THE REQUIREMENTS OF THE "JUST AND REASONABLE" STANDARD: LEGAL BASES FOR REFORM OF ELECTRIC TRANSMISSION RATES

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The return [on a public utility company's assets] should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate... to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market, and business conditions generally.

According to the North American Electric Reliability Council (NERC), electric transmission capacity in the United States is not keeping pace with demand for electric power. As a result, electric reliability and the development of competitive electricity markets could be impaired.

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2. NORTH AMERICAN ELECTRIC RELIABILITY COUNCIL, RELIABILITY ASSESSMENT 1999-2003 7 (May 2000) ("Very few bulk transmission line additions are planned. Only 6,976 miles... (230kV and above) are planned throughout North America over the next ten years. This represents only a 3.5% increase in circuit miles... The majority of the proposed transmission projects are for local system support."). Furthermore, NERC warns, "transmission systems [are] increasingly challenged to accommodate demands of evolving competitive electricity markets. Markets-driven changes in transmission usage patterns, the number and complexity of transactions, and the need to deliver replacement power to capacity-deficient areas are causing new transmission limitations to appear in different and unexpected locations." NORTH AMERICAN ELECTRIC RELIABILITY COUNCIL, RELIABILITY ASSESSMENT 1998-2003 6 (September 1998). In its comments on the FERC Notice of Proposed Rulemaking on Regional Transmission Organizations (hereinafter RTO NOPR), NERC emphasized that "the number and complexity of transactions on the grid is growing enormously." Comments of North American Electric Reliability Council on FERC's Notice of Proposed Rulemaking, Regional Transmission Originals, Docket No. R0199-2, 15 (Aug. 23, 1999). As demands on the transmission system continue to increase, NERC warns, "the ability to deliver remote resources to load centers will deteriorate." Id. In Order No. 2000, the Commission acknowledged the lack of transmission: "It appears that the planning and construction of transmission and transmission-related facilities may not be keeping up with increased requirements." Order No. 2000, Regional Transmission Organi

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bility of the bulk transmission system." A primary cause of the lack of capacity appears to be declining investment in improvement and expansion of transmission facilities. Electric industry analysts argue that, due to increased risks in the restructured environment, greater incentives are needed to spur the attraction of scarce capital needed to expand and improve the grid. It is also widely agreed that to provide such incentives, the transmission "pricing" policies of the FERC must be reformed to address the "transmission investment gap." Voices advocating transmission pricing reform have included the NERC, the Department of Energy, and Members of the Commission.

5. NERC, RELIABILITY ASSESSMENT, 1999-2008 34 (May 2000). Furthermore: "As the demand on the transmission system continues to rise, the ability to deliver energy from remote resources to demand centers is deteriorating. New transmission limitations are appearing in different and unexpected locations as the generation patterns shift to accommodate market-driven energy transactions," and the connection of new, market-responsive merchant capacity that was not considered at the time the transmission system was designed. Id. at 34. Again: "Delivering energy to deficient areas in any direction and amount that market forces desire is difficult and, at times, not possible." Id.

6. Although this shortage of capacity is the product of several factors, including siting issues at the state and local level, the lack of incentives to invest in new transmission seems to be a primary cause. According to NERC, "transmission providers...may find it difficult to justify investment in new upgraded transmission facilities without proper incentives...[i]f sufficient incentives are put in place, the growth in transmission capacity is not likely to keep pace with the business or reliability needs of the system." NORTH AMERICAN ELECTRIC RELIABILITY COUNCIL, RELIABILITY ASSESSMENT 1998-2007 34 (1998). According to Eric Hurst, annual investment in new transmission has declined by approximately $100 million per year in the past two decades. ERIC HURST, ELECTRIC RELIABILITY: POTENTIAL PROBLEMS AND POSSIBLE SOLUTIONS 10 (2000).

7. Along with the growth of wholesale competition and the "unbundling" of transmission assets, the risk "profile" of the transmission industry has changed dramatically. Statement of Paul R. Moule, Southern California Edison Company, Docket No. ER97-2355-000, at 1. Because incentives tend to be risk averse, "increased uncertainty will require compensation for the higher risk related thereto." Id.

8. The terms "pricing" and "rate-setting" or "rate-making" are used interchangeably in this article, because a rate is essentially a price fixed by the government. See, e.g., FPC v. Hope Natural Gas Co., 320 U.S. 591, 601 (1944) ("Rate-making is indeed but one species of price-fixing.").

9. See, e.g., NERC, RELIABILITY ASSESSMENT 1999-2008 7 (2000) ("It is yet unclear if appropriate incentives exist to promote transmission system additions and reinforcements to support the needs of a competitive energy market. [A]dequate pricing incentives...must be developed to deal with the need for new transmission lines for an open market.").

10. The NERC has counseled reform in this area as a remedy for transmission constraints. In comments filed with the Commission, the NERC called for incentives to increase transmission capacity and secure the benefits of competition; "transmission rates must provide incentives to get the right amount of transmission infrastructure built... We must make sure that shortages of transmission capacity do not restrict power flows and limit the benefits that otherwise could be achieved from competitive electricity markets." North American Electric Reliability Council, Comments on FERC RTO NOPR, August 23, 1999, at 14.

11. See, e.g., DEPARTMENT OF ENERGY, FINAL REPORT OF THE TASK FORCE ON ELECTRIC SYSTEM RELIABILITY, INCENTIVES FOR TRANSMISSION ENHANCEMENT III (Sep. 29, 1998). This report, known as the "Sharp Report" (for its principal author, Dr. Philip Sharp), expressly links the problem of inadequate transmission to a lack of investment: "Restructuring of the electric-power industry and unbundling of transmission from generation create challenges for reliably operating the existing transmission system and raise concerns about the future adequacy of transmission planning and incentives for investment in transmission enhancements." Id.

