual advantage. The source of commission interdependency is utility interdependency. The development of regional holding companies, multistate utilities, and power pools all

increase and economize utility interdependence. However, as a byproduct, they increase state commission interdependence.

The economic value of regional collaboration depends upon the benefits and costs caused by the regional policy. These costs and benefits, in turn, depend on the type and intensity of utility interdependencies involved. The cooperative structures capable of developing the optimal regional policy depend upon the regulatory issues confronting state commissions. As an example, resolving an externality problem requires a more complex policy because regional efficiency requires the redistribution of benefits and costs, whereas regional cooperation requires everyone to benefit. On the other hand, a simpler regional policy is needed to share in economies of scale because there are no losers, only winners. Hence, the complexity of a regulatory issue determines the complexity of the optimal regional policy and the cooperative structure used to develop and implement this policy. Specifically, the design of the cooperative structure, that is, the club, becomes more complex as the complexity of the policy increases, which in turn, depends upon the complexity of industrial activities. Hence, there is a direct relationship between industrial structure and the structure of commission collaboration.

Of course, for a club to be economical and viable, the total cost of operating it cannot exceed the club's total economic value, nor can a member's contribution exceed its private benefit. A member's contribution reflects the member's willingness to abide by the strictures embedded within the regional policy as commissions exercise their sovereignty in state-specific matters. Clubs, consequently, must be rational, both as individuals and as a group.

All clubs, including the types considered in this chapter, remain viable as long as members remain better off than they otherwise would be. During the club and policy formation process, state commissions must develop points of mutual advantage. The club's policy is, in essence, a social contract developed consensually. The policy, however, is unenforceable, implying that its longevity depends upon its ability to provide mutual benefits to all club members. Unlike consolidated clubs, the formation of cooperative clubs and policy formation are conditional and occur simultaneously. Unlike consolidated clubs, members of a cooperative club are sovereign and can terminate their participation whenever it is no longer in their best interest to belong. The ability to exit a club without explicit penalties or the consent of other members ensures that the

regional agreement must work to the benefit of all members. Unlike consolidated clubs, a cooperative club is not an institutionalized, autonomous, regional regulatory authority built at the expense of state sovereignty. Table 8-1 lists the primary attributes of the club structures discussed in this chapter. The attributes, their implications and definition in some cases, are fully presented in the next chapter which focuses upon the application of cooperative clubs to public utility regulation.

TABLE 8-1

PRIMARY ATTRIBUTES OF EPISODIC, SEQUENTIAL, COORDINATED, AND CONSOLIDATED CLUB STRUCTURES

	Cooperative Club Structures			Consolidated
Attributes	Episodic	Sequential	Coordinated	
Regulatory Issue	Unicentric	Unicentric	Polycentric	Regional
Participation	Voluntary	Voluntary	Voluntary	Predetermined
Infrastructure	None	Low	Medium	High
Decision Rule	Consensus	Consensus	Consensus	Voting
State Autonomy	High	High	Medium	Low
Enforcement Mechanism	Self	Self	Self	Institutional
Collaboration Style	Irregular	Regular	Structured	Formal
Exit Cost	None	Low	Low	High

Source: Authors.

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CHAPTER 9

APPLICATIONS OF COOPERATIVE CLUBS TO PUBLIC UTILITY REGULATION

As indicated in the preceding chapter, the choice of club structure and the degree of commission coordination depends upon the characteristics of the regional issue and the degree of interdependency among state commissions. This latter point is fundamental to understanding club formation and regional regulation in general because the purpose of a club is not necessarily to create interdependency but rather to structure existing interdependency in ways beneficial to all club members. The source of interdependency comes from linkages within the larger social system whose configuration results from the dynamic interaction between state and federal regulators, and industry participants.

The basic thesis of this chapter is that club formation is beneficial whenever collaboration improves the productivity of state commissions. The club's level of output is measured by the extent to which a state commission achieves its goals. Final outcomes which are dependent upon the regulatory process can be quite complex, involving many factors not completely under a commission's control. Regulation is not simply a control problem in which a change here or there assures the desired outcome. Instead, regulation involves many intermediate steps, some of which are dependent upon activities and decisions made outside a commission's jurisdiction, but nevertheless shaping the final results. The function of cooperative clubs is to better structure interdependencies so state commissions can better obtain state goals.

The policies and rulemakings of state commissions are themselves inputs into the social regulatory process. The presence of external linkages coupling state commissions either explicitly or implicitly is vital to policy effectiveness and club formation. The more interwoven the social regulatory process, the more the effectiveness of a state's policy depends upon the activities and decisions taken elsewhere. This underscores the efficiency and equity arguments for regional cooperation and club formation because behaving independently and ignoring interdependencies can result in suboptimal outcomes. Generally speaking, independent decisionmaking is inefficient whenever interdependencies cause private benefits and costs to differ from social levels or cause

anticipated outcomes to systematically deviate from actual ones. By forming a club, state commissions can develop policies structuring the interdependency in regionally optimal and beneficial ways.

Optimizing requires the cooperative clubs and regional policies to be formed simultaneously. A sequential club, for example, would be best when utilities are highly integrated and the regional policy is an optimal tax-subsidy program for low-income households. The effectiveness of such programs depends upon variables not easily predictable nor entirely under the control of state commissions. This suggests sequential effects are difficult to manage beforehand and are best dealt with as they occur along with the information needed to resolve them. Any policy initially crafted will likely be amended and altered with time, suggesting the need for regular collaboration and the proper club structure to accommodate change and resolve differences.

A coordination club, on the other hand, might be best for policies coupling a tax-subsidy program with an economic development rate program. This is especially true when the industry is highly interdependent. The presence of strong and persistent cross-effects requires state commissions to interact more continuously to achieve state goals in a less costly manner. For example, one state's success in luring business investments could increase its demand for electricity from other club members. The consequences of this demand's effect on the regional tax-subsidy program could be good or bad, depending upon the presence or absence of scale economies. Scale economies would strengthen the regional tax-subsidy program by lowering average cost and retail rates, and thereby help offset the tax burden on ratepayers. Scale diseconomies, by contrast, can compromise the programs because any increase in average cost penalizes all ratepayers of all states. A regionally optimal policy, one that maximizes total welfare, would incorporate this interdependency within its design.

The first section begins with a discussion of the differences between unicentric and polycentric policies, followed by an analysis in the second section of the relationships between cooperative clubs and regional policies. The episodic, sequential, and

coordinated clubs are discussed in detail in this section. The chapter ends with some conclusions on the uses of cooperative clubs in regional regulation.

Polycentric and Unicentric Policies

As mentioned, state regulatory policies are themselves inputs into a much larger regulatory process whose productivity depends upon the network of interdependencies binding together utilities, other industry participants, and state and federal regulatory authorities. The network's characteristics, along with the specific regulatory issues at hand, determine whether collaboration is most compatible with polycentric or unicentric regional policies. Polycentric literally means "many centered," and polycentric policies couple together several utility activities to improve industry efficiency. A unicentric policy, by contrast, pertains to a particular utility activity. A polycentric policy may grow naturally over time as individual unicentric policies are interwoven to form a single regulatory fabric. This natural evolution is most likely to occur when the regulated industry is moderately interconnected and managerially diverse. These characteristics encourage the formation of polycentric policies from less complex ones in a move to simplify the regional cooperative process and to conserve commission resources over time. However, when the industry is managerially concentrated or highly interconnected, a smooth evolution may not be possible. In this case, unicentric issues are themselves interdependent and for efficiency's sake must be quickly solidified during the club formation process into a polycentric policy, appearing more as an alloy than a fabric.

The purpose of a polycentric policy is to internalize any scope economies or externalities inherent to utility activities and to achieve regulatory efficiency through better coordination of commission decisionmaking. Literally, scope economies occur whenever an increase in the production of one product lowers the production costs of others, making it cheaper to produce the products jointly rather than separately.[1] Scope

[1] Scope economies are of two types, technical and market. Technical scope economies concern the engineering and cost advantages from coupling the production processes of different products. Market scope economies concern the correct industrial structure, that is, the optimal number of firms, to produce the various products. Market scope economies pressure technical scope economies.

economies can arise from sharing inputs during a production process involving engineering economies. As an example, telecommunications firms may find sharing a large switching facility less costly than independently purchasing separate facilities. Engineering economies in the design of the switching facility may enable the telecommunications firms to lower their capital investments. Scope economies also arise when the byproduct of one production process becomes an input to another. Consider cogeneration as an example. The byproduct, steam, serves as a convenient input to the generation of electricity. The availability of this steam serves to lower the cost of self-generation. Otherwise, the industrial firm would need to purchase additional inputs to produce steam if it is intent on self generation. However, scope economies do not always arise from the simultaneous production of two or more products or services. The other side of scope economies is scope diseconomies. The latter has adverse consequences on production costs. As an example, a planning process for generation that fails to consider the transmission network could easily result in expensive transmission investments and higher overall costs.

Polycentric policies are appropriate when the regulatory issues facing state commissions are interdependent and involve scope economies. A single polycentric policy would be more efficient than a set of unattached unicentric policies because it can coordinate the interdependency and realize scope economies. Polycentric policies are also appropriate to manage scope diseconomies for regulatory issues that are inseparable, perhaps because of political considerations.[2] Unicentric policies are appropriate for separable or independent regulatory issues.

Generally speaking, episodic and sequential clubs form over separable or independent regulatory issues, and therefore, form to implement unicentric policies. Coordination clubs, by contrast, form over inseparable or interdependent regulatory issues, and to implement polycentric policies. Ultimately, however, the optimal club structure and policy depend upon the costs of cooperation. Although several regulatory issues, may be interdependent, the benefits from a polycentric policy may not justify the costs to coordinate state commission activities. Forming unicentric policies may be more efficient overall even though scope economies are foregone.

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[2] The term interdependency refers to economic interrelationships. The concept of separability refers to all other interrelationships coupling regulatory issues including political factors.

Cooperative Clubs and Regional Policies

The purpose of regional cooperation is to enhance total welfare by recognizing interdependencies, structuring independent decisionmaking, defining points of mutual advantage through consensus building while enabling state commissions to pursue their states' goals. This latter point is crucial in distinguishing cooperative clubs from the more familiar concepts of consolidated clubs or regional regulatory authority. Cooperative clubs do not create regional policies or goals as substitutes for state policies and goals. Instead, they create policies that better structure interdependencies so state commissions are better able to obtain their own goals. The purpose is not to distill states' goals and objectives into a single set of mutual goals and objectives, although cooperation may have this effect.

In general, the regional policy produced by cooperative clubs is an unenforceable commitment or social contract consensually developed by state commissions. Its results can be wide-ranging because the policy is directed toward altering the inner workings of the regulated industry. However, when a regional policy is successfully implemented, it tends to change the interrelationships among utilities and other participants and in doing so, may necessitate its own change. State commissions may need to reconvene and expand, amend, or replace the original policy. Therefore, policies likely to require change further require state commissions to collaborate on a more regular basis. Policies unlikely to require change allow state commission to collaborate irregularly. Consequently, the appropriate type of club depends upon the frequency of collaboration required to implement the new policy and the manner in which policy changes are likely to occur.

Generally speaking, regional policies can range from the very specific, involving particular utilities and particular transactions to the very general, involving many activities among many utilities all structured within a common framework. An example of the former would be a joint venture initiated by several utilities. The primary issues may be the allocation of common costs and the responsibility of operation once on-line. An example of the latter may be an integrated resource plan covering many states. Here the issues may involve operation and planning responsibilities, cost sharing and equity arrangements, siting provisions and access to particular facilities.

The minimum club structure necessary to successfully implement a particular policy depends upon the policy's characteristics. The remainder of this chapter examines the relationship between regulatory issues, policy characteristics, and club structures. Regulatory issues such as the allocation of cost, the presence of externalities, the siting of facilities, capacity and modernization planning, are examined for each club structure to determine the policy characteristics under which the structure would be appropriate.

Public Utility Regulation and Episodic Clubs

Episodic clubs are feasible structures whenever the regulatory issue is singular, based upon highly predictable costs or benefits, with inconsequential or easily controllable sequential effects. The policies are unenforceable commitments by state commissions generally realized by stipulations or conditions within interutility contracts. Once the policy is finalized, the club disbands and the commissions behave independently.

Episodic clubs develop and implement unicentric policies that generally do not require reformulation at some later date. However, to be efficient, either the original agreement must stay beneficial to all members regardless of future circumstances or those adversely affected must be able to improve their situation without undermining the benefits received by others. This latter recourse is most feasible when the industrial organization is loosely interconnected both physically

and managerially.[3] However, episodic clubs can be viable even when the industry is highly integrated if the policy contains some type of buffer to insulate against sequential effects. As the following examples will bear out, this can occur whenever a third party, preferably a nonregulated entity, becomes part of the contractual process between utilities implementing the regional policy.

The survival and applicability of episodic clubs may depend upon the degree of commitment and ability of member commissions to control costly equity effects arising from the regional policy. Naturally, the more certain and predictable the regulatory issue the more easily equity effects can be forecasted and made a part of the original policy. However, high predictability is more the exception than the rule, suggesting the need for mechanisms to protect against their occurrence. This characteristic, the preagreement of controlling sequential effects, is the distinguishing feature of an episodic club.

Cost Allocation and Capacity Expansion

Suppose States A and B both need capacity to meet future demand expectations. Furthermore, assume scale economies make it cost effective for utilities to combine their capacity needs and build one large facility. Scale economies, in this case, become the point of mutual advantage made possible through cooperation. However, state commissions, when formulating the policy, must decide how to finance the joint venture. Should the utilities themselves build and operate the facility or should a nonregulated entity such as a nonutility generator (NUG) build and operate the facility? If built by the utilities, should the facility be rate based as a retail facility or treated as a wholesale

[3] The more tightly interconnected the industry is the greater the number of pathways to channel sequential effects. This suggests that a club structure that embodies sufficient procedures to resolve efficiency and equity issues is needed because such effects are likely to arise with time.

facility? The answers to these questions determine whether an episodic club is sufficient or at least feasible for the creation of a regional policy on capacity expansion.

Nonutility generators could provide a convenient buffer to either remove or mitigate sequential effects because they typically accept the construction and performance risks. The states can form an episodic club and benefit from the scale economies in construction, yet through individually designed contracts, protect themselves, at least partially, from sequential effects. Individual contracts with the NUG enable utilities and state commissions to acquire conditions peculiar to their state's idiosyncrasies and increase the club's economic value. The net benefit to each member would include the cost savings from scale economies when compared to the cost of stand-alone capacity-expansion policies. This amount might vary across state commissions because of cost differences in their stand-alone policies to accommodate future demand.[4]

What is important about this example is that the club can disband once the regional policy is finalized. The utilities negotiate jointly with the NUG to secure cost savings from scale economies as well as to insure one another that peculiarities in individual contracts will not create adverse sequential effects. The purpose of the episodic club is to mutually benefit from scale economies. Although limiting the sequential effect states have upon one another once the policy is finalized. Should this occur, a state's net benefit would depend solely upon its own circumstances and policy decisions through time and not upon those occurring within other member states. The likelihood of this happening increases whenever the regulated industrial organization is loosely interdependent or whenever member commissions have regulatory tools able to control sequential effects and can credibly commit to their use.[5]

Purchased Power

[4] Although the NUG accepts the risk of cost overruns in construction, this does not guarantee each state will receive the net benefit initially expected during the club's formation.

[5] Sequential effects are spillover effects caused by state commission decisions or rulemaking. They occur when the actions by one state commission affect the outcomes of commission policies in other states.

This purchased power example shows the importance of being able to control sequential effects in a episodic club. Suppose the two states actively transact for power with one another with State A net seller to State B. Further, suppose the load growth anticipated by State B does not materialize implying its contract with the NUG is unneeded. This could encourage utilities in State B to reduce power purchases from State A in an attempt to control costs and reduce excess capacity. But this creates a sequential effect as measured by the lost revenue to utilities in State A. Consequently, this tactic reduces the club's economic value to commission A. If this potential sequential effect had been foreseen initially, State A might have chosen to go-it-alone or form a club with other state commissions or form a sequential club with State B built upon procedures to resolve such issues.

Still, the state commissions could form an episodic club by making an explicit agreement to control sequential effects. How can the commissions credibly commit to control sequential effects once the policy has been implemented? One approach is a prudence review. In this example, the utility in State B overestimated its load growth, found itself financially challenged, and chose to reduce purchases from State A to resolve its problem. However, through a prudence review, commission B could have its utility or ratepayers absorb the costs from poor forecasting rather than pass them along to State A. Although this approach self-imposes a cost, it maintains the integrity of the original club and improves the potential for future cooperation. The appropriate form of regional cooperation depends upon the relative maintenance costs of various club structures. The state commissions in this example must determine which approach is less costly: either to commit to the use of prudence reviews (episodic clubs) or to invest in dispute resolution procedures to control sequential effects (sequential clubs). An episodic club based on irregular collaboration and explicit commitments to control sequential effects seems most appropriate when the effects of interstate transactions are only modest or when forecasts are highly reliable.