12. According to Commissioner Curt Roberts, incentive regulation can satisfy the interests of
authority to mandate RTOs."

To promote its policy of voluntary RTO formation, Order No. 2000 provides for “favorable” or “innovative” rate treatments to facilitate RTO formation. According to the Commission, “[w]e believe that it is critically important for RTOs to develop ratemaking practices that... provide incentives for transmission owning utilities to efficiently operate and invest in their systems. In particular, the Commission encourages RTOs to develop and propose innovative ratemaking practices, particularly with respect to efficiency incentives.” Specifically, Order No. 2000 provides for the Commission’s consideration of a variety of “innovative” rate treatments, including performance-based rates, return on equity (ROE) reforms, and non-traditional cost-valuation methods. The regulatory text enumerates these rate treatments as follows:

(i) A transmission rate moratorium, which may include proposals based on formerly bundled retail transmission rates;
(ii) Rates of return that (a) are formulaic; (b) consider risk premiums and account for demonstrated adjustments in risk; or (c) do not vary with capital structure;
(iii) Non-traditional depreciation schedules for new transmission investment;
(iv) Transmission rates based on levelized recovery of capital costs;
(v) Transmission rates that combine elements of incremental cost pricing for new transmission facilities with an embedded-cost access fee for existing transmission facilities; or
(vi) Performance-based transmission rates.

It must be noted that the incentive pricing language of Order No. 2000 does not bind the Commission to apply any of these rate treatments. Order No. 2000 only requires the Commission to “consider” incentive rate proposals advanced by RTO applicants and participants. Its proposed rate reforms nevertheless represent a willingness to expand upon, or even depart from, its historic methods in order to ensure that transmission rates accurately reflect new risks and responsibilities faced by transmission pro-

18. Order No. 2000, supra note 2, at 31,034. It should be noted that the Commission did not say that it lacks legal authority to mandate RTOs, and it expressly recognized the possibility of requiring RTO participation as a condition for receiving approvals for market-based rates and mergers. Id. at 31,034. The question of whether the Commission has legal authority to mandate market structure, by requiring RTO participation or by other structural means beyond its traditional ratemaking function, is beyond the scope of this article. See generally Order No. 2000, supra note 2, at 31,039-31,046 for discussion of the Commission’s legal authority with respect to RTOs.

19. Order No. 2000, supra note 2, at 31,034. Although the decision whether to join an RTO is left to the individual transmitting utility, all transmitting utilities are required to make certain informational filings explaining their plans to participate in an RTO or, if they have no such plans, to explain their reasons for not doing so.

22. Id. See infra, Part 4 for a discussion of these rate treatments.
23. 18 C.F.R. § 35.3(c)(1). The burden of development of such rate treatments rests principally on the RTO applicants. The Commission is not required to develop rate proposals sua sponte and applicants are required to include detailed justifications for their rate proposals, including a cost-benefit analysis and an explanation of how the rate treatment will further the purposes of RTOs in general. See generally 18 C.F.R. § 35.11(e).
rent law, or would it displace or even violate that standard?

Summary of Conclusions. The Article concludes that the Commission is authorized by the Constitution, the FPA, and its own policy statements to change its methods of regulation as needed to close the transmission investment gap. In doing so, the Commission may modify or even abandon old methods for the sake of protecting consumers' present and future interest in a vigorous and reliable transmission grid. Under current law, the Commission is not required to use a particular formula or method in setting rates. The Commission is, however, required to ensure that returns on transmission investments are adequate to attract the capital that a transmission provider needs to perform its public duties, including, arguably, a duty to maintain reliable, high-capacity transmission networks that are adequate to meet the demands of competitive electricity markets. The Commission's reformed policies to achieve these goals would likely withstand federal court review, provided they are supported by substantial evidence and coherent justification. Likewise, legislation to channel the Commission's discretion could be consistent with the just and reasonable standard.

Summary of Parts. The article proceeds in five parts. Part One, "The Modern Just & Reasonable Standard: Constitutional Requirements," examines the requirements of Hope that the "end result," not a particular method, governs the application of the just and reasonable standard. It also examines the requirement that the return on a regulated entity's assets be sufficient to attract the capital needed for the performance of the entity's public duties, both present and future. Part One argues that promoting a reliable, high-capacity transmission grid could fall within the category of a transmission provider's public duties and therefore, rates should enable grid expansion accordingly. Part Two, "The Modern Just & Reasonable Standard: Federal Power Act Text and Legislative History," examines the FPA to determine what guidance, if any, the Act provides the Commission in applying the just and reasonable standard. This Part concludes that, while there is little in the Act that specifically qualifies the standard or limits the Commission's discretion, several provisions (particularly under the Energy Policy Act of 1992 (EPAct)) suggest that the Commission has a statutory responsibility to promote the overall adequacy of transmission networks. Part Three, "The Modern Just & Reasonable Standard: Administrative Law Principles," sets forth the basic requirements of federal administrative law applicable to transmission ratemaking under the FPA. It explains that, as a matter of administrative law, the court's obligation of review under the just and reasonable standard is strictly limited to a determination of whether the Commission has engaged in reasoned decision-making supported by substantial evidence. The Commission is, therefore, free to depart from precedent, provided that it acknowledges and carefully justifies such departure.

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content, if any, of the just and reasonable standard in light of the Constitution’s requirements, and to determine the nature and limits of the Commission’s obligation under the standard. This Part reaches three broad conclusions: (1) neither the Constitution nor the FPA mandates the use of a particular method, formula, or set of factors in applying the just and reasonable standard, rather, it is the “end result” that matters; (2) the Commission is required to set rates at levels that accommodate both investor and consumer interests, sufficient to allow a public utility to perform its “public duties;” such duties arguably include maintenance and, in some instances, construction of transmission networks vigorous enough to meet the reliability and capacity demands of consumers in competitive markets; and (3) the Commission has discretion to take into account, not only the present, but the future interests of the public, arguably including the public’s interest in the long-term reliability and commercial adequacy of transmission infrastructure.

(A) No Particular Formula Or Method Required; End Result Test; Zone of Reasonableness

Under the Fifth Amendment, the government may not take private property for “public use” without paying “just compensation.” In the context of ratemaking by regulatory agencies, at least since the Railroad Commission Cases, the Supreme Court has held that in the context of ratemaking, public utilities have a constitutional right to earn a sufficient return. In other words, the government must allow a regulated industry to earn a reasonable rate of return on its investment. This is because an unreasonably low rate would effect an unconstitutional taking of the industry owners’ property without just compensation. As the Supreme Court explained in Bluefield, “[r]ates which are not sufficient to yield a reasonable rate of return . . . are unjust, unreasonable, and confiscatory, and their enforcement deprives the public utility company of its property in viola-

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result" test which requires a balancing of investor and consumer interests. 30

Hope: End Result Test. It was not until the 1944 case of FPC v. Hope Natural Gas that the Supreme Court decided to "withhold its legislative hand" and leave the choice of methods to the regulatory agency. The Hope opinion made clear that the NGA does not require the use of a specific method or formula for calculating a reasonable rate: "Congress... provided no formula by which the 'just and reasonable' rate is to be determined. It has not filled the details of the general prescription. 31 It follows that Congress has delegated its legislative authority to the ratemaking agency to the extent necessary to "fill" such details. Accordingly, "the Commission is not bound to the use of any single formula or combination of formula in determining rates. 32 This is so even if the method used is internally inconsistent, provided the overall result is just and reasonable: "an otherwise reasonable rate is not subject to constitutional attack by questioning the theoretical consistency of the method that produced it. 33 The important thing for constitutional purposes is the result of the rate, not the underlying method: "it is the result reached not the method employed which is controlling." 34 Thus, "the fact that the method employed to

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51. ALFRED E. KAHN, THE ECONOMICS OF REGULATION 40, n. 45 (quoting "the immortal words of Lord Montesquieu").


53. See, e.g., Permian Basin Area Rate Cases, 344 U.S. 747, 776 (1953) ([T]he legislative discretion implied in the rate making power necessarily extends to the entire legislative process, embracing the method used in reaching the legislative determination as well as that determination itself... It follows that rate-making agencies are not bound to the service of any single regulatory formula; they are permitted, unless their statutory authority otherwise plainly indicates, to make the pragmatic adjustments which may be called for by particular circumstances"). The constitutional aspects of delegation of legislative authority to a ratemaking agency are discussed in Part III infra.

54. Hope, 320 U.S. at 602. See also Wisconsin v. FPC, 373 U.S. 294, 309 (1963) (To declare that a particular method of rate regulation is so sanctified as to make it highly unlikely that any other method could be sustained would be wholly out of keeping with this Court's consistent and clearly articulated approach to the question of the Commission's power to regulate rates. It has repeatedly been stated that no single method need be followed by the Commission in considering the justness and reasonableness of rates.). Grand Council of the Cree (of Quebec) v. FERC, 198 F.3d 950 (D.C. Cir. 2000) ("In interpreting the statutory provision, 'just and reasonable,' the Supreme Court has emphasized that 'the Commission is not bound to the use of any single formula or combination of formulas in determining rates.'" (quoting Hope at 602)).

55. Duquesne, 438 U.S. at 314 (addressing whether a rate set by a State public utility commission was reasonable). Moreover, The adoption of a single theory of valuation as a constitutional requirement would be inconsistent with the view of the Constitution this Court has taken since [Hope]... [C]ircumstances may favor the use of one ratemaking procedure over another. The designation of a single theory of ratemaking as a constitutional requirement would unnecessarily foreclose alternatives which could benefit both consumers and investors.

Id. at 316. Duquesne, 438 U.S. at 314 (citing Wisconsin v. FPC, 373 U.S. 294 (1963) (gas case holding that the Commission is not limited to a single method in determining the whether a rate is just and reasonable)).

56. Hope, 320 U.S. at 602. Moreover, "if the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry... is at an end."

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tory and a ceiling above which the rate would be exploitative." The extent to which the Commission has discretion to "lean" in one direction or the other within the zone is not entirely clear.

Flexibility to Serve Public Interest. In Duquesne, the Supreme Court also emphasized the importance of leaving the State or regulatory commission a free hand to "decide what rate-setting methodology best meets their needs in balancing the interests of the utility and the public." For the Court to identify a single method as a constitutional requirement "would necessarily foreclose alternatives which could benefit both consumers and investors." Because the reasonable balance of consumers and investor interests may vary widely according to the diversity of circumstances, the regulator is free to use whatever method or methods will yield a reasonable result. The regulator's duty to balance these interests takes precedent over any slavish adherence to precedent or traditional method for its own sake.

Indeed, when the interests of consumers and investors require it, the rate-maker's methodological discretion is not even limited to the field of cost-based methods. Although the "no single formula" doctrine of Hope arose from debates over historical cost versus present (reproduction) costs, the principle has been applied in the context of non-cost-based theories as well, such as market-based rate treatments.