Modernization

Regional policies based upon well-known technologies improve the efficiency of episodic

clubs. The better known the technology the more predictable its costs and benefits. Certainty enables initial policies to remain efficient and equitable well into the future and tends to favor episodic clubs. Unpredictable costs or benefits, by contrast, raise questions of responsibility and fairness should initial expectations fail to mature once the policy is implemented. Club members must then address sequential effects should they occur, suggesting the need for procedures to resolve disputes and build consensus because collaboration requires more regularity to be viable.

As a result, episodic clubs are less appropriate when modernization incorporates newer technologies whose cost and service characteristics are less well known. It is likely, therefore, that attempts to modernize facilities with untested technologies will require sequential policies to help share the costs from potential failures that occur naturally during the learning process. The exception to this rule occurs whenever the deployment of untested technologies is small in scale, implying that sequential effects should be inconsequential.

Externalities

Episodic clubs, generally speaking, are not well suited to problems of externality such as pollution or congestion.[6] In economics there is a well known theorem, the Coase theorem, which states that externalities can be internalized contractually when negotiation costs are minimal. Unfortunately, the outcome, although efficient, is unlikely to conform to any acceptable standard of fairness. When the externality is a cost, for example, typically the recipient, not the originator, pays to reduce its effect. However, when the externality is a benefit, the recipient tends to avoid compensating the originator and instead freely enjoys the benefit. Because externalities create inequities, cooperation becomes less likely unless points of mutual advantage can be found. Generally, this requires a more global policy tactfully combining many aspects of the issue to encourage club formation and regional efficiency.

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[6] An externality occurs whenever the cost or benefit of some action is not properly assigned. Pollution is an example. The whole costs of electric utilities producing costly toxins, until recently, were not assigned to the utility. As a result, the utilities did not incorporate into their planning process the social cost of pollution. The consequence has been excessively high pollution levels.

The transmission grid and the shared common channeling infrastructure are sources of externalities in the electric and telecommunications industry, respectively. The actual flow of power and signals will generally disperse along multiple paths creating loop flows as discussed earlier. Loop flows can cause congestion, line losses, and lower reliability for some utility systems. These costs constitute an externality whenever the private costs to some utilities understate the true amount of congestion costs. This leads to inefficient decisionmaking by all utilities. With respect to the electricity industry, the amount of power transacted might exceed the socially optimal level should internal costs, those considered by the transacting parties, exclude the external costs from loop flows.[7] Thus, power agreements that are rational to the contracting utilities might be uneconomical regionally suggesting commission clubs could be useful. In order to be beneficial to all club members, the club must be able to form a regional policy capable of promoting equity and efficiency simultaneously. This is possible only when the equity effects balance out over time, implying the club's policy should only address efficiency issues.

Suppose State B is planning to market its excess capacity and increase its level of interstate power sales. Suppose State A has adequate capacity and intends to use its transmission network primarily for intrastate economy and coordination transactions to lower generation cost statewide. The power sales by utilities in State B could restrict economy transactions in State A should loop flows result. State B, although creating an external cost, has no incentive to compensate utilities in State A particularly if this arrangement is expected to continue. From State B's perspective, cooperation implying compensation serves only to lower its profits from power sales. An episodic club based upon a compensatory club policy is unlikely to form unless State B is willing to accept a smaller return from its activities.

Should the equity effects tend to balance over time, then an episodic club becomes possible but is not particularly robust because any significant change in circumstances could easily

[7] The observed consequence in the telecommunications industry is an understatement of required common channel signalling capacity when congestion costs are not reflected in the interutility contracting process.

undermine the balance.[8] Suppose the equity balance appears stable and an episodic club forms policy methods to internalize the costs from loop flows. In this case, the points of mutual advantage for state commissions come from improved utility decisionmaking arising from more accurate cost information and the removal of random shocks to one another's transmission network. The absence of shocks improves utility planning by improving the reliability of forecasts. Although the club policy is group-rational, utilities in both states have the private incentive to misreport transactions to escape from paying compensation. The utilities might cleverly structure power agreements in ways which keep with the letter of the agreement without keeping its spirit. State commissions, consequently, must jointly monitor power transactions because simply trusting the information provided will not likely suffice. Responsibilities of this type require a more permanent club structure and greater coordination by state commissions. However, episodic clubs are based upon irregular cooperation and therefore would be less appropriate.

The problem is much simpler in the telecommunication industry because the source of a particular signal can be easily delineated. Although the externality occurs as congestion on the transmission system, the particular source of signals can be easily discerned and, unlike electricity, service can be stopped unless the utility is fully compensated. Hence, the formation of an episodic club to efficiently control congestion costs is highly feasible in the telecommunication industry.

[8] A balance requires utilities in State A to likewise engage in interstate power sales.

Emergency Transactions

The construction of a transmission line to support emergency transactions between interstate utilities is an activity that falls into the category of initially minor sequential effects. Although the state commissions involved could independently approve the line's construction and cost sharing arrangements, it may be prudent to form an episodic club for the purpose of placing explicit restrictions on the utilities' use of the line. For example, the club could require the utilities to obtain approval from the state commissions before using the transmission line for anything other than emergency transactions. This gives state commissions a greater opportunity to jointly study the proposal for additional use and determine its full impact. It further offers commissions greater control over the extent of industry interdependency which, as argued above, underlies commission interdependency. Therefore, collaboration by state commissions may be prudent particularly when minor sequential issues have the potential to grow with time and become consequential regionally.

Public Utility Regulation and Sequential Clubs

Sequential clubs, like episodic ones, craft policies that allow state commissions to behave independently afterwards. As always, the primary task in policy development is to recognize interdependencies and find points of mutual advantage made possible through collaboration. As stated, collaboration is more regular in sequential clubs because actual outcomes are more sensitive to circumstances not entirely under commission control nor entirely predictable. Consequently, state commissions must develop procedures or guidelines to resolve conflict should it occur afterwards. In its simplest form, a sequential club becomes a temporal sequence of episodic clubs supported by a set of dispute resolution procedures to strengthen intercommission harmony.

The regional policy developed by a sequential club, although unicentric in design, is typically more general than is possible within an episodic club and can be implemented in a greater variety of ways. Consequently, some of the findings for episodic clubs have to be extended for sequential clubs. As an example, episodic clubs use contracts as the primary vehicle to implement the club's policy. These contracts usually pertain to a specific set of interutility transactions. Sequential clubs can expand upon this approach and develop rules, standards, or incentive

mechanisms to govern utility interaction and encourage regional efficiency at lower regulatory cost. Rather than focusing upon a specific set of utility transactions, sequential clubs can generalize and economize over many general transactions although this may result in occasional imbalances which are reconciled through conflict-resolution procedures.

Another option available to sequential clubs is the use of "utility clubs" to implement and monitor the commission club's regional policy. This option is particularly well-suited to industry issues involving externalities with equity and efficiency consequences. As discussed below, the commission club, by viewing the externality in its entirety, may develop regional policies covering a large territorial expanse and affecting a large number of utilities. Such regional policies, consequently, treat utilities within the territory as a single group with the goal of realizing points of mutual advantage through formatted cooperation.

Sequential clubs also reduce the presence of federal regulators, courts, or legislators and to subsidize the cost of learning the effects of new technologies. The sequential club's ability to resolve equity issues can both insure the financial integrity of utilities and offer state commissions more control over the final decisions affecting ratepayers in their jurisdictions. Utilities, moreover, can move up the learning curve for innovative technologies more rapidly if the sequential club established equitable risk sharing criteria between the utility, NUGs, and ratepayers. This is a real benefit when the market for new technologies is not well-developed. An immature market does not provide the information necessary to remove unsystematic risks from decisionmaking.

Cost Allocation

Continuing with the capacity expansion example, suppose States A and B require additional generation capacity to accommodate anticipated load growth. Also, suppose a regional holding company services both states. Because a holding company tends to pool the needs of its operating companies, the holding company may propose to build a large facility to benefit from scale economies and to minimize overall risk. However, the proposal's success crucially depends upon the accuracy of the load forecasts and cost projections; any large deviation from expected values could easily overwhelm any benefit from construction savings. The project's riskiness and consequential equity problems offer state commissions the opportunity to form a sequential club

and jointly affect the proposal's final characteristics.[9]

Because the levels of uncertainty and risk are potentially high, an episodic club's policy might myopically set guidelines to control and allocate costs should the forecasts or cost projections prove inaccurate. The policy, for example, could allocate cost overruns based upon the extent of forecast inaccuracy; that is, the larger its inaccuracy the more an operating company would contribute to cost overruns or revenue shortfalls. Another potential policy would be to share cost overruns based upon messages sent or kilowatthours consumed. Larger customers would shoulder the most burden under such a plan. Finally, the club could agree to apportion the overrun in proportion to the amount of capacity originally contracted for by the operating companies.

The viability of the elected policy depends upon whether adherence to it is rational once the source of cost overruns becomes apparent. That is, the policy must make sense ex post, when faults and mistakes are more easily discernible. Suppose State A's operating companies correctly forecast load growth and State B's companies do not. Now assume that this error exacerbates cost overruns. Furthermore, suppose the policy apportions cost overruns equally over messages sent or kilowatthours consumed. Once the cause of overruns becomes common knowledge, it is unlikely Commission A will want its utilities sharing cost overruns caused by the poor forecasts of utilities in State B. This would simply penalize its ratepayers, and in effect, subsidize those in State B. Ironically, those best at forecasting load growth are made worse off by the club's equal-sharing policy. Although equal sharing of penalties may seem equitable before the sources of errors are known, once these sources become common knowledge those not responsible are reluctant to abide by any previous agreement making them worse off. An episodic club based on equal sharing of penalties, therefore, is not sustainable unless the utilities are equally at fault ex post. A sequential club, by contrast, would develop procedures to resolve cost overruns ex post rather than propose ex ante solutions to yet unknown problems.

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[9] State commissions could avoid forming a sequential club by simply agreeing to a wholesale power facility and then organizing the less expensive episodic club to develop the associated regional policy. The selection of the optimal club structure requires consideration of all costs and benefits, not just those associated with club formation. An NUG might select a technology whose construction and operating costs are not easily predictable. The utilities' customers might be asked to absorb some of the risks as the quid pro quo for nonutility production. This outcome may be more costly in the long run than the outcomes associated with forming a sequential club.

Whenever unexpected problems occur, those not responsible or less responsible are not likely to accept the dictates of policies that now seem unfair. Therefore, it is often difficult to develop efficient and equitable initial policies when costs are relatively uncertain. There are several reasons why this is so. First, the construction of an explicit policy that is not likely to be disputed after the fact, depends upon before-the-fact knowledge of the primary cause of any deviation from expected values. This is not generally possible in situations where more than one factor can affect an observed outcome. Second, should more than one factor be possible, the policy must address each one separately, which is a costly exercise. Third, explicit policies may exacerbate naive behavior or create perverse incentives.

As an example of a naive behavior, suppose the burden of sharing cost overruns are assigned in accordance with capacity amounts initially contracted for by each utility. Those anticipating small load growth might naively consider overstating their capacity needs as a cheap means to lower future supply risk and cost.[10] Should cost overruns occur, however, those utilities nominating larger capacities are held more accountable. Consequently, those utilities seeking a low-cost solution to supply risk may find themselves saddled with larger-than-necessary shares of any cost overruns because they naively overstated their capacity needs. Conversely, those utilities not relying on capacity nominations to offset supply risk benefit from the sequential policy should cost overruns occur. Then again, a perverse incentive may originate. The utilities may understate their capacity needs to mitigate the burden of cost overruns[11] but this compromises the attainment of scale economies and raises average cost.

A sequential club would avoid creating adverse incentives by recognizing the multifaceted nature of the sequential process and avoiding explicit remedies to unknown problems. Instead, the policy could include dispute resolution procedures to resolve sequential issues. The

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[10] This seems rational individually because the joint project involves scale economies by assumption: the larger the project's capacity, the lower its average costs. However, such a policy is speculative because overstated amounts may be unneeded, unmarketable, and may straddle core customers.

[11] Some utilities may deliberately understate their capacity needs if they believe that others are overestimating theirs. This enables them to reduce their contribution to cost overruns should they occur, and if their presumption is correct, there should be sufficient capacity available to cover understated amounts. In short, naively crafted sequential policies can induce gaming and undermine the value of cooperation.

apportionment of unanticipated costs as they occur requires a club structure capable of resolving equity disputes amicably so as to encourage lasting cooperation. Otherwise, equity disputes could eventually undermine commission cooperation over time. This can be quite costly because one sizeable failure at cooperation might cause state commissions to pass over future opportunities to benefit from collaboration.

The institutional framework required to resolve disputes and maintain collaboration over time adds to the total cost of a sequential club. As an example, a part of the club's activities might include regularly sharing information, conducting joint problem-solving workshops, and forming advisory and technical councils when resolving inequities. The additional costs may be judged worthwhile when the regional benefits made possible through regular collaboration are compared to lack of agreement at all or to the regional benefits obtainable under an episodic club.

Externalities

A common aspect of externalities is that they typically involve clear-cut sets of winners and losers that remain relatively stable over time. As discussed earlier, episodic clubs are unable to remedy the equity problem. One possible remedy is to form a sequential club to deal with the externality. A sharing of the electricity transmission grid

provides a good example on how expanding the issue helps a sequential club solve a distribution problem.[12]

As stated previously, states which are heavy users of the transmission grid are disinclined to form clubs with low-use states because the regional policy might require them to make compensatory payments to the low-use states. These payments, though, would improve the allocation of resources by properly assigning costs and internalizing the externality. In other words, heavy users of the transmission grid would pay more should they create costly loop flows. However, state commissions whose utilities are responsible for heavy usage would not likely join clubs with the sole purpose of improving efficiency by properly assigning loop flow costs. They would have to see some benefit for their ratepayers.

One approach for resolving this dilemma is to recognize that heavy usage also quickens the pace of investment into the transmission grid. Although internalizing loop flow costs penalizes heavy users, greater efficiency in investment planning would benefit heavy users because such penalties would be less likely to arise. In particular, heavy users of the transmission grid would be more likely to join a club when they are assured that low-use states will invest sufficiently in their portions of the transmission grid to accommodate the needs of the heavy users. Such an outcome is regionally beneficial because the actual level of investment would conform to its higher social value instead of a lower value based solely upon those developing the investment plan. A possible regional policy then might entail compensation for those adversely affected by loop flows in return for allowing heavy users' input into their transmission investments. By expanding the regulatory issue beyond operational issues and including capacity

[12] A comparable situation can arise in the telecommunications industry. Suppose that a local exchange company is required to switch the messages and calls of an alternative local exchange carrier but the alternative local exchange carrier is not required to lease intertrunking facilities from the local exchange company. Intertrunking facilities connect the switches of a local exchange company together. Under these conditions, by underforecasting their intertrunk facilities needs, an alternative local exchange carrier can create the equivalent of loop flows, that is, nontraceable demands on the intertrunking facilities.

considerations, points of mutual advantage can be ascertained even within the context of an externality.[13]

By expanding the issue, a sequential club can benefit all members by using efficiencies made possible by cooperation to balance inequities and overcome inefficiencies caused by externalities. Of course, the regional policy suggested above is just one of many which could overcome the problems and issues inherent to electric transmission. However, generally speaking, cooperation requires the regional policy to internalize the externality in ways advantageous to those creating it; in other words, the net benefit to those internalizing the externality must exceed the costs from compensating those adversely affected. At the same time, the regional policy must make better off, or at least no worse off, those initially and adversely affected by the externality. Such policies, however, require a more permanent club structure for successful implementation, one built upon a process of regular collaboration.

Earlier, the effect of the industry's organization upon the necessity and structure of commission clubs was emphasized, however, the causal connection also runs in the opposite direction because commission clubs implement policies shaping the mechanics of interaction among regulated entities. These mechanics affect the organizational structure of the industry. The regional policy, described above, to resolve the transmission externality would require the participation of regulated utilities for successful implementation. The utilities would need to share information cooperatively and develop accounting methods to monitor transactions affecting the distribution of benefits and costs along the transmission network. State commissions might develop guidelines for creating a utility club to efficiently implement their regional policy. As an example, the commission club could determine utility membership criteria, reporting practices, sharing rules, contract provisions, as well as other issues during policy formation. Once the utility club is in operation, state commissions might meet primarily to resolve disputes among utilities or among themselves or to craft new guidelines whenever changing circumstances warrant such action.

Environmental Compliance

[13] Additionally, heavy users would be compensated for investments they make in their portion of the transmission grid if low users benefit. This encourages investment efficiency. Heavy users would incorporate loop flow payments when contemplating whether or not to expand their transmission system.

A regional approach to environmental compliance can take on various degrees of complexity. A compliance strategy embedded within a much larger least-cost plan would be quite complex and involve agreements over generation and transmission investment, fuel selections, scrubber investments, economic dispatch, and so on. A sequential club would not be appropriate because of the polycentric nature of the regional policy required to systematically organize the various activities. However, a sequential club could form for simpler tasks, for example, to establish a utility club designed solely to exchange pollution allowances. This could be the first practical step to developing a national market as envisioned by the Environmental Protection Agency and Congress.