67. See, e.g., Jersey Cent. Power & Light Co. v. FERC, 810 F.2d 1165, 1177 (D.C. Cir. 1987) (stating that zone of reasonableness is "bounded at one end by the investor interest against confiscation and at the other by the consumer interest against exorbitant rates") (quoting Washington Gas Light Co. v. Baker, 185 F.2d 11, 15 (D.C. Cir. 1950)); Farmers Union Cent. Exchange, Inc. v. FERC, 734 F.2d 1456, 1902 (D.C. Cir. 1984) (holding that the FERC may approve rates that fall within zone of reasonableness where rates are neither "less than compensation" nor "excessive"); City of Chicago v. FPC, 353 F.2d 721, 750-51 (D.C. Cir. 1971) (affirming that rates must be high enough to attract investors but low enough to prevent exploitation of consumers), cert. denied, 403 U.S. 1074 (1972).

68. The standards for determining a zone of reasonableness and a particular rate within that zone are discussed in subparts (2) and (3) of this Part.


70. Id. As discussed in the remaining subparts of this Part, this point is critical discussion of pricing reform promote investment in new transmission capacity.

71. See generally Penn. Basin Area Rate Cases, 390 U.S. 747, 790 (1968); "We must reiterate that the breadth and complexity of the Commission's responsibilities demand that it be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of its intensely practical difficulties." Also, we see no objection to its use of a variety of regulatory methods. Provided only that they do not together produce arbitrary or unreasonable consequences, the Commission may employ any "formula or combination of formulas" it wishes, and is free to make the pragmatic adjustments which may be called for by particular circumstances.

Id. at 800 (quoting FPC v. Natural Gas Pipeline Co. 315 U.S. 575, 584 (1942)).

72. See, e.g., Penn., 390 U.S. 747 (1968) (upholding so just and reasonable area rate methodology that did not account for costs of individual gas producers); Mobil Oil Corp. v. FPC, 417 U.S. 229, 303 (1974) (noting that, in Pennsylvania, the Commission "had not adhered rigidly to a cost-based determination of rates, much less one that based each producer's rates on his own costs"); Farmers Union, 734 F.2d 1456, 1903 (D.C. Cir. 1984) ("non-cost factors may legitimate a departure from a rigid cost-based approach.") The mere invocation of a non-cost factor, however, does not absolve a reviewing court of its duty to assure itself that the Commission has given reasoned consideration to each of the pertinent circumstances.
form of marginally higher rates." As the court stated in *Hope*, "the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks." Indeed, the regulator should consider the investor's "legitimate concern with the financial integrity of the company whose rates are being regulated." The return must include not only operating costs, but also the capital costs of running a viable business enterprise. Echoing *Bluefield*, *Hope* provides additional guidance on this point: "[The] return ... should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." The Court did not define the term "confidence," nor did it specify how much capital is enough to "maintain" credit or to constitute an "attraction" of capital. "From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business." To ensure that sufficient revenue is available to cover capital costs, the rate of return must be comparable to returns in industries with similar risks: "the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks."

The Court neither imposed nor proposed a method for measuring the risks faced by "other enterprises," or for comparing such risks with those faced by the regulated firm. Nor did the Court specify whether the field of "other enterprises" should be limited to firms in the same industry, e.g., electric or gas utilities, or even to regulated industries in general. The Court did not say that the regulated firm should earn the same returns as, for example, the manufacturing or financial services industries, or the average return earned by the Standard & Poors 500 companies. On the other hand, the Court did not say that they should not earn the same returns as such industries. The term "corresponding risks" suggests that the Commission should compare the regulated firm to other firms that are in comparable circumstances, e.g., that the Commission should compare regulated gas firms with other regulated gas firms. However, the term should not be read so narrowly. It could be read in terms of "quantity" or level of risk, rather than in terms of specific industry characteristics or regu-

77. This is particularly the case in the area of transmission rates, where the transmission portion of the rate constitutes a relatively small portion of the overall price for delivered power, and transmission itself constitutes a critical link in the overall efficiency and proper functioning of the market. As Alfred Kahn explains, the quality and reliability of the service provided by a regulated utility may justify marginal increases in rates: "the nature of our dependence on public utility services is typically such that customers may correctly be more interested in ... the reliability, continuity, and safety of the service than in the price they have to pay." ALFRED E. KAHN, THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS 21 (1993).
78. FPC v. Hope, 320 U.S. 591, 603 (1943).
79. Id.
80. Hope, 320 U.S. at 603.
81. Id. ("These [costs] include service on the debt and dividends on the stock... ").
Permian Basin: Assessment of Public Interest. As noted, Bluefield required that rates be sufficient to allow a utility to discharge its "public duties." The Commission's duty to consider public duties is not limited to a formulaic analysis of costs or expected levels of investment. As the Supreme Court stated in Permian Basin, "[t]he Commission cannot confine its inquiries either to the computation of costs of service or to conjectures about the prospective responses of the capital market; it is instead obliged at each step of its regulatory process to assess the requirements of the broad public interests entrusted to its protection by Congress."

In light of the pragmatic nature of the Commission's mandate, it must be free to use whatever method best ensures the attraction of capital adequate for the discharge of "public duties." The Commission must also be free to change its methods to reflect changes in circumstances over time. As the Court recognized in Bluefield, "[a] rate of return may be reasonable at one time, and become too high or too low by changes affecting opportunities for investment, the money market, and business conditions generally."\n
The importance of this constitutional principle of flexibility in rate-making cannot be gainsaid, particularly in the context of the transmission capacity. To the extent that interstate transmission service is an integral part of electric service, particularly for the purpose of maintaining system reliability in a cost-effective manner, it is certainly an activity affected with the public interest. This is all the more the case in connection with growing competition in interconnected wholesale markets. The public's interest in reliable electric service at competitive prices is apparent. The reliable provision of an essential service, however, goes to the heart of the

89. Permian Basin, 390 U.S. at 791.
91. See, e.g., Oster Tail Power Co. v. United States, 410 U.S. 366, 378 (1973) (discussing the significance of transmission as an essential facility for "isolated electric power systems"); Gainesville Utils. v. Florida Power Corp., 402 U.S. 315, 319-20 (discussing the role of transmission in maintaining system equilibrium, freeing isolated systems from the "necessity of constructing and maintaining its own equipment").
92. See, e.g., Transmission Access Policy Study Group v. FERC, 2000 WL 762706, *3 (D.C. Cir. 2000) (acknowledging that "[a]ny entry into wholesale power generation markets increased ... the ability of customers to gain access to the transmission services necessary to reach competing suppliers became increasingly important."); (quoting Order No. 888, F.E.R.C. Stats. & Regs. ¶ 31.036 at 33.062).
93. See, e.g., Transmission Access Policy Study Group, 2000 WL 762706 at *5 (acknowledging the FERC's findings regarding the for "access to competitively priced electric generation" and the "substantial benefits" to consumers of lower electricity prices resulting from wholesale competition) (quoting Open Access NOIR, F.E.R.C. Stats. & Regs. ¶ 20.514, 33.032). The primary consumer interest in electric power markets is reliable, high-quality electric service. In the high-tech economy and infrastructure of the United States today, this means not only keeping the lights on, but also eliminating disruptions or fluctuations in the flow of power required to keep personal and business computers, sophisticated health care equipments, air and rail traffic control systems, and the myriad other precision, electricity-dependent systems and technologies upon which our economy and our very lives depend. See generally Alfred E. Kahn, The Economics of Regulation: Principles and Institutions 21 (1992).
other *Hope* nor *Bluefield* imposed a specific temporal framework on the scope of property value, consumer interests, or the performance of public duties. Indeed, the broad public interest mandate of these cases suggests that a regulatory commission should take a long view, as well as a broad view, of a utility’s public duties.

**Permian Basin.** Subsequent cases suggest that the FERC has a duty to consider the future, as well as the present interests of the public. In *Permian Basin Area Rate Cases*, the Supreme Court summarized the duties of a reviewing Court in applying the *Hope* “end result” test, holding that the court must, among other things, “determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests, both existing and foreseeable.” The Court further held that the FERC must assess the “consequences” of its rate order on the “character and future development of the industry.”

In *Permian Basin*, the Commission employed an “area” method of rate regulation, whereby rates for different geographic areas were set at different levels to advance a policy of promoting increased exploration and production of natural gas within certain areas. The Court made it clear that the rate need not be based exclusively on costs and rate of return, but could be used to advance policy goals not directly related to cost. The Commission could, within the zone of reasonableness, “employ price functionally in order to achieve relevant regulatory purposes; it may, in particular, take fully into account the probable consequences of a given price level for future programs of exploration and production.” The Commission furthermore linked the need for methodological flexibility to the Commission’s duty to protect consumers, “[t]he Commission’s responsibilities necessarily oblige it to give continuing attention to values that may be reflected imperfectly by producers’ costs; a regulatory method that excluded as immaterial all but current or projected costs could not properly serve the consumer interests placed under the Commission’s protection.”

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679, 693 (1922).


99. *Id.* (emphasis added).

100. *Permian Basin*, 390 U.S. at 792.

101. *Id.* at 796-97.

102. *Permian Basin*, 390 U.S. at 796-97, 815. See also *Mobil Oil Corp. v. FPC*, 417 U.S. 223 (1974) (upholding Commission area gas rate order and rejecting the argument that a “rate must be based entirely on some concept of cost plus a reasonable rate of return. We rejected this argument in *Permian Basin* and we reject it again here. The Commission explicitly based its additional ‘cost’ inferences on the evidence of a need for increased supplies.”).


104. *Id.* at 815. (cited in *Mobil Oil Corp. v. FPC*, 417 U.S. 223, 309-10 (1974)). Similarly, in *Mobil Oil Corp. v. FPC*, another area rate gas case, the Supreme Court held that the Commission could use area method as an “appropriate mechanism for protecting the public interest,” in view of a “serious and growing domestic gas shortage.” In view of such shortage, the Court held that it was reasonable for the Commission to conclude that area-differential rates (as opposed to uniform rates) were on
Commission had nevertheless considered "massive evidence on supply, demand, and the relationship between the two." On this basis, the Court found that the "record sufficiently supports the Commission's conclusion" that its area rate method would be "more likely to lead to the immediately increased capital necessary in the face of a crisis." 

**TAPS v. FERC.** The recent case of Transmission Access Policy Study Group v. FERC (hereinafter TAPS) supports the view that the FERC has an obligation to consider the future public interest in setting rates under sections 205 and 206 of the FPA. In connection with Order No. 888, the Court applied the just and reasonable standard to the Commission's rate determination related to stranded cost recovery. The Commission's rate determinations under the Order provided for retail stranded cost recovery in situations where State laws did not provide for recovery of such costs. The Commission noted in the Order that "[r]ecognition of this type of cost through a transmission rate is obviously not the norm, but is necessitated by the need to deal with the transition costs associated with this Rule." In this context, the Court noted the "wide discretion the FPA affords [the] FERC to determine what constitutes 'just and reasonable rates' and 'undue discrimination'..." The Court also acknowledged the "unusual circumstances created by an industry change as fundamental as Order 888's open access requirement." Thus the Court established the premise that "unusual circumstances" in connection with the establishment of a new policy warrant the use of novel methods of ratemaking.