A well-functioning regional pollution allowance market requires the standardization of reporting data regarding actual utility transactions and the creation of incentives to encourage efficient exchange, that is, exchange which is motivated to reduce the regional cost of pollution compliance. The commission club could create institutions such as regional banks, to minimize the cost of influencing and overseeing utility activity. These banks could record all buy-sell transactions or leasing arrangements taking place within the region, as well as between regions and provide state commissions, with the types of information required to judge the prudence of utility activities under their jurisdictional control. The banks could oversee brokering activities and provide for over-the-counter transactions. Such operations would reduce transactions costs and improve the dissemination of information, both factors are conducive to workable competition and optimal levels of market interaction.

Additional compliance strategies may involve the use of clean coal technologies. Many of these technologies are relatively new and have yet to be extensively tested. Their cost and service characteristics are less well known as a result, and therefore, may be considered financially risky from the perspective of a single state. Still, their use could be encouraged through commission clubs willing to share the risks of newer technologies. This approach, however, would require a sequential club built upon dispute resolution procedures able to fairly apportion risks and rewards and sustain regularity of collaboration.

Standardization of Information

Sequential clubs are appropriate for standardizing financial, accounting, and engineering data especially when the industry is not highly integrated. Its benefit is to reduce transaction costs by creating a common language enabling easier and more descriptive communication between state commissions and other participants, such as utilities. However, standardization can cause equity effects if the industry is highly integrated or consolidated because of the myriad of interutility linkages. Generally speaking, a more integrated industrial organization increases the value of standardized information but it also increases the incidence of sequential effects from state commission actions. Hence, standardizing and pooling information can become costly at the regional level should state commissions behave independently and without regard to the regional consequences of their decisions.[14]

As an example, suppose States A and B are served by a single multistate utility company whose financial and accounting data have been standardized allowing more informed commission decisions. Unless policy restrictions have been formed for the use of this information, State A might consider the utility's activity and profitability in both states when negotiating its revenue requirement during a rate case. This could provide the utility with the incentive to shift common costs to State B's jurisdiction and ratepayers which, from the perspective of State B, might not have occurred without a common database. This could provoke a sequence of uncooperative responses by both states and result in a regionally suboptimal outcome.

[14] The standardization and pooling of information heightens the interdependency among state commissions of a given industrial organization and encourages club formation. However, when developing a common language, state commissions must consider the ramifications affecting club durability, particularly when the club's structure is sequential since this type of club allows independent behavior afterwards. This might require club members to restrict or constrain their individual decisionmaking.

In short, the standardization of information can be useful within the context of a sequential club when the industrial organization is loosely coupled. The benefit to state commissions is having a better sense of the region which should enable more informed policy decisions. As long as the regulated industry is loosely interconnected, independent and unrestrained decisionmaking will not create consequential sequential effects. However, should the contrary hold with utilities highly interconnected, then consequential sequential effects are bound to occur. A sequential club would be incapable of resolving all differences since the standardized information would likely shape commission policies overseeing many utility activities. The polycentric use of standardized information requires a polycentric policy to coordinate state commission activities.

Incentive Mechanisms

The use of incentive mechanisms is growing in regulation. Typically, the mechanism is a compliance strategy, rewarding utilities for efficient performance and penalizing them for imprudent practices. When an incentive mechanism works efficiently, it changes the underlying circumstances and dynamics associated with the utilities. Effective mechanisms, therefore, need to be readjusted regularly to remain efficient; otherwise, they may induce inefficiency or simply provide too weak an incentive to coerce efficient behavior.

One reason state commissions may want to collaborate when developing incentive mechanisms is to remove inconsistencies across compliance approaches. This is particularly important when the utility network operating across states is managerially integrated as with regional holding companies or multistate utilities. Inconsistent mechanisms can create dilemmas, similar to those associated with tax-subsidy programs and economic development rates, by sending mixed messages to the operating companies about what is most important to the regulatory authorities.

Besides the removal of inconsistencies, the cooperative development of incentive mechanisms may generate its own positive externality. As an example, a mechanism designed to encourage aggressive behavior in upstream input markets works best when

many utilities secure supplies aggressively.[15] The greater the response of utilities to input price differences, the more likely upstream suppliers will behave competitively.

As stated above, incentive mechanisms need to be readjusted regularly if they are to remain efficient over time. Regulatory oversight and collaboration must likewise be regular suggesting state commissions must form sequential clubs to effectively implement a policy involving incentive mechanisms. A part of the club's policy is to update the mechanism when warranted by circumstances. The commissions, therefore, will need to share information on a regular basis and form technical committees, when necessary, to improve the mechanism's efficiency.

Public Utility Regulation and Coordination Clubs

Coordination clubs are vehicles to develop and implement polycentric policies and to streamline the formation of less-structured clubs, such as episodic and sequential clubs. As previously discussed, a polycentric policy coalesces multiple regulatory issues in an attempt to build points of mutual advantage and capture economies of scale and scope. Some regulatory issues, particularly ones involving an externality, may be too narrow for a consensual policy that is both mutually beneficial and regionally efficient.

Coordination through regional committees is the principal mechanism by which regional economies are captured. Their role, however, is solely to guide state commission decisionmaking rather than direct it along a particular course. As an example, a sequential club could form and develop an incentive mechanism to reward and penalize utility performance. The policy could initially determine its design and parametric values, and allow future values to be set independently by state commissions. The interaction of future adjustments, although seemingly efficient at the state level, may induce regional inconsistencies and create costly inequities and inefficiencies. Although sequential clubs are designed to resolve such problems, the state commissions may find it more efficient to operate more continuously and collectively should the frequency of readjustments be high. A more coordinated approach, organized through a regional

[15] An incentive mechanism capable of increasing procurement efficiency can be found in an earlier published NRRI report. For further details, see, Robert E. Burns, Mark Eifert, and Peter A. Nagler, *Current PGA and FAC Practices: Implications for Ratemaking in Competitive Markets*, (Columbus, OH: The National Regulatory Research Institute, 1991).

committee, could better orchestrate parametric changes and thus increase regional welfare by increasing the mechanism's effectiveness.

The role of the regional committee, in this case, would be to collect information, develop a "sense of the region", and reduce inconsistency. The committee could be localized, staffed, and financed by member commissions. As a part of the club's policy, a member commission would be required to first consult the regional committee prior to reaching a final decision. The committee could model and analyze the commission's proposal as well as provide alternative courses of action. Discretion regarding the final course of action would remain with each state commission.

The committees within a coordinated club help to "regionalize" decisionmaking. It is through this regionalization process that economies of scale and scope, both industrial and regulatory, are realized. However, the concept of regionalization should not be confused with the foreign notion of centralization. Coordination clubs are not quasi-autonomous regulatory authorities operating at the regional level. They do not exist independently of state commissions nor do they institutionalize power and authority. They operate through consensus building, unanimity, and autonomy. A state commission abides by the conditions of the club's policy, that is, it remains a member as long as cooperation enables it to obtain state goals more easily. This ensures Pareto efficiency, implying, as regional trends change, that coordination clubs must respect and treat equally the needs of all members. Coordination, by definition, is the harmonious interaction of parts deemed "equal" in importance.

An example of a coordination club is the exchange rate mechanism (ERM) currently operating in Europe. The ERM consists of exchange rate parities that allow the actual exchange rate of two countries to operate within an interval around a previously agreed rate. This allows the countries to independently develop monetary strategies consistent with their own national agenda. This is contingent on the exchange rates staying within prescribed bounds. The advantage of the ERM is that it helps stabilize exchange rates which naturally facilitate trade and economic growth within the European Bloc. As with the ERM arrangement, coordination clubs occasionally break down. This occurs whenever the original set of exchange parities no longer benefits particular members. However, club breakdown is vital to the survival of cooperation and serves as the signal to revamp the club's original policy. Occasional breakdowns provide the internal dynamics necessary to insure regional efficiency and fairness. Naturally, coordination

clubs must have the institutional practices and procedures to resolve disputes amicably.[16]

Policy Formation

One way to form a polycentric policy is to merge unicentric ones. Another approach is to begin with a holistic plan coalescing several regulatory issues simultaneously. The first approach views coordination clubs as a vehicle to organize sequential and episodic clubs and their policies. Earlier, a sequential club was described as a temporal sequence of episodic clubs held together by a common set of dispute resolution procedures. A coordination club can equally be described as a temporal combination of episodic and sequential clubs efficiently coupled through regional committees.

Sequential clubs form unicentric policies addressing singular regulatory issues, such as transmission or generation or modernization. Although the clubs may be internally efficient, a collection may not be, especially when different sets of state commissions are involved. The policies or decisions emanating from some clubs may undermine those of others or make cooperation too costly or ineffective because of spillover effects. As an example, a set of state commissions might form a sequential club to internalize externalities within its transmission network. Once implemented, the policy would alter power transactions and flows along the network which could affect adjacent states and their transmission systems. The effects may be benign or malign but decisionmaking will become less efficient unless the spillover effects are correctly internalized.

One potential solution is to expand the initial sequential club to include all affected states. However, this involves a more complex and costly consensual process that may lack the mutual advantages required to benefit both new and original club members. This expansion process could become uneconomical, particularly if the costs to form and maintain a sequential club

[16] A more complete discussion on consensus building and dispute resolution is provided in the next chapter.

exponentially increase with membership size.[17] There is also the problem of foregoing economies of scope made possible through coalescing multiple regulatory issues. A pervasive unicentric policy may unduly restrict the formation of other policies beneficial to regional efficiency by overburdening limited commission resources.

An alternative is to form a coordination club and establish a regional committee to help oversee club formation. Its purpose would be to analyze regional issues and suggest possible club and policy configurations to maximize regional welfare. When new clubs are contemplated, the committee could examine the effect its policy would have upon surrounding extant commission clubs and recommend ways to mitigate interclub sequential effects. The committee could help further eliminate information barriers between clubs and suggest points of mutual advantage made possible through club mergers or policy reformulations. However, above all, the regional committee should facilitate consensus building and cooperation and pacify forces attempting to balkanize commission clubs.

Innovative Generation Technologies

Currently, the Department of Energy (DOE) has supported an array of environmentally benign generation technologies at various stages of development. How to continue development and eventually introduce innovative generation technologies (IGTs) into the electric industry is still under discussion. One possible avenue is through the formation of coordination clubs.

[17] See appendix B for theoretical details concerning conditions on optimal club size.

In part, the question of how to proceed depends upon the marketability of the various technologies. A technology is marketable whenever state commissions, utilities or NUGs, and financial institutions can enter into mutually acceptable agreements on a regular basis. A subsidy may be needed to enable currently unmarketable IGTs with high potential to reach their full development and adoption. One possibility would be to form coordination clubs and treat the technologies as public goods to be publicly financed.

State commissions interested in particular IGTs could jointly assist their progression. For example, state commissions could form a club to pool their electric customers and finance initial capital investments through taxes on electricity consumption. The facilities could be operated by teams of technical experts from the various utilities and power could be sold through wholesale power contracts. The ratepayers receiving electricity could be protected by having their rates set equal to what they would have been otherwise.

The advantage to forming a coordination club and treating the development of unmarketable IGTs as a public investment is severalfold. First the risk of innovation can be spread thinly across many ratepayers rather than concentrated upon a few. Second, a coordinated approach can remove duplication of effort. Rather than have several states promote the same technology, several technologies could be pursued simultaneously. By developing a portfolio of IGTs, state commissions could actually improve their chances of developing successful technologies at lower overall risk. Third, the club good derived from coordination would be the engineering designs and operational knowledge from successfully developed projects. This information would be freely shared among all member commissions to maximize the club's economic value.

The above illustration of state commission coordination is only one of many possibilities concerning the development of IGTs. It is presented as an example of how state commission coordination can act as a proactive force in shaping the future course of the electric industry.

Conclusions

The club structure appropriate for regional cooperation depends upon the degree of interdependency among regulatory issues and state commissions. Generally speaking, commission clubs will require more institutional structure as the complexity of regional issues increases and as the degree of interdependency among state commissions grows. Episodic clubs should grow in pervasiveness as the importance of nonregulated entities increases within traditionally regulated markets. As nonregulated entities begin to accept more risk, episodic clubs can, in some instances, substitute for greater industrial integration and add greater certainty to commission policies. The policies of episodic clubs are unicentric and explicit and are typically embedded within utility contracts. These contracts may be interutility or involve utilities and nonregulated entities. Since they are intended to stand the test of time, follow-up adjustments and procedures to implementation are not institutionalized within the club's structure. Episodic clubs, therefore, are perhaps most efficient when the regulatory issue is highly localized and involves only minor sequential effects.

Sequential clubs are appropriate when there is a possibility that unanticipated problems could occur with time and undermine the policy's economic value. Consequently, a part of the club's structure involves procedures to build consensus and resolve disputes as follow-on adjustments become necessary. Their advantage over episodic clubs is the formation of general policies along with well-defined dispute resolution procedures to better secure points of mutual advantage and sustain cooperation. The resolution procedures help to "regularize" cooperation which becomes necessary whenever explicit agreements are inefficient due to likely consequential uncertainties beyond the club's control.

A part of the resolution process may require collecting data on utility activities and participating in joint problem-solving workshops, or advisory and technical councils when problems occur. Since the club's policy does not prescribe any specific solutions, the resolution process is highly unrestrictive and sufficiently capable of making both small or large adjustments as necessary. Sequential clubs are most appropriate when regulatory issues are separable and sequential effects from incomplete agreements are consequential.

Coordination clubs are most appropriate whenever regional regulatory issues are strongly interrelated, implying that any separation could forego economies of scope or create inconsistencies. Generally speaking, the economic value of a coordinated club grows as regulated entities become more integrated and coordinated in daily activity. The principal vehicle used to achieve policy coordination is the regional committee. The regional committee is designed to help guide state commission decisionmaking in ways benefitting the state and the region. A part of their purpose is to develop a "sense of the region."

Unlike consolidated clubs, coordination clubs do not institutionalize power or authority. They should not be confused with some type of quasi-autonomous regional authority. The policies are implicit social contracts which maintain their viability as long as all club members are made better-off by adhering to the policy's strictures. This encourages a more Pareto-efficient outcome since member commissions adversely affected by the club's policy can always leave at their own discretion. Although coordination clubs occasionally breakdown, this "breaking-down process" is what guarantees the formation of regional policies that are both fair and efficient.

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CHAPTER 10

CONSENSUS-BUILDING PROCEDURES FOR REGIONAL REGULATION

Earlier chapters have shown that the need and opportunity for multistate commission regulation in some cooperative form is substantially greater now than a decade ago. Various spurs to action have intensified the interest in regional regulation. In particular, regional regulation provides an alternative for state public service commissions and federal agencies, such as the Federal Energy Regulatory Commission (FERC) and the Federal Communications Commission (FCC), to provide an appropriate level of regulatory control over regional utility companies. Indeed, after the Mississippi Power & Light case, regional regulation may provide the only effective means to control the actions and policies of regional electric holding companies. The alternative is for state public service commissions, under the Pike County exception, to regulate the purchases of buying utilities. If the purchase obligations of the buying utility are set pursuant to a FERC-approved allocation agreement, state commissions are preempted and are denied the authority to disallow excessive purchase power costs, even though lower-cost power may be available. The FERC, on the other hand, does not have authority to provide plant siting or certification, and is therefore unable to engage in integrated resource planning (IRP). An effective means of regulating the policies and actions of a regional holding company is to form an equal regulatory partnership among the FERC and the appropriate state public service commissions. A parallel example for telephone indicates that regional regulation is also an attractive alternative for state and federal commission regulation of regional holding companies and other multistate situations when it is in the interest of neighboring state commissions to coordinate their actions.

Regional regulation through a joint-board concept might provide one reasonable means for the coordination of state and federal regulatory policies. The use of regional regulation in the joint-board context has the advantage of providing state commissions with a means of regulating regionally without violating the Commerce Clause. It also allows the federal agency, FERC or the FCC, to avail itself of meaningful state commission participation in a regional decisionmaking

process that includes federal issues without violating the "nondelegation" doctrine. However, the current use of joint boards by the FERC has been somewhat disappointing. As noted earlier, the FERC rarely, if ever, uses joint boards. The FCC, on the other hand, uses joint boards extensively, but the decisions of the joint board are treated as being merely advisory or proposed decisions. The FCC Commissioners are free to amend the findings of the joint board in their final decision. In order for joint boards to be a meaningful and worthwhile example of regional regulation, Commissioners must show great deference to the decisions of the joint boards and make certain that legitimate local interests, not merely parochial in nature, are allowed to be reflected and balanced in the joint-board setting. To accomplish such a balance, the use of alternative administrative procedures that emphasize consensus building is envisioned.

Consensus-Building Procedures

Many federal and state public utility commissions rely heavily on adjudicatory procedures to make industry-wide policy decisions. The reason for this is mainly historical. State commissions, virtually from their formation, used trial-type proceedings for ratemaking and related matters. These are appropriate for commission determinations of a "revenue requirement" based on an historical test year. Indeed, adjudicatory procedures have proven themselves, both in court and administrative cases, to be well-suited for a retrospective determination of facts. In particular, adjudicatory procedures are appropriate in the context of a zero-sum game.

Today, unlike years past, many of the issues that face federal and state commissions are industry-wide policy issues. These implicitly or explicitly require the agency to make economic and financial decisions about future events and conditions, and to engage in regulatory planning or policymaking based on these decisions. Many of these decisions are regional in nature. To meet these needs, state and federal commissions may need to become more forward-looking economic regulatory and planning bodies, geared toward promoting efficient policies with respect to their individual industry, that fit into the broader economic system. This is particularly true for state commissions and the FERC, state commissions and the FCC, as well as administrative agencies concerned with natural resource, energy, and environmental law. Furthermore, regional issues,

particularly prospective issues, are not a zero-sum game. The inherent diversity between states creates opportunities for consensus building that result in spillover benefits being captured by club members. Consensus-building procedures can be utilized to assure that no single member commission is worse off than if it had "gone it alone." The consensus-building mechanisms discussed below can result in a win-win situation where all state commissions benefit from regional regulation.

It is widely recognized that adjudicatory procedures are cumbersome vehicles to address forward-looking policy issues. Adjudicatory procedures also tend to make it difficult to obtain any outcome other than that of a zero-sum game with winners and losers. Because the agency must limit its decision in a trial-type procedure to the record as presented by the parties, certain innovative ideas and solutions may not be brought to the agency's attention. Commissioners or other agency decisionmakers may be restricted or precluded by the adjudicatory format from using their own best judgments and ideas because of an inadequate record. When trial-type hearings are used in the context of regional planning by a regional regulatory body, these problems are compounded by variations in the details of procedural and evidentiary rules, and practices of each agency. Thus, although a joint adversarial hearing is a possible procedure to use in the context of regional regulation, its usefulness is quite limited.

Neither does an adjudicatory procedure lend itself to proactive regulation. Adjudicatory procedures cause an agency to be passive and reactive, to respond to pressure by the parties, and to fail to define its own agenda, and to fully exercise its power. In fact, the use of the direct testimony/cross-examination/rebuttal format is the reason adjudicatory procedures are often so long, tortuous, and hard to bring to a clear resolution. While this format has the appearance of fairness, it is limited in its ability to produce informed determinations regarding forward-looking policy issues. As an example, a typical trial-type procedure would not provide for adequate public participation in the IRP processes currently being considered by many of the state commissions that might also be considered by a regional planning body. The policy choices facing the commissions in these cases require, for good results, the best possible knowledge about state-of-the-art demand and load forecasting, existing and on-the-horizon supply options, available load-management techniques, available conservation measures, risk-assessment data and techniques, and a myriad of other financial, economic, and engineering issues. Moreover, through

an adjudicatory proceeding, it would be difficult, if not impossible, for a state or regional commission itself to gather the quality of information that it needs in a coherent fashion.

Nor is it that the typical notice-and-comment rulemaking procedure can solicit the type or quality of information needed. Unsupplemented, it does not provide an opportunity to probe deeply into the reasons for differences between the various parties' positions nor to probe the assumptions behind comments. Nor, again, does it necessarily allow decisionmakers to use their own expertise to determine what might be the best resolution of the policy issue. Building a consensus among the interested parties and gaining a better understanding of the areas of agreement and disagreement among the parties through the use of a dialogue with agency decisionmakers are difficult to achieve in an unsupplemented notice-and-comment rulemaking. Also, an unsupplemented notice-and-comment rulemaking is simply not designed to be useful in a regional regulatory context in anything less than a new regional regulatory entity.

Other new and innovative administrative procedures, however, are increasingly in use by federal and state commissions.[1] These procedures allow agency decisionmakers

[1] Much of the discussion and analysis in this section is adapted from Robert E. Burns, *Administrative Procedures for Proactive Regulation* (Columbus, OH: The National Regulatory Research Institute, 1988); and Robert E. Burns, "The Evolving Role of Dispute Resolution in Administrative Procedures," *Natural Resources & Environment* Vol. 5:2 (Fall 1990). It should be noted that these procedures are not costless. Indeed, consensus building can be as costly as a trial. However, a consensus-building procedure is more likely to yield a more satisfying win-win result.

(agency directors or commissioners, administrative law judges, or senior staff making initial advisory decisions) to become more involved in the forming of prospective policy, and to consider prospective policy issues in a more complete, thorough, and coherent fashion than the typical adjudicatory or notice-and-comment rulemaking procedure, which they tend to supplement rather than supplant. In other words, some alternative procedures can be used early in the administrative process in combination with rulemaking or an abbreviated adjudicatory hearing. Many of these procedures use one or more of the "alternative dispute resolution" (ADR) techniques of mediation, negotiation, and arbitration, to achieve their end. Alternative dispute resolution has as its end creative outcomes that take advantage of the diversity of the parties (or in this case club members) to produce win-win outcomes that take advantage of potential spillover benefits. However, the alternative procedures go beyond what is traditionally understood as ADR by providing decisionmakers additional means of engaging in proactive regulation in an administrative process. One such example is negotiated rulemaking, where a negotiation process is followed by the more traditional notice-and-comment rulemaking. In the context of regional regulation, these procedures might be useful for the initial formulation of policy, particularly if the policy issue is prospective in nature.

What these procedures have in common is that they can improve the quality of regulation, particularly forward-looking regulation, because they help the policy decisionmaker gather, organize, and consider pertinent and complete information that is necessary for proactive policymaking in a more organized and rational fashion than current procedures. They are procedures that can be used for planning and would be useful for regional regulatory efforts that involve some degree of regional planning. Some also allow the decisionmaker to use his or her expertise and to engage in in-depth discussions or full and wide-ranging inquiries on prospective policy issues. They include negotiated rulemaking, joint problem-solving workshops (sometimes called "the collaborative process"), technical conferences, and commission task forces. Many of these procedures emphasize consensus building. Without consensus building, the

regulatory club (described earlier) that is the model for the formation and maintenance of regional regulation cannot easily take place.

By using new and innovative administrative procedures, state and federal commissions are designing the tools they need to provide the necessary input to decide prospective policy issues that involve economic and financial projections, as well as scientific uncertainty. These new and innovative administrative procedures can be valuable tools in the context of regional regulation. Whether a loose, informal, and flexible regional regulatory structure is put in place or a more permanent, formal regional regulatory entity, these innovative administrative procedures make possible regional planning and the regional consideration of prospective policy issues, and provide a means for creating a win-win situation that makes the formation and maintenance of the regional regulatory club feasible. Further, they can substitute for more centralized approaches to cooperation, such as megacommissions. While centralized authority helps to reduce coordination costs by limiting those involved in policymaking, the use of task forces and other consensus-building mechanisms also streamline policy formation, but with wider participation.

Matching Consensus-Building Mechanisms To Regional Clubs

There is a wide variety of potential regulatory topics that could be regional in nature. As an example, in the electric sector, regional topics could include environmental externalities, capacity planning and modernization, transmission or power plant siting, IRP or least-cost planning, allocation and accounting control, efficiency incentives, allowance trading, and acid rain compliance. It is not possible, without knowing the precise context within which these issues are raised, to say that one form of regulatory club is most appropriate and effective. Rather, this is an area of judgment for the state commissions involved. An indication of the appropriateness of various levels of regional regulatory involvement, however, is suggestive. As an example, although accounting controls might best be handled in an episodic club, once cost allocation issues are raised it might be more appropriate to engage in more regularized cooperation in the form of a sequential club. On the other hand, regional integrated resource planning could involve complex, polycentric issues that certainly require regularized attention of the coordination club.

As a simple issue becomes more complex, the appropriate club structure moves from episodic to sequential to coordinative, and then to consolidative.

Consensus building helps both regulatory club formation and initial policy formulation. The consensus-building mechanisms mentioned are necessary to organize a regional club, particularly a more formalized one such as a coordination club. Once a regulatory club structure is established, based on whether the issue involved is a seldom or regularly-recurring single or a polycentric issue, the next step is to choose appropriate consensus-building procedures to continue to make the club viable. As shown in Figure 10-1, the limited nature of an episodic club makes it likely that regulatory commissions might limit their resources and use technical committees and possibly joint problem-solving workshops as consensus builders.

The regularized nature of the sequential club would tend to make the use of joint problem-solving workshops more common, with continued use of technical conferences and committees as necessary. More involved forms of consensus building are needed for a sequential club to help to resolve disputes and amend policies later on.

A coordination club, because of its continuous nature and the complex, polycentric issues addressed, would use technical conferences, joint problem-solving workshops, and where appropriate, task forces to build consensus. These consensus-building procedures are needed on an ongoing basis so that they can help resolve disputes ahead of time and avoid costly disagreements between club members.

A megacommission or interstate compact, because it is its own entity and can independently issue its own orders or rules, might find negotiated rulemaking useful, as well as any of the other procedures mentioned above. Two examples of how regional regulation might be used to address current electric and telephone issues are contained in Appendix C.

Fig. 10-1. Matching consensus-building procedures to regulatory club structures.

REGIONAL POLICIES	UNICENTRIC		POLICENTRIC	
CLUB STRUCTURE →	EPISODIC	SEQUENTIAL	COORDINATIVE	INTERSTATE COMPACT & MEGACOMMISSION
TOPICAL EXAMPLE (Electric)	(Accounting Control)	(Cost Allocation Control)	(Facilities Planning and Siting)	(Integrated Resource Planning)
CONSENSUS BUILDING PROCEDURES ↓				
Negotiated Rulemaking	--	--	--	X
Technical Conference	X	X	X	X
Joint Problem-Solving Workshops	sometimes	X	X	X

Task Forces	--	--	X	X

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CHAPTER 11

CONCLUDING REMARKS

Regional regulation is attractive, not only as an alternative to incomplete and ineffective regulation that can occur when state and federal commissions cannot individually control a utility's actions; it is also attractive when cooperation between states would yield a superior result than state commissions acting on their own. It can also be superior to the alternative of automatically having a federal agency become the appropriate forum on an issue that is interstate in character. The authors have explored and expanded upon the academic literature to create alternative forms of regulatory clubs to provide insight into how and why regional organizations with state commissions "as members" can be formed and sustained to take advantage of spillover benefits.

The authors have also demonstrated that state commissions might find it advantageous to form regulatory clubs with diversity of interest among the membership. Otherwise, state commissions could merely act in tandem without the need for even irregular cooperation. Experience shows that homogeneity of state interests, however, tends to be the exception rather than the rule. Therefore, the opportunity to gain from spillover benefits from the formation of regulatory clubs is expected to be frequent, if not commonplace. While the diversity of club members makes it possible to take advantage of potential spillover benefits, the same diversity makes consensus-building procedures of the alternative dispute resolution variety necessary for club formation and maintenance.

Of course, state commissions might find it to their advantage to form their own regional regulatory clubs without federal participation. As an example, when there is a simple, well-focused (unicentric) issue to be decided that does not have extensive externalities or ongoing spillover benefits, state commissions might find it to their advantage to engage in irregular consultation to reach a unified, one-time decision. This is called an episodic club.

If a simple, well-focused (unicentric) regulatory issue does have either externalities or spillover benefits, or if circumstances over time are likely to call for adjustments to the policy reached in light of new information, then a more regular form of cooperation is called for. We

call this a sequential club.

If a regulatory issue is relatively complex with consequences that are polycentric in nature, that is, a gain by any one party has consequences on all others, then a more complex regional regulation may be necessary.[1] Polycentric issues tend to have spillovers and externalities that are long-term with changing consequences over time so that any policy decision made would need continuous monitoring and readjustments. These decisions require regularized cooperation and a more formal structure, which we call a coordinative club.

An alternative way to deal with polycentric issues is for state commissions to form a consolidated club that replaces the state commission on the jurisdictional issue involved. In other words, the consolidated club would in effect be a "megacommission" made up of the state commissions but making policy decisions as a group. The policy decisions would then be binding on the state commissions. The Northwest Power Planning Council is an example of a consolidated club.

The interstate compact is another category of regional regulatory clubs that is not coequal with the other examples: episodic, sequential, coordination, and consolidated clubs. Like the joint board or joint conference, the term "interstate compact" describes an institutional arrangement. With an interstate compact, the regional regulatory entity is officially sanctioned by Congressional legislation. As such, an interstate compact is permitted to take on what would otherwise be exclusively federal matters. These include matters that, under the Commerce Clause, would fall outside of state commission jurisdiction because they involve interstate commerce and matters that the compact is specifically authorized to address even if they would otherwise be preempted by a federal agency. Thus, an interstate compact could provide different forms of regional regulatory clubs with an ability to deal with a mix of state and federal issues without fear of preemption. However, as the Arkansas Plan and the Northwest Power Plan experiences have shown, interstate compacts, once proposed, rarely are passed in their original form. Congress is

[1] A polycentric problem is many centered and is characterized by a large number of potential results with many interest groups affected by any adopted solution. The problem is like a spider web, where a pull on one strand will distribute tensions in a completed pattern throughout the whole web; each cross of strands is a distinct center for distributing tension.

free to amend any proposed interstate compact and change its substance and procedure, except when regulating matters normally assigned to federal jurisdiction. State commissions might find it preferable to consider other regional regulatory options that provide them with broader substantive and procedural discretion. Should the Federal Energy Regulatory Commission (FERC) and the Federal Communications Commission (FCC) adopt a more expansive view of what is possible under their joint-board and joint-conference procedures, state commissions might find that such procedures offer the same advantages as an interstate compact with greater procedural and substantive flexibility.

The authors have demonstrated that the need and opportunity for regional regulation using consensus building is substantial, and the creation of regional holding companies and the issues associated with them intensify the need for regional regulation. Indeed, experiences with regional regulation have focused on particular multistate utilities and holding companies or specific issues that transcend state boundaries. Although several state commissions lack explicit authority to engage in regional regulation, most have implicit authority to at least engage in less formal forms, such as the episodic club with irregular cooperation. As mentioned, federal authority now exists for dealing with issues of regional concern to multiple states. However, it is virtually unused by the FERC and irregularly used by the FCC. Because of the mix of federal and state jurisdictional issues involved in regional holding companies, multistate companies, and other multistate issues, the interests of state commissions in maintaining and reestablishing effective regulatory authority may drive them toward regional regulatory arrangements, sometimes in partnership with the FCC or the FERC.

Today, regional regulation often exists on a de facto basis, particularly in the more informal forms of irregular consultation or regularized cooperation of episodic and sequential regulatory clubs. Regardless of court or legislative actions, regional regulation is likely to become even more commonplace in the future as state (and, where appropriate, federal) commissions recognize that major benefits can be captured and shared by regional regulation through the formation of regional regulatory clubs, made feasible through use of consensus-building procedures.

Indeed, regional regulation could become the next item on the national agenda, as the

FERC and possibly Congress consider the role of regional transmission authorities for resolving transmission access disputes. A coherent and comprehensive approach to regional transmission issues would recognize, that although new authority is given to the FERC to mandate access pursuant to the 1992 National Energy Policy Act, federal regulation of transmission is incomplete. Although there is significant federal authority in wholesale pricing and access, state commissions have exclusive authority over retail pricing, as well as transmission planning and siting. Without a regional regulatory solution that involves the FERC and state commissions, a coherent, comprehensive regulatory policy cannot emerge. The applications of the regional regulatory approaches discussed in this report are just a small sample of the potential applications of regional regulation. As former Governor Bill Clinton recently observed, "regional coordination. . . could be applied to all utilities everywhere in the country."[2]

[2] "Bill Clinton Looks at Electric Power Issues," *The Electricity Journal*, October 1992, 14.

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APPENDIX A

SURVEY OF STATE STATUTES PROVIDING FOR STATE UTILITY COMMISSION COOPERATION

The following statutory provisions of the states were identified as providing in some way for cooperation of the state utility commissions and other states.[1] The examination attempted to identify those explicit statutory provisions authorizing cooperation. Many state utility commissions possess broad statutory authority subject to liberal construction, thus commissions in those states may also possess cooperative powers even without express statutory authority.

Alabama

Code of Alabama §§ 37-1-45 and 37-1-46 provide as follows:

§ 37-1-45. Sitting or conferring with commissions of other states.

The members of the Commission may sit with and confer with other state utility commissions and public service commissions, either within or without the state, in general utility matters; but in no event shall the Commission make any order without proceeding to carry out the other provisions of this title in respect to notice and hearings.

§ 37-1-46. Sitting or conferring with federal commissions or agencies.

In any proceedings involving directly or indirectly any rate, charge, practice, rule, or regulation in force in the state of Alabama, the Commission through any of its members may sit with and confer with the Interstate Commerce Commission, Federal Power Commission, Federal Communications Commission, the Securities and Exchange Commission, or any other federal commission or agency.

[1] Review of state statutes through LEXIS® search by Robert Poling, Law Division, Congressional Research, U.S. Congress.