Order No. 888 was intended to supply a long-term, albeit "structural," remedy to a perceived "systemic" problem of discrimination in transmission access, implicating consumer interests. To the extent that this rate determination was ancillary to the overall purposes of Order No. 888, it

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111. Id. at 318.
112. Mobil Oil, 417 U.S. at 319-20.
114. Although the case addresses issues of access to existing facilities rather than expansion of such facilities, the Court's discussion of the Commission's ratemaking authority are apropos independent of questions surrounding the Commission's authority to mandate unbundling and open access on a generic basis. See infra Part 3 of the article for discussion of TAPS in the context of Chevron deference.
116. Id. at 49 (quoting Order 888-A, 113 F.E.R.C. STAT. & REGS. ¶ 31,043, at 30,413).
117. TAPS at *9.
118. Id.
ELECTRIC TRANSMISSION RATES

FPA Transmission Adequacy Policy. Other sections of the FPA suggest that the Commission has a duty to promote the maintenance and expansion of vigorous, efficient transmission networks to support reliability and commerce. Section 202(a) of the FPA sets forth the purposes of "assuring an abundant supply of electric energy throughout the United States with the greatest possible economy and with regard to the proper utilization and conservation of natural resources..." Ensuring an "abundant supply" of electricity with the "greatest possible economy" arguably presupposes a properly functioning, reliable, high-capacity transmission network. In addition to its duty to "divide the country" into districts for the "voluntary interconnection and coordination" of transmission facilities, the section sets forth a general duty to "promote and encourage such interconnection and coordination within each such district and between such districts." Construction or modification of transmission facilities needed to achieve such interconnection and coordination is a highly capital-intensive enterprise. To the extent that it can, the Commission arguably has an obligation under section 202(a) to set transmission rates at levels that are high enough to encourage such construction and modification.

Transmission Rate Standards Under EPAct and FPA Sections 211 and 212. In 1992, Congress passed the Energy Policy Act of 1992 (EPAct), which, among other things, amended sections 211 and 212 of the FPA to require the Commission to apply certain standards in setting rates in connection with mandatory transmission orders under section 211. Section 212, as amended, requires the Commission to permit a utility, subject to mandated open access, to recover "all the costs incurred in connection with the transmission services and necessary associated services, including, but not limited to, an appropriate share, if any, of legitimate, verifiable, and economic costs, including taking into account any benefits to the transmission system of providing the transmission service, and the costs of any...

(Quoting 15 U.S.C. § 717a). Specifically, the Court held that the Commission could use a non-constrained area method to encourage gas exploration and production. 16 U.S.C. § 825h ("The Commission shall have the power to perform any and all acts, and to prescribe, issue, make, amend, and repeal such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this chapter.").

128. To achieve the purposes in section 202(a), the Commission is empowered and directed to divide the country into regional districts for the voluntary interconnection and coordination of facilities for the generation, transmission, and sale of electric energy, and it may at any time thereafter, upon its own motion or upon application, make such modifications thereof as in its judgment will promote the public interest.

Id. Thus, it seems to follow that "voluntary interconnection and coordination" for the sake of ensuring an abundant electricity supply are in the public interest.

130. Pub. L. No. 102-486, Title VII, §§ 721-722 (1992). Section 211, as amended, authorizes the Commission in order, on a case-by-case basis, transmitting utilities to provide upon request transmission service. Under section 211(a), a utility or supplier may apply to the Commission for an order requiring a transmitting utility "to provide transmission service (including any enlargement of transmission capacity necessary to provide such services) to the applicant..." 16 U.S.C. § 824(a) (1985)
requirements of full cost recovery for expanded transmission should apply to all transmission rates set by the Commission, not just to rates set as a result of a section 212 interconnection order. The legislative history also suggests that the pricing requirements of section 212 should apply in any instance in which the FERC orders transmission services under section 203 or section 205 for whatever reason. Subsequently, in Order No. 888, the Commission did precisely that—relying in part on sections 205, 211, and 212, it ordered open access to transmission service by generic rule. Thus, consistent with the legislative history, the pricing standards set forth in section 212(a) arguably should apply to all rates set in connection with transmission services provided pursuant to Order No. 888. In other words, to the extent that these sections apply to rate orders under sections 205 and 206, the Commission is arguably required to take transmission expansion costs into account in determining all rates.

(3) Transmission Expansion Policy. At a minimum, the transmission cost language of section 212 indicates a policy concern for adequacy of transmission facilities to support wholesale competition. In particular, the requirement that rates permit recovery of costs for “enlargement” of transmission facilities supports such a policy. Also, the requirement that rates promote “economically efficient” transmission suggests a policy in favor of transmission networks of optimal capacity to handle the demands of competitive electricity markets.

This Part showed that the FPA prescribes no particular requirements for applying the just and reasonable standard, but it provides additional support for the view that the Commission has legal authority to set rates at levels sufficient to promote investment in transmission infrastructure for the future needs of consumers.

137. See also 138 Cong. Rec. S17,613 (daily ed. Oct. 8, 1992) (statement of Sen. Johnson). Senator Johnson, Chairman of the Committee on Energy and Natural Resources, engaged Senator Wallop in a colloquy, in which Senator Wallop asked: “Do the pricing provisions of new FPA section 212(a) apply only to FERC-ordered transmission pursuant to section 211, or do they also apply to the pricing of transmission pursuant to other authorities under the FPA?” Johnson replied: “I see no reason why these new pricing principles should not be applied by the FERC in other transmission orders. It would make good policy sense to do so.” Id. See also Joshua Z. Rokach, Transmission Pricing Under the Federal Power Act: Applying a Market Screen, 14 Energy L.J. 95, 96 (1993).


11] If for some reason not based on this legislation the FERC concludes that it has a legitimate claim of authority to require transmission services under section 203 or section 205 (which I do not believe they do), the FERC should adopt the pricing criteria and standards included in amended FPA sections 211 and section 212 because they provide the clear intent of Congress with regard to any non-voluntary transmission services.