Alaska

Alaska Statutes §42.05.141(a)(6) provides as follows:

General powers and duties of the Commission.

The Alaska Public Utilities Commission. . .may appear personally or by counsel and represent the interests and welfare of the state in all matters and proceedings involving a public utility before an officer, department, board, commission, or court of the state or of another state or the United States to intervene in, protest, resist, or advocate the granting, denial, or modification of any petition, application, complaint, or other proceeding.

Arizona

No explicit statutory provisions.

Arkansas

Arkansas Code of 1987 Annotated § 23-2-304(b) provides as follows:

Certain powers of commission enumerated.

(b) In the discharge of its duties under this [public utilities] act, the Commission may cooperate with regulatory commissions of other states, and of the United States. It may also hold joint hearings and make joint investigations with such commissions.

Arkansas Code of 1987 Annotated §§ 23-18-507(b), (c), and (d) provide as follows:

Authority of Arkansas Public Service Commission.

(b) The Arkansas Public Service Commission, in the discharge of its duties under this subchapter [§§ 23-18-501 *et seq*.] or any other act, is authorized to make joint investigations, hold joint hearings in or outside the state, and to issue joint or concurrent orders in conjunction or concurrence with any official or agency of any other state or of the United States, whether in the holding of such investigations or hearings or in the making of such orders the Commission functions under agreements or compacts between states, or under the concurrent power of states to regulate interstate commerce, or as an agency of the United States, or otherwise.

(c) In the discharge of its duties under this subchapter [§§ 23-18-501 *et seq*.], the Commission is further authorized to negotiate and enter into agreements or compacts with

agencies of other states, pursuant to any consent of Congress, for cooperative efforts in certification, construction, financing, operation, and maintenance of major utility facilities in accord with the purposes of this subchapter and for the enforcement of respective state laws regarding them.

(d) The Arkansas Public Service Commission is deemed to be the agency of the State of Arkansas that shall be the member of any regional hearing authority or commission created by the terms of any compact between Arkansas and other states, or between Arkansas and the United States of America otherwise concerning the implementation of this subchapter, except as may be provided by §§ 23-18-505 and 23-18-506.

California

No explicit statutory provisions.

Colorado

Colorado Revised Statutes § 40-2-115(1) provides as follows:

Cooperation with other states and with the United States.

The Commission is authorized to confer with or hold joint hearings with the authorities of any state or any agency of the United States in connection with any matter arising in proceedings under this title, under the laws of any state, or under the laws of the United States; to avail itself of the cooperation, services, records, and facilities of authorities of this state, any other state, or any agency of the United States as may be practicable in the enforcement or administration of the provision of this title; and to enter into cooperative agreements with the various states and with any agency of the United States to enforce the economic and safety laws and regulations of this state and of the United States. The Commission is authorized to provide for the exchange of information concerning the enforcement of the economic and safety laws and regulations of this state, of any other state, and of the United States relating to public utilities or to safety of transportation of gas by any person including a municipality.

Connecticut

No explicit statutory provisions.

Delaware

26 Delaware Code Annotated § 214 provides:

Joint investigations, hearings and orders; cooperation with agencies of other states or of the United States.

The Commission may make joint investigations, hold joint hearings within or without this state, and issue joint or concurrent orders in conjunction with any official, board, commission, or agency of any state or of the United States. Whether in the holding of such investigations or hearings or in the making of such orders, the Commission shall function under agreements or compacts between the states or under the concurrent powers of states to regulate the interstate commerce, or as an agency of the federal government, or otherwise.

District of Columbia

No explicit statutory provisions.

Florida

No explicit statutory provisions.

Georgia

No explicit statutory provisions.

Hawaii

No explicit statutory provisions.

Idaho

Idaho Code § 61-505 provides as follows:

Joint hearings and investigations--Reciprocity--Contracts with regulatory agencies of neighboring states.

(1) The Commission shall have full power and authority to make joint investigations, hold joint hearings within or without the state of Idaho with any official, board, commission, or agency of any state or of the United States, whether in the holding of the investigations or hearings the Commission shall function under agreements or compacts between states or under the concurrent power of states to regulate the interstate commerce, or as an agency of the federal government, or otherwise.

(2) The Commission shall have full power and authority to contract with the regulatory agencies of neighboring states to hold hearings and set rates and charges for customers in Idaho located in or nearby border communities served by utilities principally located in states other than Idaho. These contracts may have a term that extends beyond the terms of the current commissioners.

(3) The Commission shall have this authority under subsection (2) of this section only if it finds that:

(a) The affected Idaho residents live in or nearby a border community that is or may be served by a utility principally located in a state other than Idaho;

(b) The provision of utility service to such a community by a utility located principally in a state other than Idaho is in the public interest;

(c) It is impractical or not in the public interest to conduct proceedings for these affected Idaho residents separate from proceedings conducted by the regulatory agency of the neighboring state for rate payers of that utility located in that state;

(d) The affected Idaho residents have full rights of participation in the hearings conducted, as well as the same rights that customers in the neighboring state have to pursue service-related issues; and

(e) The rates, charges and service regulations for Idaho customers are not less favorable than those of similarly situated customers in the neighboring state.

(4) When the Commission has entered into a contract authorized in subsection (2) of this section, the findings, decisions and orders of the regulatory agency of the neighboring state are presumptively correct and will take effect according to the terms of the order of the regulatory agency of the neighboring state. Affected Idaho customers may petition the Commission for a review of the contract or the rates set under the contract upon a showing that:

(a) All remedies with the neighboring state's utility have been exhausted;

(b) All remedies with the neighboring state's regulatory agency with which the Commission has signed a contract have been exhausted; and

(c) Idaho customers have been discriminatorily, preferentially, or otherwise unlawfully treated by the regulatory agency of the neighboring state.

The Commission, upon its preliminary finding that rates set by the regulatory agency of the neighboring state are prima facie discriminatory, preferential or otherwise unlawful, and that all remedies with the neighboring state's utility and commission have been exhausted, may initiate proceedings to review the decision of the regulatory agency of the neighboring state. Any subsequent order of the Commission altering the decision of the regulatory agency of the neighboring state will be of prospective effect only.

(5) The contract authorized in subsection (2) of this section, may be revoked if the Commission finds that the affected Idaho residents have been unreasonably, discriminatorily, preferentially or otherwise unlawfully treated by the neighboring state's regulatory agency.

Illinois

111 2/3 Illinois Annotated Statutes § 4-301 provides as follows:

Actions taken with other states or the United States--Hearings regarding pending legislation:

(1) The Commission may confer in person, or by correspondence, by attending conventions, or in any other way, with Commissions and any and all agencies dealing with public utilities of other states and of the United States on any matters relating to public utilities.

(2) The Commission shall have full power and authority to make joint investigations, hold joint hearings within or without the state, and issue joint or concurrent orders in conjunction with any official, board, commission, or agency of any state or of the United States. In the holding of such investigations or hearings or in the making of such orders, the Commission shall function under agreements or compacts between states or under the concurrent power of states to regulate the interstate commerce, or as an agency of the United States, or otherwise.

(3) The Commission shall make, whenever requested by the Governor, a report within ninety days of such request, which shall contain copies of all orders issued by the Commission which it deems of special importance or general significance, and any information in the possession of the Commission which it shall deem of value to the people of the state.

(4) The Commission shall conduct a hearing and take testimony relative to any pending legislation with respect to any person, corporation, or matter within its jurisdiction, if requested to do so by the Governor, the General Assembly, or by either branch thereof, and shall report its conclusions to the Governor or the General Assembly, as the case may be. The Commission may also recommend the enactment of such legislation with respect to any matter within its jurisdiction as it deems wise or necessary in the public interest. The Commission shall, at such times as the Governor shall direct, examine any particular subject connected with the condition and management of public utilities, and report to him in writing its opinion thereon with its reasons therefor.

Indiana

No explicit statutory provisions.

Iowa

No explicit statutory provisions.

Kansas

No explicit statutory provisions.

Kentucky

No explicit statutory provisions.

Louisiana

No explicit statutory provisions.

Maine

No explicit statutory provisions.

Maryland

Annotated Code of Maryland, Art. 78, §§ 58 and 59 provide as follows:

§ 58 Interstate Commerce

The Commission shall study the rates and service of public service companies in interstate commerce beyond its jurisdiction, insofar as they affect the interests of the people of this state, and may apply to and appear before appropriate agencies of the federal government to protect such interests.

§ 59 Joint Action

The Commission may act jointly or concurrently with any official board or commission of the United States or any state thereof or the District of Columbia in any proceedings relating to the regulation of public service companies. Such action may be under interstate compacts or agreements, or under the concurrent power of the states to regulate interstate commerce, or as an agency of the federal government, or otherwise.

Massachusetts

No explicit statutory provisions.

Michigan

No explicit statutory provisions.

Minnesota

Minnesota Statutes Annotated § 216B.19 provides as follows:

Joint hearings and investigations

In the discharge of its duties under Laws 1974, Chapter 429, the Commission or the department may cooperate with similar commissions of other states and any federal agency and may hold joint hearings and make joint investigations with other commissions.

Mississippi

No explicit statutory provisions.

Missouri

Vernon's Annotated Missouri Statutes, § 386.210 provides as follows:

Conferences, cooperative agreements, investigations authorized--funds may be received and distributed, how:

(1) The Commission may confer in person, or by correspondence, by attending conventions, or in any other way, with the members of railroad, public utility, or similar commission of other states and the United States of America, or any official, agency, or instrumentality thereof, on any matter relating to the performance of its duties.

(2) The Commission may enter into and establish fair and equitable cooperative agreements or contracts with, or act as an agent or licensee for the United States of America, or any official, agency, or instrumentality thereof, or any railroad, public utility or similar commission of other states, that are proper, expedient, fair and equitable, and in the interest of the state of Missouri and the citizens thereof, for the purpose of carrying out its duties under section 386.250

as limited and supplemented by section 386.030 and to that end the Commission may receive and disburse any contributions, grants, or other financial assistance as a result of or pursuant to such agreements or contracts. Any contributions, grants, or other financial assistance so received shall be deposited in the public service commission utility fund or the state highways commission fund depending upon the purposes for which they are received.

(3) The Commission may make joint investigations, hold hearings within or without the state, and issue joint or concurrent order in conjunction or concurrence with any railroad, public utility, or similar commission, of other state or the United States of America, or any official, agency, or any instrumentality thereof, provided that in the holding of such investigations or hearings or in the making of such orders, the Commission shall function under agreements or contracts between states or under the concurrent power of states to regulate interstate commerce, or as an agent of the United States of America, or any official, agency, or instrumentality thereof, or otherwise.

Montana

No explicit statutory provisions.

Nebraska

No explicit statutory provisions.

Nevada

Nevada Revised Statutes § 703.230 provides as follows:

Cooperation with federal and state agencies.

The Commission may, in carrying out its duties:

(1) Cooperate with the federal government, its departments and agencies.

(2) Confer with the regulatory agencies of other states on matters of mutual concern and benefit to persons served by the public utilities, motor carriers and brokers of this state.

(3) Use the services, records, facilities, and cooperation of federal and state regulatory agencies, and hold joint hearings and participate in joint conferences to reach decisions in matters which require cooperation. All necessary expenses incurred in attending hearings and conferences outside the state are a charge against the state, and must be audited and paid as other claims against the state are paid. The claims must be sworn to by the Commissioner who incurred the expense and approved by the chairman.

New Hampshire

No explicit statutory provisions.

New Jersey

No explicit statutory provisions.

New Mexico

New Mexico Statutes Annotated § 62-4-1 provides as follows:

Joint hearings and orders.

The public service commission in the discharge of its duties under the Public Utility Act is authorized to make joint investigations, hold joint hearings within or without the state and issue joint or concurrent orders in conjunction or concurrence with any official or agency of any state or of the United States, whether in the holding of such investigations or hearings or in the making of such orders, the Commission may function under agreements or compacts between states to regulate interstate commerce. The Commission, in the discharge of its duties under the Public Utility Act, is further authorized to negotiate and enter into agreements or compacts with agencies of other states, pursuant to any consent of congress, for cooperative efforts in certificating the construction, operation and maintenance of major utility facilities in accord with the purposes of the Public Utility Act and for the enforcement of the respective state laws regarding same.

New York

No explicit statutory provisions.

North Carolina

General Statutes of North Carolina § 62-37 vests broad authority with the Utilities Commission to conduct investigations, although no express reference is made to joint or cooperative actions with other states in that section. However, read together with declared policies of the state, such authority might be derived.

General Statutes of North Carolina § 62-2 provides, in part, as follows:

Upon investigation, it has been determined that the rates, services and operations of public utilities as defined herein, are affected with the public interest and that the availability of an adequate and reliable supply of electric power and natural gas to the people, economy and government of North Carolina is a matter of public policy. It is hereby declared to be the policy of the State of North Carolina. . .[t]o cooperate with other states and with the federal government in promoting and coordinating interstate and intrastate public utility service and reliability of public utility energy supply.

North Dakota

North Dakota Century Code § 49-02-02(8) and (9) provide as follows:

Powers of public service commission with reference to public utilities.

The Commission shall have power to. . .

(8) Cooperate with and receive technical and financial assistance from the United States, any state, or any department, agency, or officer thereof for any purposes relating to federal energy laws that deal with energy conservation, coal conversion, rate reform, and utilities subject to the jurisdiction of the Commission. The Commission shall also have the authority to file any reports, hold hearings, and promulgate regulations for any such purposes.

(9) Cooperate with and receive technical and financial assistance from the United States, any state, or any department, agency, or officer thereof, and to file such reports and promulgate rules as required by federal law or regulation for any purposes relating to the

regulation of safety standards for pipeline facilities and the transportation associated with those pipeline facilities.

Ohio

No explicit statutory provisions.

Oklahoma

No explicit statutory provisions.

Oregon

Oregon Revised Statutes Annotated §§ 190.410 through 190.470 provide as follows:

190.410 Definitions for ORS 190.410 to 190.440

As used in ORS 190.410 to 190.440, "public agency" includes any county, city, special district, or other public corporation, commission, authority, or entity organized and existing under laws of this state, or any other state, or under the city or county charter of any county or city of this or any other state.

190.420 Public agencies authorized to make agreements with agencies in other states; contents of agreement

(1) Any power or powers, privileges, or authority exercised or capable of exercise by a public agency in this state may be exercised and enjoyed jointly with any public agency in another state to the extent that the laws of the other state permit such joint exercise or enjoyment.

(2) Public agencies in this state and in another state may enter into agreements with one another for joint or cooperative action. Such action must be recorded by ordinance, resolution, or in other lawful manner by the governing bodies of the participating public agencies.

(3) An agreement under subsection (2) of this section must specify its duration, the organization, composition, and nature of any separate legal or administrative entity created to exercise the functions agreed upon, the purpose of the agreement, the method of financing the joint or cooperative undertaking, the methods to be employed to terminate the agreement, and any other necessary and proper matters.

(4) No agreement under subsection (2) of this section shall relieve any public agency of any obligation or responsibility imposed on it by law.

190.430 Agreement to be reviewed by Attorney General

Every agreement made under ORS 190.420 shall be submitted to the Attorney General before taking effect. The Attorney General shall determine whether the agreement is in proper form and compatible with the laws of this state. If the Attorney General determines that the agreement is in some instance improper, he shall give written notice to the governing body of the public agency in this state concerning the specific respects in which the agreement fails to comply with law. Failure to give such notice within 30 days of the submission of the agreement to the Attorney General shall constitute approval of the agreement.

190.440 Public agency's powers under agreement

Any public agency entering into an agreement under ORS 190.410 to 190.440 may expend funds and may sell, lease, give, or otherwise supply the administrative board of other legal or administrative entity that operates the joint or cooperative undertaking by providing such personnel or services therefor as may be within its legal power to furnish.

190.470 Council of State Governments

The Council of State Governments is a joint governmental agency of this state and of the other states which cooperate though it.

Pennsylvania

66 Purdon's Consolidated Statutes Annotated § 313 provides as follows:

Joint hearings and investigations; reciprocity

(a) Joint hearings and investigations--The Commission shall have full power and authority to make joint investigations, hold joint hearings within or without this Commonwealth, and issue joint or concurrent orders in conjunction or concurrence with any official, board, commission, or agency of any state or of the United States, whether in the holding of such investigations or hearings, or in the making of such orders, the Commission shall function under agreements or compacts between states or under concurrent power of states to regulate the interstate commerce, or as an agency of the federal government, or otherwise.

(b) Reciprocity--The Commission shall have full power and authority to arrange reciprocity of treatment of public utilities and contract carriers by motor vehicle of this Commonwealth by regulatory laws of other states, and to that end the Commission is hereby vested with power to impose upon public utilities and contract carriers by motor vehicle of other states, the same penalties, restrictions, and regulations as are imposed by the regulatory body of such other states upon public utilities and contract carriers by motor vehicle of this Commonwealth when operating into, out of, or through such other states.

Rhode Island

No explicit statutory provisions.

South Carolina

Code of Laws of South Carolina § 58-27-170 provides as follows:

Joint investigations, hearings and orders with other state or federal boards or commissions.

The Commission may make joint investigations, hold joint hearings, and issue joint or concurrent orders in conjunction or concurrence with any official board or commission of any state or of the United States. Whether in the holding of such investigation or hearings or in the making of such orders the Commission shall function under agreements or compacts between

states, or under the concurrent power of states to regulate interstate commerce, or as an agency of the federal government, or otherwise.

South Dakota

No explicit statutory provisions.

Tennessee

No explicit statutory provisions.

Texas

No explicit statutory provisions.

Utah

No explicit statutory provisions.

Vermont

30 Vermont Statutes Annotated § 33 provides as follows:

Joint hearings and investigations

The Board shall have full authority to make joint investigations, hold joint hearings within or without the state of Vermont, and issue joint or concurrent orders in conjunction or concurrence with any official, board, commission, or agency of any state or of the United States, whether, in holding of such investigations or hearings or in the making of such orders, the Board shall function under agreements or compacts between states or under the concurrent power of states to regulate interstate commerce, or as an agency of the federal government, or otherwise.

Virginia

No explicit statutory provisions.

Washington

Revised Code of Washington § 80.01.070 provides as follows:

Joint investigations, hearings, orders

The Commission shall have full power to make joint or concurrent investigations, hold joint or concurrent hearings, and issue joint or concurrent orders in conjunction or concurrence with any official, board, or commission of any state or of the United States, whether in the holding of such investigations or hearings or in the making of such orders the Commission functions under agreements or compacts between states, or under the concurrent power of states, or regulate interstate commerce, or as an agency of the federal government, or otherwise. When necessary the Commission may hold such joint hearing or investigation outside the state.

West Virginia

No explicit statutory provisions.

Wisconsin

Wisconsin Statutes Annotated § 196.02(12) provides as follows:

Sue; be sued.

The Commission may sue or be sued in its own name, and may confer with or participate in any proceedings before any regulatory agency of any other state or of the federal government.

Wyoming

No explicit statutory provisions.

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APPENDIX B

OPTIMAL SIZE FOR REGIONAL REGULATION ORGANIZATIONS: AN APPLICATION OF THE THEORY OF CLUBS

Introduction

Effective regional regulation makes and implements regional policy for the production and consumption of public utility goods and services susceptible to the ill effects of crowding out. Crowding out is a physical phenomenon that causes congestion costs[1] and two other adverse economic effects. First, crowding out creates situations in which existing users of the affected good or service receive fewer benefits when new users consume this good or service. Second, some potential users are not able to consume the good. To illustrate the effects of crowding out, consider the following situation: too many people attempt to use the regional telecommunications or electricity infrastructures at the same time, and it is too expensive to build regional infrastructures to meet these demands. The regulators' and firms' response to this situation is to ration the access to and the use of these infrastructures; otherwise, the alternative is deterioration of the reliability of the electricity and telecommunications networks. Rationing, of course, means that consumers are experiencing the effects of the crowding out phenomenon.

Regional regulation minimizes the effects of crowding out by providing a forum where state regulatory agencies, regulated firms, and groups of affected individuals can initiate a cooperative process of give and take that creates rules and procedures that ensure that no one is unreasonably denied access to and use of the infrastructure.

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[1] For discussions of the effects of congestion costs, see Jerome Rothenberg, "The Economics of Congestion and Pollution: An Integrated View," *American Economic Review*, 60 (1970): 114-21; William H. Oakland, "Congestion, Public Goods and Welfare," *Journal of Political Economy* 1 (1972): 339-57; Robert H. Haveman, "Common Property, Congestion and Environmental Pollution," *Quarterly Journal of Economics* 87 (1973): 278-87.

Obviously, cooperation is not a costless activity. Equally obvious is that some or all of these costs must be shared among the members. Therefore, for optimality of a regional club, it must be more economic to share costs and policymaking authority than it is to retain policymaking autonomy.

The purpose of this appendix is to provide an analysis of the factors affecting and determining the optimal size of a regional club. The issue is important because the optimal size of a regional club can be less than the number of state commissions eligible to be included in it. The appendix is divided into three sections. The theory of clubs is used in the first section to solve the problem of optimal club size.[2] The second section addresses the desire of a member of a regional club to hedge against total reliance on regional policy by retaining some resources for the purpose of making state-specific policy. Conclusions are presented in the third section.

Optimal Size for a Regional Club

In general, optimum size occurs when the marginal benefit that existing club members secure from the addition of a new member is equal to the marginal cost incurred by existing members when a new member is added to the club.[3] When the beneficial effects of intraregional spillovers are accounted for,[4] the optimal size

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[2] See James M. Buchanan, "An Economic Theory of Clubs," *Economica* 32 (1965): 1-14; Todd Sandler and John T. Tschirhart, "The Economic Theory of Clubs: An Evaluative Survey," *Journal of Economic Literature* 18 (1980): 1481-1521.

[3] Optimal size is finite whenever impure public goods are produced. See Buchanan, "An Economic Theory of Clubs," 1.

[4] See Chapter 7 for a brief discussion and illustration of spillover benefits in the context of the regional regulation of shared public utilities infrastructure. More rigorous discussions of spillover effects can be found in: Todd Sandler, "The Economic Theory of Alliances: Realigned," in *Comparative Public Policy: Issues, Theories, and Methods*. Craig Liske, William Loehr, and John McCamant, eds. (New York: Wiley and Sons, 1975); Todd Sandler, "Parieto Optimality, Pure Public Goods, Impure Public Goods and Multiregional Spillovers," *Scottish Journal of Political Economy* 22 (1975): 25-38; Martin McGuire, "Group Segregation and Optimal Jurisdictions," *Journal of Political Economy* 82 (1974): 112-32.

increases whenever a new member continues to contribute goods and services to the club after receiving the positive spillover benefits from other members of the club.[5] Spillover benefits, measured in terms of additional resources available for the production of private goods, emerge as a result of the joint production of pure and impure public goods.[6] They are important for regional regulation because they free pent-up demand for private goods and services produced by regulated firms and minimize the costs of constructing "shareable" facilities, such as telecommunications and electricity infrastructures.

Figure B-1 describes the *basic* solution to the optimal size problem when the club's management knows that the club members will consume *a predetermined* amount of either telecommunications or electricity infrastructure in the form of network transmission services.[7] The curve, BB, is total benefit per club member, where the number of members increases as we move along the curve from left to right. Alternatively, BB may be interpreted as the average total benefit for a given club size. BB's shape is a "hill" because the crowding out phenomenon, at some point, adversely affects the benefits that members receive form the club. The curve PP represents the total cost per member of constructing infrastructure. PP is downward sloping because it

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[5] The existence of spillover benefits is the major result of the theory of alliances. See, Mancur Olsen and Richard Zeckhauser, "An Economic Theory of Alliances," *Review of Economics and Statistics*, 48 (1966): 266-79.

[6] Loosely speaking, a private good is something that cannot be used by more than one person at any point in time. Pure and impure public goods, on the other hand, can be used simultaneously by more than one person at any point in time. The difference between pure and impure public goods is that pure public goods are not subject to the ill effects of crowding out.

[7] It is difficult to defend the assumption that the level of transmission infrastructure is predetermined before the regional club is formed. It would seem that such decisions would be a primary activity of the club. Consequently, a procedure applicable to actually determining optimal club size is to build around the *simultaneous* determination of the amount of infrastructure to be constructed and the size of the club that will use this infrastructure most efficiently. This point is made intuitively in Buchanan, "An Economic Theory of Clubs," 6-12. It was presented theoretically in Sandler and Tschirhart, "The Economic Theory of Clubs: An Evaluative Survey," 1487-91.

Fig. B-1. Maximum average net benefit per club member: no maintenance, formation, and transaction costs.

is assumed that only fixed costs are incurred when constructing infrastructure. As a result, each club member is required to pay less for the recovery of infrastructure as the number of members increases. *Total net benefit per member* is obtained by subtracting total cost per club member from total benefit per member.

Optimal size is represented by N^1 in Figure B-1.[8] Optimizing occurs because the *reduction* in the average total benefit per member, which is caused by the addition of another member, is equal to the *reduction* in the total cost per member.[9]

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[8] Seven important assumptions are embedded in this solution. First, no adverse or beneficial effects are visited upon club member A from an action that benefits club member B. Second, the club has as members only those states that are the same in all relevant respects. These assumptions allow us to find a solution for the representative club member, which then applies to all members. Still, no variation in the use of infrastructure and equal per unit of infrastructure prices are difficult assumptions to defend in real-world applications. In actual applications, recourse must be made to analytical methods that do not assume that each member of a regional club is identical in all respects. The five other assumptions are: (a) each member shares equally in the cost of constructing the public utilities infrastructure, (b) each member consumes all of the infrastructure in the sense that there is no variation in the use of the infrastructure across individuals, (c) each member is assessed the same per unit price for membership and pays the same amount to be a member in the club, (d) the sum of the individual payments completely finances the construction of the predetermined amount of shared infrastructure, and (e) the individual payment is the only exclusion device necessary for the creation of an optimally sized regional club.

[9] This optimality condition also is described as equating the marginal benefit for an additional club member to the marginal cost of an additional member (however, this description is confusing because the *actual benefit* of the additional member is reflected in the cost schedule, PP, and the *actual cost* is reflected in the benefits schedule, BB). Moreover, the terms marginal benefit and marginal cost have a nonconventional meaning in the context of Figure B-1. Usually marginal benefit means the change in total benefit caused by an additional unit of output, which in this instance is an additional club member. Similarly, marginal cost is the change in total cost caused by the addition of a club member. In this instance however, marginal benefit is the change in total cost per member caused by the addition of a member, and marginal cost is the change in total cost per member caused by the addition of the same member. Hence as more members are added to the regional club, marginal benefit and marginal cost represent the rate of change of average benefit and average cost, respectively.

Up until now, it has been assumed that costs are not incurred to form and maintain a regional club. Figure B-2 describes what happens to optimal size when these costs are present. Club formation and maintenance costs are reflected in the average-variable-cost schedule, VV. This schedule indicates that variable cost rise with increases in size. The linear specification was selected because every member is assumed to be identical to all other members in all relevant respects. Hence, differences in individual tastes and preferences cannot by assumption affect the shape of VV. What this assumption means to a real-world application is that the club's management does not have to deal with average variable costs rising at an increasing rate when they attempt to cope with the needs of an increasingly diverse club membership.[10]

The new club size is N^2. N^2 is less than N^1 because the variable costs have offset some of the benefits of sharing fixed costs with more members. Hence, variable costs are structurally equivalent to crowding costs. They become a more important element of the membership as the size of the regional club grows.

Figure B-3 provides the solution to the problem of determining optimal size when members also incur transaction costs to form the regional club. This second type of club formation costs are represented by schedule EE in order to isolate them from the variable costs of forming the club. This schedule is drawn such that cost per member increases as the number of members increases.

The optimal size for a club that incurs only transaction costs during its formation is N^3.[11] Optimal size is smaller than in the two preceding examples because this cost schedule rises faster than the schedule of average variable costs shown in Figure B-2.

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[10] It is possible that as club maintenance becomes more routine, these variable costs would rise at a decreasing rate. However, there is no real reason to make this assumption, and consequently, the more conservative assumption of a constant rate of increase is made.

[11] Several important assumptions are embedded in this solution. First, formation costs have not affected any potential member's valuation of the total benefit received from the club. Second, formation costs incurred in one state do not affect membership decisions in other states. That is, formation costs do not create spillover effects.

Fig. B-2. Maximum average net benefit per club member: adjusted for variable formation and maintenance costs.

Fig. B-3. Maximum average net benefit per club member: adjusted for transaction costs.

Consequently, it is optimal to decrease the size of the club. Decreasing club size serves to reduce the upfront costs of forming a regional club.

Figure B-4 integrates Figures B-1 through B-3. The quasi-U-shaped cost schedule, UU, is the (vertical) summation of schedules PP, EE and VV.[12] Owing to the shape of BB and UU, the optimal alliance size, N^4, can occur on either the downward-sloping or upward-sloping portion of UU. In this instance, the optimal size is associated with the upward-sloping portions of the benefit schedule, BB, and the cost schedule, UU. Although the final location of N^4 depends on how quickly fixed costs decline and how slowly formation, maintenance, and transaction costs rise, the optimal size, N^4, must be smaller than N^2, N^1, or N^3 because transaction costs reenforce the effects of formation and maintenance costs. That is, all three types of costs serve to decrease optimal club size. This result occurs even if formation, maintenance, and transaction costs rise slower than the decline in fixed costs.

Figure B-5 adds externality abatement costs and spillover benefits to the costs considered in Figures B-1 through B-4. Spillover benefits are assumed to increase with club size; however, the rate of increase is assumed to decrease. Hence, the schedule of spillover benefits, SS, has a concave shape, which means that eventually the spillover benefits will reach some maximum level. This shape suggests that free-rider strategies are used more heavily as club size increases. Externality abatement costs are assumed to increase linearly with club size. They are represented by schedule AA. This assumption is made for convenience because it is not clear, in general, whether the rate of change of these costs is increasing or decreasing.

[12] Vertical summation means that all costs per member for a specific club size are added together.

Fig. B-4. Maximum average net benefit per club member: adjusted for formation, maintenance, and transaction costs.

Fig. B-5. Maximum average net benefit per club member:
adjusted for spillover effects, formation, maintenance, transaction,
and externality abatement costs.

The optimal size for a regional club is N^5.[13] Spillover benefits have caused the BB schedule to shift upward and to the right. The new schedule, BS, has a maximum average benefit at a larger club size. Moreover, a slower rate of decline is experienced after the maximum average benefit is reached. These changes are a result of a schedule of spillover benefits, SS, with the characteristic that the maximum level is approached relatively quickly. The shape of BS is different if spillover benefits increase at an increasing rate. For example, the BS schedule might never turn downward.

An important point reenforced by Figure B-5 is that equilibrium--the maximization of average net benefit per club member--does not have to occur on the downward-sloping portion of the average benefit schedule. In this figure, the locations of AA, VV, EE, and PP are such that equilibrium occurs on the upward-sloping portions of the full cost schedule, UA, and the full benefits schedule, BS.

Figures B-1 through B-5 apply to the formation and maintenance of any regional entity organized around the extraction of mutual benefits. Clearly, optimal club size is not a predetermined number. It depends on the issues being addressed, and how the resolution of these issues affects the costs of the regional club.

Complication With Respect to the Operation of a Regional Club

A member of a regional club can hedge against a regional policy, such as the promotion of the use of shared infrastructure, by retaining some resources to construct unshared infrastructure. A quality hedge, for example, would be a state-specific infrastructure that complements and improves the shared regional infrastructure.

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[13] In this instance, the optimal size is less than N^3. This result, however, is not general. The optimal size of a regional club, facing these costs and benefits, could be larger than N^3. This would occur if the spillover schedule is shifted upward and the externality abatement cost schedule is shifted downward. A downward shift in AA means that externality abatement costs are lower for every club size. An upward shift in SS means that spillover benefits are higher for every club size.

There are, however, some conditions that have to be met before an acceptable overall infrastructure, comprised of regional and state-specific components, can be constructed from combinations of pooled and segregated resources. First, each club member must be able to freely transfer a unit of productive resources between the construction of the state-specific hedge and shared regional infrastructure. Second, each member has to select the size of the hedge and shared infrastructure that maximizes its net benefits.[14] Third, any spillover benefits emanate solely from the shared regional infrastructure. Fourth, state-specific benefits accrue only to the state that produces its own hedge of state-specific infrastructure.

Under these conditions, a member of a regional club is in the position to choose from a continuum of resource combinations available for the construction of its overall infrastructure. The continuum begins with the use of only state-specific resources. It ends with a production technology that uses only pooled resources. The point selected on this continuum by the club member is the point that minimizes the member's cost of producing an acceptable overall infrastructure.[15]

It is interesting to note what happens when the amount of resources that can be transferred between the construction of state-specific hedge and shared regional infrastructure is limited; and as a result, it is not possible to equalize the prices of resources used in state-specific and regional construction activities. If the price of a unit of regional resources is greater than the price of a unit of state-specific resources because the employment of regional resources incurs higher transaction costs than the employment of state-specific resources, then the efficient construction of total infrastructure, comprised of state-specific and regional components, requires

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[14] If each member of the regional club is identical and adopts the same elements of the regional policy, then these members would maximize the same average net benefit.

[15] Efficient production takes place where the marginal productivity of the pool resources divided by the marginal productivity of the private resources equals the price of the pooled resources divided by the price of private resources. The lower boundary efficiency is the infrastructure *isoquant* associated with the minimum level of acceptable quality. Subject to this production constraint, the member wants to minimize the cost of producing the infrastructure. To do this, the member finds the lowest regulatory policy *isocost* curve that is feasible with the production of the infrastructure at the minimum acceptable level of quality. Definitions of isoquants and isocost curves may be found in any intermediary economic textbook.

that the marginal productivity of the regional resource is *greater than* the marginal productivity of the state-specific resource.