139. See also Order No. 885, F.E.R.C. Stats. & Regs. 31,056 (1995).

140. See discussion infra Part 4 of this Article where the Commission adopted this interpretation of section 212(a) in its 1994 Transmission Pricing Policy Statement.
"[Judges are not experts in the field..."

Rate making is a specialized task involving analysis of enormous quantities of data using a variety of technical economic and financial concepts. The sheer practical burden of reviewing each "subordinate element" of an ROE formula or rate base accounting scheme seemed to be a major factor in the Court's "retreat" from "method" review.

The second reason for the Court's deference is the constitutional principle of the separation of powers. Under Articles I and III, legislative power belongs to Congress; the judiciary, by contrast, is authorized only to "say what the law is," not to make the law." Rate making is essentially a legislative enterprise involving legislative-style fact finding (involving enormous quantities of data) and the characteristic legislative task of balancing multiple, competing policy considerations and political factions. Thus, the methodological elements of rate making are not only beyond the Court's technical competence, but also beyond the Court's constitutional authority. Thus, under Chevron, when a statutory term is broad or unclear, the courts generally defer to the agency's expertise in exercising its delegated authority.

It could be objected that substantive judicial review is necessary to prevent the politics of a particular President's administration from unduly influencing an agency's regulatory policy. According to Chevron, however, "an agency to which Congress has delegated policy-making responsi-

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146. See also Richard J. Pierce, Jr., Public Utility Regulatory Takings: Should the Judicial Attempt to Police the Political Institutions?, 77 Geo. L.J. 2831 (discussing institutional limits of the courts to engage in substantive review of rate making decisions of regulatory commissions).
147. Marbury v. Madison, 1 Cranch 137, 177 (1803). See also U.S. Const., art. I (All legislative powers herein granted shall be vested in a Congress of the United States...""); U.S. Const. art III ("The Judicial Power of the United States shall be vested in a Supreme Court, and in such inferior courts as the Congress may from time to time ordain and establish.").
148. See also Chevron, 467 U.S. at 865 (Observing that judges "are not part of either political branch of the Government" and must not substitute their "personal policy preferences" for the determinations of the regulatory agency).
149. In Chevron, the Supreme Court addressed a challenge to the Reagan Administration EPA's interpretation of the term "stationary source" in the Clean Air Act Amendments of 1977. Id. at 842. The Act required a rigorous permitting process for each new "stationary source" of certain pollutants.

Chevron, 467 U.S. at 840. The EPA reasoned that all pollution-emitting devices within the same industrial facility could qualify as a single stationary source. Id. at 840-42. The petitioners argued that the purposes of the Clean Air Act would be better served by requiring that each single device be subject to the permitting regime. Chevron, 467 U.S. at 839-55. In other words, the petitioners effectively asked the Court to hold that the EPA had failed to choose the best policy to advance the purposes of the Act. The Court refused to substitute its judgment for that of the agency on constitutional grounds.

When a challenge to an agency construction of a statutory provision, fairly encompassed, really centers on the wisdom of the agency's policy, rather than whether it is a reasonable choice within a gap left open by Congress, the challenge must fail. In such a case, federal judges - who have no constituency - have a duty to respect legitimate policy choices made by those who do. The responsibilities for assessing the wisdom of such policy choices and resolving the struggle between competing views of the public interest are not judicial ones: "Our Constitution vests such responsibilities in the political branches..."

At 866.
court has no authority to "substitute its [policy] judgment for that of the agency." Rather, the court need only ensure that the policy choice is coherently presented and justified by the facts, and that the agency has not failed to consider relevant factors in the rulemaking record. In general, this standard is "highly deferential" to the FERC.

In TAPS, the D.C. Circuit applied the arbitrary and capricious standard to the Commission's variable treatment of stranded costs in rate determinations under Order No. 888. Certain petitioners claimed that the FERC acted arbitrarily and capriciously in determining that just and reasonable transmission rates include "retail stranded cost recovery in some circumstances but not others." Specifically, they noted that rates must be just and reasonable and not unduly discriminatory. Therefore, they argued, by approving different transmission rates (some including stranded costs and others not including such costs), the Commission acted arbitrarily and capriciously. In response, the court stated that those petitioners "ignore the wide discretion the FPA affords FERC to determine what constitutes 'just and reasonable rates' and 'undue discrimination,' as well as the unusual circumstances created by an industry change as fundamental as Order 888's open access requirement." The court held that the mere fact that some transmission rates include stranded costs, while others do not, does not by itself make the rate determination arbitrary and capricious. Rather, the court added, "petitioners must show that there is no reason for the difference.... We think [the] FERC has provided a convincing explanation for the difference."

Typically, a rate determination fails the arbitrary and capricious test only if the Commission fails to provide a coherent, or at least somewhat thorough, explanation. In North Carolina Utilities v. FERC, for example, the court held that the Commission's use of a novel "hypothetical capital structure" used to calculate ROE, and its decision to allow the company a rate of return at the high end of the zone of reasonableness, were arbitrary and capricious. The Commission provided "no explanation" of why its