Figure B-6 summarizes the preceding analysis. The isocost lines are drawn to reflect that the price of the regional resource V, X_1^1, is greater than the price of the state-specific resource, V, X^2. The isoquant labelled Q_1Q_0 represents the construction of a total infrastructure at the minimum acceptable level of quality. The isoquant labelled Q_1Q_1 represents the same total infrastructure at the maximum acceptable level of quality. Hence, X_0^1 and X_0^2 units of state-specific and club resources, respectively, are required for the efficient construction of the minimum quality infrastructure, while X_1^1 and X_1^2 units of state-specific and club resources are necessary for the efficient construction of the maximum quality infrastructure.

It should be noted that the solution presented in Figure B-6 indicates that it is never efficient to use only state-specific or regional resources to construct the total overall infrastructure available to a particular state. This interior solution is optimal because of the shapes of the isoquants shown in Figure B-6. These isoquant shapes imply that state-state infrastructure is a substitute for shared regional infrastructure because state-specific infrastructure can replace shared regional infrastructure. As a result, it is not optimal for any state to put all of their infrastructure eggs in one basket. If these conditions do not hold, then it can be optimal for a state to opt for the construction of only state-specific infrastructure or the construction of only shared regional infrastructure.

Conclusions

The optimal size of a regional club depends in part on the issue being resolved. One factor affecting optimal size is the rate of change of costs as the number of members increases as shown by the sets of costs examined in the first section of this

Fig. B-6. Production mixes for minimum quality and maximum quality infrastructure.

appendix. Another factor is rate of change to benefits accruing to the members of a regional club. Two results emerge from the interaction between these benefits and costs when it is assumed that each club member is identical. First, the addition of variable and transaction costs to fixed costs serves to decrease optimal size because these cost increases offset the cost savings associated with sharing the fixed costs of constructing the shared infrastructure. Second, spillover benefits serve to increase optimal club size because the rate of decline of the benefits schedule is dampened and a larger club size is associated with the maximum average benefit available to a member.

Regional clubs, however, do not always include identical members. The set of examined cost schedules is not appropriate when a club includes diverse members. For example, the schedules of variable formation and maintenance costs should increase faster as a diverse membership grows. Also, membership diversity affects the magnitude of the predetermined amount of shared infrastructure. In general, the construction of shared infrastructure for a club with diverse members is less than the construction of shared infrastructure for a club with an equal number of identical members. This occurs because a diverse club will find fewer regionally-based outcomes acceptable.

The allocation of resources by state members to the regional club depends on several factors. One of the most important is how a member intends to join its state-specific construction of infrastructure with the regional construction of shared infrastructure. It is obvious that the same construction and production technologies can be used to create total infrastructure when state-specific and regional resources complement each other and state-specific infrastructure is a substitute for regionally shared infrastructure. However, the construction and production technologies of the regional club are different from the technologies used by the state when these conditions are not met. However, in either instance, an efficient allocation resource between state and regional infrastructure activities is achieved when the ratio of the marginal productivity of the state-specific and regional resources equals the ratio of the prices of these resources.

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APPENDIX C

TWO EXAMPLES OF THE POTENTIAL USE OF REGIONAL REGULATION

This appendix contains two hypothetical examples of how regional regulation could be used. The first example concerns the use of regional regulation in developing telecommunications infrastructure. It shows that use of regional regulation is beneficial, but posits that state commissions might be unwilling to cooperate if the additional cost of regulation is not offset by benefits to ratepayers. The second example concerns the use of regional regulation in the setting of electric utility regional holding companies.

An Example of the Use of Regional Regulation for Telecommunications Infrastructure

It is not difficult to find anecdotal confirmation of the observation that more and more information is being transmitted and exchanged domestically and globally. The usual explanation is that the world has entered the Information Age, which presages the eventual replacement of the slower transmitting telecommunications technologies. A perennial regulatory issue, associated with the deployment of new technologies, is who will pay for it. An inescapable related issue is how much will the technology cost. This second issue lies at the center of our hypothetical example of how a regulatory alliance would operate in the telecommunications industry.

In our example, local exchange companies (LECs) are planning the deployment of common channel-signalling networks. None of these firms provides services to customers in more than one state. However, each of these companies is part of a telecommunications holding company. This larger company operates in more than one state. This particular holding company has LECs concentrated in a well-defined and contiguous geographic area, called a region.

State public utilities commissions, overseeing the activities of the LEC, do not preapprove investment decisions.[1] However, no state commission is completely in the dark concerning the investment plans of an LEC subject to its jurisdiction, because representatives of the LEC talk informally with representatives of the state commission. These discussions serve as a means to exchange information--albeit asymmetrically. During these discussions, state commissions are in the position to provide informal input into the utilities' planning and evaluation processes. Finally, each state commission can exercise its authority to disallow investments independent of the actions and decisions of any other state commission. This traditional regulatory environment is supplemented by a regional regulatory alliance. The alliance exists because the affected state commissions have recognized independent actions are not always efficient. In particular, the alliance members have discovered that independent deployment decisions by LECs have resulted in the unnecessary duplication of facilities and costs. The objective of the alliance is to reduce the amount of resources used during the planning and deployment of the telecommunications infrastructure. The alliance members, however, are aware of the downside to organizational arrangement. There is the "spillover cost" of reduced autonomy, which is associated with coordinated decisionmaking.

The task facing the members of the regulatory community and the LECs is efficiently planning and constructing an addition to the existing telecommunications infrastructure. Maximum efficiency is attained for the regulated firm when the marginal reduction in construction costs is equal to the marginal increase in planning and development costs. The regulators attain maximum efficiency when the marginal reduction in construction costs is equal to the marginal increase in decisionmaking costs.

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[1] The absence of preapproval means that no investment made by any local exchange company will automatically find its way to the rate base and into the rates and charges of the rate-of-return regulated firm. Instead, all investments are subject to tests of prudence and necessity, and some investments may be disallowed from the rate base on the strength of administrative finding that they are imprudent or unneeded. See, Robert E. Burns et al., *The Prudent Investment Test in the 1980s* (Columbus, OH: The National Regulatory Research Institute, 1985).

Figures C-1 and C-2 show two possible equilibrium points. However, the equilibrium levels for these marginal costs and marginal benefits are sensitive to the selection of the strategy used to make infrastructure deployment decisions. Thus, different network configurations are associated with different deployment strategies.

Because of the correspondence between deployment strategies and network configurations, it is useful to focus attention on whether regional regulation contributes to the selection of the optimal infrastructure deployment strategy *by the LECs*. To reduce the dimensions of the problem, we restrict the LEC to either of two strategies. The first is a cooperative strategy, where the LECs voluntarily share information and discuss problems, but do not commit themselves to joint infrastructure deployment decisions. The second is a coordination strategy, where binding agreements between the LECs are reached on issues of infrastructure deployment. Both strategies result in "spillover benefits," measured as the reduction costs for the same level and quality of service. Either the cooperative or coordinated strategy is preferred to the "go-it-alone" approach when "spillover benefits" exceed "spillover costs," and the converse is true when "spillover costs" exceed "spillover benefits." Otherwise, neither strategy is preferred by the state commissions or the regulatory alliance.

Table C-1 summarizes the decisionmaking environment described. The classes of activities that may be followed by LECs within a holding company are shown along the top of the matrix, and the classes of regulatory activities are shown alongside the matrix. On the surface, it appears that the regulatory alliance and the LECs within a holding company have synchronized their respective activities in the northwest cell of the table. Regulatory authorities within the region are coordinating with each other and the LECs within the holding company are doing the same. However, this serenity is misleading. Nothing in the structure of the example requires that the regulatory authorities coordinate their activities with the LECs and vice versa. A discussion of what can happen when the two competing sets of decisionmakers are not acting in unison and what happens when the holding company and regulatory alliance are acting consistently follows.

Returning to the story told by Figures C-1 and C-2, the LECs have reached their equilibrium before the regulatory alliance. This implies that the costs of planning and

Fig. C-1. Equilibrium for regulated firm.

Fig. C-2. Equilibrium for regulators.

TABLE C-1

SEPARABLE COORDINATION ACTIVITIES OF REGULATORS AND UTILITIES

	Utility Coordination	No Utility Coordination
Regulatory Coordination	yes/yes	yes/no
No Regulatory Coordination	no/yes	no/no

development for these firms when operating in an environment characterized by a regulatory alliance are higher than the cost of joint decisionmaking experienced by members of the regulatory alliance. This means in terms of real-world decisionmaking that the regulatory alliance would like to see more integrated planning and development *across the region* than the holding company would willingly accede to. The converse would be true if the regulatory alliance reached its equilibrium before the holding company.

When the regulatory alliance and holding company are in external and internal equilibrium, and actual marginal reduction in construction costs is equal for both the alliance and the holding company, then both groups of decisionmakers want the same amount of regional integrated planning and development with respect to the deployment of telecommunications infrastructure. Therefore, serenity may be defined with respect to this example as fully consistent, integrated planning, where fully consistent means that

the regulatory alliance and holding company have willingly adopted the same cost-reduction target.

The southeast cell of Table C-1 conveys the opposite situation from the northwest cell. No one is coordinating or cooperating with another at any level. The regulatory alliance is at odds with the holding company. The members of the regulatory alliance do not agree with each other, and the members of the holding company do not hold reenforcing positions. In sum, the corporate and regulatory environments are tumultuous.

The northeast and southwest cells represent asymmetries in the coordination process. In the northeast cell, state commissions are coordinating with each other but the LECs are not. In the southwest cell, it is the LECs that have coordinated their planning, development, and construction activities. In both of these instances, the problem facing the LECs and the state commissions is how much of their autonomy each should give up to achieve the cost reductions associated with coordination and cooperation.

Table C-1 captures the essence of a limited number of relationships between LECs, state commissions, the holding company, and regulatory alliance. It does not summarize the multiplicity of mixed situations, when only some of the LECs are cooperating with each other and only some of the state commissions are cooperating. As an example, consider a situation where there are three state commissions and three LECs. It is conceivable that coordination and cooperation exist between one LEC and the state commission that has jurisdiction over it, while the remaining commissions and companies stay at an arm's length distance from each other. Other combinations of partial coordination and cooperation are natural extensions of this case. The point then, is that coordination and cooperation at all relevant levels is only one of many possible combinations of joint behavior.

We continue the description of the decisionmaking environment facing the LECs and the state commissions by asserting that economic, social, or political factors exist that

indicate that coordination and cooperation are viable problem solving approaches in a regulated environment. We complete the description by defining the telecommunications infrastructure as a set of primitive and derivative technologies.[2] In the past, analog-signal technology played this part of the primitive technology and a derivative technology would multiplex these signals. At present, the part of the primitive technology is played by digital-signal technology with common-channel signalling as the derivative technology.[3]

In our example of how regional regulation can affect the LECs' decisionmaking, we examine the selection of an optimal strategy for deploying a more extensive common-channel signalling network to be used for the dual purposes of offering reduced costs and introducing new services.[4] The question is whether the deployment strategy should be coordinated or noncoordinated. A noncoordinated deployment strategy preserves the maximum autonomy for each state commission and each LEC. This problem-solving approach, however, will prove to be more costly because of the marketing dimension of

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[2] Many types of telecommunications technologies are employed by a telecommunications firm. Primitive technologies are required to run the network at the minimum level of acceptable efficiency and the minimum level of services. Derivative technologies can be though of as producing the bells and whistles of the network.

[3] Multiple primitive telecommunications networks can be interconnected with each other through signal transfer points which are the brain of a common-channel signalling network.

[4] For purposes of this problem, it is assumed that neither cost reduction or new service introduction are sufficient as a cost-benefit justification for the deployment of common channel signalling either by an LEC in isolation or by the holding company. However, these reasons together create the presumption that the technology should be deployed by each firm in each state.

the problem. Consider Figure C-3.[5] Selected digital telecommunications switches provide the gateway to the common-channel signalling technology. Attached to these gateways are packet switches, which are called signal transfer points. These switches are essential to the operation of the common channel signalling technology, but, they are also quite expensive. Therefore, the LECs and the state commissions prefer to minimize their deployment. Although not shown in Figure C-3, these packet switches are interconnected when there is more than one in the common channel signalling configuration. Attached to these packet switches are data bases, which are called service control points. Service control points are used in the production of many types of advanced telecommunications services such as calling number identification and information services.

The description of the decisionmaking environment establishes that each LEC and each state commission has two courses of action that they may follow as they plan the configuration of the common-channel signalling technology and then build the selected configuration. Looking at the firm first, one of its options is for each LEC in a holding company to plan and build without coordinating its activities with the other LECs in the

[5] Figure C-3 is a simple schematic or a portion of a common channel signalling network. The signal entry point, at the top of the figure, is portrayed for expository purposes as a telecommunications facility that is separate and distinct from the digital telecommunications switch that supports it. The function performed by the signal entry point is to take a telecommunications signal, currently in the format of the primitive network, and convert it to the format of a common channeling network. The signal transfer point lies directly below the signal entry point in the network hierarchy. The signal transfer point assists in the routing and set-up of the call or data message. Specifically, the signal transfer point allows the network to call ahead to see if the called party is free to accept the call or message before the primitive technology ties up network facilities to actually place the call or deliver the message. Directly below the signal transfer point is the service control point. This component of a common-channel signalling network is indispensable for the so-called "data base services" such as the toll-free 800, operator, third-party billed, and credit-card services. It also is the basis for custom local access area services such as call waiting, call forwarding, and calling number identification.

Fig. C-3. Schematic of portion of common-channel signalling network.

holding company. Because there is no joint planning in this instance, the LEC owning the new infrastructure has the right to deny access to other LECs within the holding company. The firm's other option is to coordinate its activities with other firms. Because there is joint planning in this instance, the use of one LEC's infrastructure by another LEC in the same holding company is more difficult to monitor and control. In planning, development and construction costs are shared among the components of a holding company, and any denial of access to any specific LEC cannot be unilateral.

The members of the regulatory alliance are confronted with similar choices. Each state commission within the region can agree to coordinate its activities and decisions with other commissions having jurisdiction in the same region, or each state commission can choose to make independent decisions. The similarity does not end with the choices. Whereas the firms find it more difficult to deny access to facilities after joint planning and developments have occurred, any state commission will find it more difficult to restrict access to information useful in joint planning and development projects.

When state commissions *and* LECs decide not to cooperate or coordinate at any level, that is, they are located in the southeast cell of Table C-1, the result is completely independent common-channel signalling systems for each state and each firm. Figure C-4 depicts this outcome. As drawn, this figure is at best the barest description of how this technology can be deployed independently. The complete configuration is comprised of one gateway, one packet switch, and one computer in each state.[6]

Instances, however do exist where Figure C-4 represents an inefficient solution to the problem of planning a common-channel signalling network. There is no engineering

[6] When each LEC takes a go-it-alone stance, there are four signal transfer points and four service control points. There are two transmission links connecting the service control point to the one digital telecommunications switch that is hosting the service entry point. One transmission link connects the service entry point to the signal transfer point, the other transmission link connects the signal transfer point to the service control point. Because there are four states, there are eight transmission links in all, two for each state. There are not transmission links connecting the signal transfer points to each other or a service control point connected to more than one signal transfer point.

Fig. C-4. Regional deployment of common-channel signalling: no cooperation or coordination.

mandate that requires one computer to support one packet switch. Depending on traffic patterns and total demand for data-base-related services, here are situations where it is more efficient to have one computer support multiple packet switches. Such a configuration is shown in Figure C-5. Here, the common-channel signalling technology is fully integrated across LECs and states. Necessarily, each state has a gateway to the common-channel signalling system. State A, in fact, contains only a gateway. State D is the home of the computer and nothing else. States B and C contain the packet switches, which are not directly interconnected. However, any gateway can reach either packet switch; therefore, the system has some redundancy.

If cost economies can be obtained by building longer and larger transmission lines and sharing larger computers and packet switches, it is apparent from a comparison of the facilities deployed in Figure C-4 versus those deployed in Figure C-5, that the sharing configuration is less costly than the configuration without sharing. Therefore, an optimal decision based solely on the cost of deploying facilities is to select a sharing over a nonsharing solution, which means the adoption of a coordination strategy at the production level and a cooperative strategy at the marketing level. A coordination strategy is optimal at the production level because the LECs are required to jointly plan *and* to timely deploy the common-channel signalling technology and associated data bases used to market advanced services. Joint decisionmaking at this level of detail is achieved by coordinating all construction and all related financial activities. The joint decisionmaking requirements are much looser at the marketing level. In this area, each LEC has to ensure only that the deployed common-channel signalling technology can meet its independent marketing needs. This outcome can be achieved by sharing information in a friendly atmosphere. Hence, a cooperative strategy is sufficient to reach the desired result.

Because we have assumed that sharing economies characterize packet switches and computers, it is evident that the sum of the development and deployment costs for the sharing solution is less than the sum of these two costs with respect to the nonsharing solution. If this were not the case, then there would not be any sharing economies. This implies that the sum of the planning and decisionmaking costs for the shared

Fig. C-5. Regional deployment of common-channel signalling: cooperation and coordination.

configuration must be greater than the sum of these costs for the nonsharing configuration if the common-channel signalling system depicted in Figure C-4 is ever preferred to the system shown in Figure C-5. However, the deployment costs do not represent the total cost of either configuration. There are planning, development, and decisionmaking costs that have to be added to the deployment costs.

Network planning costs are substantial partly because the planning exercise is labor and data intensive. Several teams of analysts work on different parts of the network plan. One team analyzes traffic flows and peak-load patterns. Another team makes switch-location and switch-size decisions. Still another team makes transmission-location and cable-size decisions. If the network contains fiber optics, the third team also makes repeater and electronics decisions. Throughout this procedure, these planners tend to prefer more information over less information. Furthermore, they tend to prefer more accurate information over less accurate information. Joint planning meetings allow planners to satisfy both of these preferences. More information will be available to each planner because each planner has access to data bases associated with more than one LEC. The information used in the planning process will be more accurate because planners will have the opportunity for the systemwide reconciliation of discrepancies in LEC data. On the negative side, it is generally believed that it is more costly to gather more accurate information and to analyze more information of the same level of accuracy. Additionally, coordinating the activities of a larger number of planners is in general more costly than doing the same thing over a smaller number of planners. It, therefore, may be concluded for purposes of this example that the planning costs for the shared configuration are greater than the planning costs of a common-channel signalling configuration without sharing.

It is apparent that in cost-minimizing, LECs would not select either a cooperation or coordination strategy if incremental planning costs offset the cost savings associated with economies of scale. It is more efficient for each state and each LEC to make independent decisions such that each company deploys a self-contained common-channel

signalling system in each state.[7] Because joint planning is not an optimal process in this instance, the proactive role of regulatory alliance is substantially diminished. The alliance does not have to suggest or enforce a cooperative or coordination strategy. The alliance does not have to facilitate the collection and analysis of regionwide data. In fact, the alliance, if it does anything, should discourage the adoption of either type of strategy when the exclusive objective is to minimize the total costs incurred by the holding company. It, therefore, is assumed for purposes of continuing this example that the incremental planning costs are not sufficiently large to cause the LECs to select the nonsharing configuration over the sharing configuration.

While sharing facilities can result in easily measurable cost savings as made evident by this example, there also are measurable transaction costs associated with the joint decisionmaking between the LECs that underlies the sharing agreements. The additional costs are related to the additional time, labor, and capital necessary to reach joint decisions vis-a-vis individual decisions. Bargains have to be struck and agreements have to be negotiated and formalized. Because transaction costs increase as the number of decisionmakers rises, cooperative, and coordinating strategies begin to look less and less appealing to the holding company and its individual firms. Not surprising then, excessive additional transaction costs can cause the holding company to abandon any plans to share facilities as shown in Figure C-5.

Measurable cost inefficiency is not the only thing that can stop the holding company from adopting either cooperation or coordination strategies. Joint decisionmaking of any type involves some loss of autonomy by each LEC and a gain in the power of the holding company. As the perceived costs to each LEC caused by the loss of autonomy rise, these firms have renewed incentives to resist joint decisionmaking ventures. When these perceived costs reach some

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[7] When the additional planning costs caused by joint decisionmaking exceed the reduction in construction costs caused by the same decision, it is obvious that the "stand-alone" configuration shown in Figure C-4 would be deployed unless this decision is overridden by the regulatory alliance. However, it is not likely that such a decision would ever be made in a regulatory environment dominated by the pursuit of cost savings. A regulatory order, overriding the construction decision of the local exchange companies would in this instance cause the local exchange companies to incur costs that they could avoid without doing harm to their customers. Because of the regulatory order mandating this action, these additional costs would be passed on to consumers.

threshold level, these renewed incentives are sufficiently strong to bring forth individual and independent actions that will sink the holding company's efforts to implement a joint decisionmaking procedure that captures the cost efficiencies associated with sharing production facilities. Consequently, the combination of loss of autonomy in conjunction with rising transaction costs can be enough to stop what would otherwise be cost-efficient cooperation or coordination between LECs. When this occurs, the regulatory alliance has to step in and take an active role in furthering joint decisionmaking at the holding company level. While loss of autonomy is no doubt frustrating at the LEC level, there is in this example a greater good to be served by joint decisionmaking. Specifically, production costs have been lowered while service quantity and quality have remained unchanged.

A related question is whether loss of autonomy alone is sufficient reason for individual LECs to scuttle efforts at joint decisionmaking by the holding company. A definitive answer cannot be given in the context of this example. At most, we can say that the threshold level at which this result occurs can easily be beyond the reach of the individual LEC. In the final analysis, each LEC is subject to the jurisdiction of the holding company. The power implied by this jurisdiction serves as an effective counterweight to the cost-minimizing opportunity incentives that the LEC has to forego to cooperate and coordinate.

An almost identical analysis applies to the structure and stability of a regulatory alliance. Like the holding company, the regulatory alliance wants to achieve the cost reductions associated with the sharing of facilities. However, the alliance does not want to obtain this benefit regardless of the magnitude of the transaction costs and loss of autonomy that they face as they adopt cooperative, coordinated, or consolidated strategies for the oversight of the holding company and the related LECs. As with the holding company, the regulatory alliance will balk at incurring excessive transaction costs. When this occurs, the alliance will dissolve and with the opportunity to adopt joint strategies. As with the LECs, the alliance members will resist any loss of autonomy. The alliance will shatter when this resistance is strong enough and widespread enough. The difference between the two analysis is the relative importance of any loss of autonomy. This negative result carries more weight in the regulatory environment than in the corporate environment. A regulatory alliance's power and jurisdiction over its members are not as

strong and secure as the jurisdiction and power possessed by the holding company over the LECs. Therefore, loss of autonomy alone, is more likely to stop joint decisionmaking efforts by state public commissions than it is to stop similar efforts by LECs.

In summary, the LECs planning activities are more costly under a coordinated strategy because state-specific data discrepancies are reconciled and more information is processed and analyzed. An economy of sharing is not a sufficient condition for the adoption of coordinated strategies by LECs. The sufficient condition for a coordination strategy is that economies of sharing outweigh the incremental planning costs arising from the joint planning exercise. Coordination between LECs is the minimally suitable strategy for the planning and deployment of telecommunications infrastructure. Cooperation among the LECs is the minimally suitable strategy for regional marketing of the new services.

The optimal activity for a regional regulatory alliance is monitoring construction costs and progress when a coordination strategy is voluntarily adopted by the LECs. The optimal course of action for a regulatory alliance is to overcome the negative force caused by the LECs' loss of autonomy that is associated with every coordination strategy whenever this force is strong enough to stop joint decisionmaking by these firms. A regulatory alliance is more susceptible to the negative effects of a loss of autonomy when compared to a holding company. Finally, a regulatory alliance is more likely to cooperate and share information than to adopt a more binding coordination strategy.

An Example of the Use of Regional Regulation for Regional Electric Utility Systems

The proliferation of multijurisdictional utility systems, including centrally dispatched utility systems, power pooling, and bordering arrangements, joint venture agreements, and other arrangements between individual utility companies presents a challenge and a threat to state regulatory commissions. The threat could originate from possible federal regulatory agency usurpation of what has been traditionally thought of as state regulatory authority through such actions as expanded federal control over power pooling and system reliability standards, increased federal encroachment in utility planning and system expansion activities (including integrated resource planning--IRP), and rate-base allocation of new plant.

The challenge for state utility commissions is to recognize their common interests and to regulate de facto regional electric utility systems as well as regional holding companies so as to maximize the potential benefits to all regulatory jurisdictions and to all customers within the regional system's service area. The alternative is to regulate on a piecemeal basis that portion of a system that lies within a particular state.

The advantage of regulating on a regional basis is the likely reduction in service costs and rates occasioned through the cooperative effort of the various state regulatory commissions, and, when appropriate, the Federal Energy Regulatory Commission (FERC). This reduction in the cost of service may be achieved by promoting on a regional basis such activities as increased system interties and power pooling arrangements, promoting and monitoring power plant productivity programs, coordination of power plant and transmission siting efforts, analysis of utility system planning and expansion activities, promotion of least-cost acid rain compliance, and promotion of energy conservation and load management activities.

A first key step for regional coordination and regulation of a regional utility system is for state utility commissions (and the FERC, when appropriate) to regulate jurisdictional electric utilities based upon systemwide supply and demand information. This process would require an expanded coordination of regulatory efforts between and among commissions. Standardized ratemaking with regard to rate design, expansion planning, and cost of service issues might be thought to be the ultimate logical result of this process. Each utility system, then would be

confronted with uniform and consistent regulatory signals from the various jurisdictional utility commissions.

However, standardized ratemaking would not be the necessary outcome of using systemwide supply and demand information. State commissions could still regulate individual utilities within their own jurisdiction concerning cost of service and rate design. Use of systemwide information would allow the state commissions to rationally project the effect of their decisions upon jurisdictional customers by tracking potential costs and benefits of proposed actions to jurisdictional and nonjurisdictional customers. State commissions could then better coordinate their actions to maximize benefits to all customers systemwide, while minimizing or avoiding cross-subsidization between the various customer classes in different jurisdictions.

Further, standardization of systemwide rate design, expansion planning, and cost-of-service filing requirements could lead to economies in the collection, processing, and analyzing data and information and would allow state commissions to begin to regulate the activities of the entire electric utility system, instead of portions of it. In addition, standardization and coordination could aid in eliminating opportunities for utilities to forum shop or game on the basis of jurisdictional location or assignment of ownership on such jurisdictional factors as inclusion of construction work in progress in rate base, preapproval of expenditures, the existence and design of fuel adjustment clauses, the varying rates of return among jurisdictions, the nature of the customer mix, or the treatment of emission allowances.

Regional coordination of state utility regulatory activities might also aid state commissions in presenting their views in issues brought before the FERC, in halting the gradual encroachment of state regulatory authority by federal agencies, and in building a new partnership with the FERC on the regulation of centrally dispatch regional holding companies.

Once there is regional cooperation and standardization on the collection and analyses of systemwide data, then there is an opportunity for state commissions (and the FERC, when appropriate) to engage in forms of regional cooperation and coordination that make use of the consensus building mechanisms that are described in Chapter 10.[8] State commissions might find it

[8] For a more thorough discussion of these mechanism, see Robert E. Burns, *Innovative*

(continued...)

appropriate to undertake several of the above mentioned issues related to regional regulation. These include increasing regional inter-utility coordination of the construction and operation of generating and transmission facilities and related environmental issues (such as acid rain compliance), power plant productivity issues, coordination of power plant and transmission siting efforts, and IRP for both the need for new power plants and the promotion of appropriate energy conservation and load management techniques. Although a subset of these issues might be undertaken, because of the advantages of having polycentric issues for dispute resolution and the formation and maintenance of the regional regulatory alliance, it is helpful that the alliance of state commissions deal with as comprehensive a set of issues as possible. The existence of polycentric issues makes possible trade-offs between different states, creating the possibility of win-win solutions, as well as preventing any one conflict from becoming dominant. It also allows and encourages a heterogeneity of alliance membership that can lead to a more stable and dynamic regulatory alliance by allowing the regulatory alliance to produce joint goods and by encouraging the state commissions to accurately reveal their true preferences toward particular policies, improving the allocation of commission resources within the alliance and minimizing free-rider problems. Also as noted above, the existence of polycentric issues helps to allow for a "sense of the region and the regulatory community" to develop, and in doing so helps to clarify differences in commission goals at an early stage, which enables consensus building to naturally occur.

Here is how a regulatory alliance of state commissions might work. (FERC might be included in this process when and where appropriate, participating under its joint conference authority coupled with its authority under the National Alternative Dispute Resolution Act.) One issue that might be undertaken by state commissions is the encouragement of inter-utility coordination and interties, particularly for the construction and operation of transmission facilities and related environmental concerns. On a per unit energy basis, one 345 kilovolt (kv) transmission line can carry approximately nine times the energy of a 115 kv line at less than three times the cost. As a result of these economies of scale and recent advancements in extra high

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(...continued)
Administrative Procedures for Proactive Regulation (Columbus, OH: The National Regulatory Research Institute, 1988).

voltage transmission technology, electric utility systems are becoming increasingly interconnected.

Also, a regional alliance of state commissions might want to encourage greater inter-utility coordination. They can do this by giving the utility system clear signals on how to balance the jurisdictional utility's own internal management objectives and primary obligations to its own customer with the objective and needs of the utility system. Also, inter-utility coordination often requires individual utilities to coordinate operations and system planning. A regulatory alliance including state commissions (and the FERC, where appropriate) may help to achieve an equitable distribution of costs and benefits among the participating states' ratepayers, as well as determine transmission access rights, and methods of pricing transmission service, and other wholesale services for transactions within the system.

For siting of high-voltage lines to occur, there needs to be regional coordination of transmission siting. The two principal constraints in transmission siting are health and environmental effects and the determination of need. If each state commission does not view the utility system as a whole, but instead attempts to reach siting decisions on a jurisdictional utility fashion, then the state commissions' piecemeal approach to transmission siting might adversely affect the regional utility's systemwide plan. For example, if a state commission were to individually consider environmental restraints without considering the restraints that the utility system faces in other jurisdictions of the utility system, a utility might find itself blocked from building a transmission line the entire region requires. Siting issues could be further complicated if individual state commissions prevent siting within their own jurisdiction because there is not a determination of need within their jurisdiction. While an individual jurisdictional utility might not have significant load growth, the utility system might. To solve this problem,

the regulatory alliance might consider the use of a task force and either an advisory committee or a science panel on environmental and health issues.

A related area for regional regulation is IRP of utility plans for system expansion as well as demand-side management through conservation and load management. While most state commissions have the authority to approve major additions to utility generation and transmission facilities, few commissions actively consider the regional or systemwide implications of these additions. An individual state commission might not have a primary interest in attempting to determine the most economically efficient way to meet the needs of the system. This is particularly true if the commission considers only the requirements for that part of an interconnected system that lies within its own state. With each state commission acting in what it views to be the public interest, there is no assurance that any particular facility will meet the needs of the entire system in a least-cost manner. State commissions regulating on a regional, systemwide basis would tend to lead to lower cost-of-service and hence lower rates for all consumers in the system.

Also, for a utility system operating according to economic dispatch, the effective promotion and use of energy conservation and load management requires systemwide coordination. Otherwise, a state commission in one jurisdiction which is aggressively promoting conservation might merely be offset by another state commission's policy to promote off-peak growth. Further, if state commissions do not coordinate their efforts of promoting energy conservation and load management within the context of a regional integrated resource plan, then state commissions and their jurisdictional utilities might misforecast the need for future plant within the system and their own jurisdiction.

Before a utility is allowed to obtain a certificate of convenience and necessity for a new plant or allowed to issue a request for proposals to build new plant, the utility should have to prove to the regional alliance of state commissions that the proposed increment of capacity is the most efficient way to meet the needs of the system and that other alternatives have been examined. These other alternatives, of course, include conservation, load management, repowering, as well as building or bidding for other types of plants. The regulatory alliance might best achieve these results by using a joint problem-solving workshop approach (also known as the

collaborative process) that is now in use at many state commissions.

A final polycentric issue contained within our examples is incentive rate provisions to encourage power plant productivity. Improved power plant productivity is achievable and can significantly reduce the cost of electricity, largely from more efficient use of base load electric generating plants. By productivity and performance improvements, we mean increasing the time that an electric generating plant is available for operation, reducing the time the plant is not available at rate power, and improving the plant's on-line efficiency. There are several measures of power plant productivity commonly used to assess the efficiency of generating plants. These include capacity factor, forced outage rate, equivalent availability, and operating availability. None of these indices is sufficient individually to assess power plant productivity. Rather, they must be evaluated collectively to determine the efficiency of individual generating plants. Even then, when multiple indices are monitored, in-depth analysis must be performed to identify root causes of low productivity and to determine appropriate remedial action. The benefits of improved power plant productivity include reduction in fuel or purchased power costs, possible deferral of capacity additions, and reduced operations and maintenance costs. While primary responsibility for improved power productivity rests with the utilities, state commissions can implement various programs to promote cost-effective power plant productivity improvements. These include: (1) developing a commission position or policy statement to encourage productivity improvements by the utility, (2) coordinating state efforts with industry and federal efforts to improve the acquisition of power plant performance data and the maintenance of quality information system, (3) acquiring the capability to perform independent analyses of power plant productivity, (4) directing the establishment of productivity improvement programs, including explicit performance objectives for existing and planned plants and performance assurement, (5) establishing a program of incentives to promote productivity improvement activities, and (6) participating in ongoing efforts to promote productivity improvements.

The difficulty faced by state commissions when attempting to act on these suggestions is that systemwide data is necessary to assure that all available economies of operation are being utilized. If a state commission analyzed productivity strictly on a jurisdictional basis, improvements of efficiency on one part of the total system may decrease efficiency somewhere

else. An effective power plant productivity incentive program must consider the utility system as a whole rather than looking at individual parts. What is required is cooperation among the several state commissions served by a utility system, using the approaches discussed above.