161. Oversea Park, 491 U.S. at 416.
162. See, e.g., Jersey Cent. Power & Light Co. v. FERC, 810 F.2d 1165 (D.C. Cir. 1987) ("where... the Commission has reached its determination by fatally refusing to consider a factor to which it is undeniably required to give some weight, its decision cannot stand.") (citing Oversea Park, 491 U.S. at 416).
163. See also Indiana Municipal Power Agency v. FERC, 36 F.3d 247 (D.C. Cir. 1994), upholding the Commission finding that exorbitant prices allegedly including a premium passed on to wholesale electricity customers were not unjust or unreasonable under the FPA. In Indiana, the court observed that, "[b]ecause issues of rate design are highly technical and, isolating as they are not technical, involve policy judgments that lie at the core of the regulatory mission," our review of whether a particular rate design is "just and reasonable" is highly deferential." Id. at 252 (citations omitted).
165. Id. at *48.
166. TAPS, 2000 WL 762706 at *49.
167. Id.
169. Id. at 663.
would have been appropriate to have a higher return. The court found, however, that the Commission had failed to consider a change of circumstances, which no longer justified a return at the same level. Presumably this reasoning would apply in the reverse scenario. If circumstances were to change such that a higher (rather than a lower) return were justified, it would be arbitrary for the Commission to adhere to obsolete, counterfactual zones of reasonableness. This principle could be applied in the context of the transmission investment gap, in which new risks facing the transmission industry may justify an upward adjustment of the zone of reasonableness for transmission rates.

Substantial Evidence Review. Although the arbitrary and capricious standard may seem rather undemanding, the courts have made clear that "[a] review is not, however, an empty gesture: the Commission must be able to demonstrate that it has 'made a reasoned decision based upon substantial evidence in the record.'"\(^{170}\) Section 706(2)(E) of the APA, provides that the reviewing court shall set aside an agency action that it finds to be "unsupported by substantial evidence" contained in the "whole record." This evidence, however, need not constitute a preponderance of the evidence, instead, it need only be such evidence as "a reasonable mind might accept as adequate to support a conclusion." Nor must the evidence establish that each element of the Commission's method or calculation was fully persuasive, so long as the end result is just and reasonable. Moreover, the Commission need not use what the court might regard as the "best" method even the method that produces the most favorable end result, so long as the end result, whatever it may be, appears to be reasonably articulated and supported by substantial evidence. As the court stated in *Alabama Power Co. v. FERC*, "[s]o long as its decision is

170. *Town of Norwood, 80 F.3d 526.*

171. *Id.*

172. *Northern States Power Co. v. FERC, 30 F.3d 177 (D.C. Cir. 1994) (upholding FERC order rejecting rates that would "be within the direction of the transmission from or across Northern States' control area") (quoting *Town of Norwood, 80 F.3d at 23*).


175. According to the Supreme Court in *Permian Basin*, "We are not obliged to examine each detail of the Commission's decision. If the 'total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.' *Permian Basin Area Rate Cases, 390 U.S. 747 (1968)*. So long as the rate is within the 'zone of reasonableness,' the Court lacks authority to overturn it. *Id.* (Moreover, this Court has often acknowledged that the Commission is not required by the Constitution or the Natural Gas Act to adopt as just and reasonable any particular rate level, rather, courts are without authority to set aside any rate selected by the Commission which is within a 'zone of reasonableness')."

176. See, e.g., Public Serv. Co. of New Mexico v. FERC, 832 F.2d 1321 (10th Cir. 1987) ("The Commission's pronouncements in [the area of ROE] are admittedly not uniform... However, we need not enter this morass for it is not our prerogative to require the Commission to use what we perceive to be the 'best' methodology. We are to ensure only that the methodology employed was reasonable and produced reasonable rates.").

177. *Alabama Power Co. v. FERC, 993 F.2d 1537, 1539 (D.C. Cir. 1993) (holding that a single system-wide transmission rate based upon an average system transmission cost is just and reasonable).*
The D.C. Circuit has applied this principle in cases involving the FERC's rate determinations. For example, in *Boston Edison Co. v. FERC*, the court found that "the law simply requires a commission, wishing to depart from a prior rule or prior precedent, to focus on the departure, to decide to change, and to explain why it has done so." Likewise, in *Tennessee Gas Pipeline Co. v. FERC*, the court emphasized that the Commission is "free to adopt a minority position in the financial and economic communities," such as an unconventional variant of the DCF method. "But it must say so, and, if the rejection is inconsistent with prior decisions, explain the change," the court added. In this case, the Commission had rejected the "efficient market theory," an element of a particular DCF method, apparently without providing adequate justification for the departure. The court noted that the Commission "appears quite wedded to DCF analysis and to efficient market theory as its theoretical mainstay..." This case highlights the Commission's obligation, particularly in the ROE context, to provide thorough justification for any departure from conventional DCF practice.

Conclusion to Part 3. This Part showed that the courts' review of rate determinations is highly deferential, particularly regarding matters of method and detail. The Commission must nevertheless support its rate determinations under the just and reasonable standard with carefully reasoned arguments and substantial evidence. The Commission is free to change its policies to reflect new conditions, but must take particular care to justify such departures from precedent. The next Part discusses particular areas in which the Commission has proposed to reform its ratemaking policies.

PART 4. FERC PRICING POLICIES THROUGH ORDER NO. 2000

The preceding parts of this article examined the legal boundaries of transmission ratemaking from the standpoint of constitutional, statutory, and administrative law doctrines. An examination of the Commission's own application of these doctrines in its ratemaking decisions and policy statements further illustrates the breadth of the Commission's discretion.

191. *Boston Edison Co. v. FERC*, 853 F.2d 962 (1st Cir. 1988) (upholding FERC's adjustment of a utility's rate of return to take into account general decline in interest rates).

192. Id. at 966 (citing *Pacific Northwest Power Agency v. FERC*, 37 F.3d 1517, 1522 (D.C. Cir. 1994)) (holding that the FERC order applying a certain uniform discount rate was consistent with resuming of prior order, but noting that "[i]t is true that an agency acts arbitrarily when it departs from its precedent without giving any good reason."). *But see* *Environmental Action v. FERC*, 996 F.2d 401, 411 (D.C. Cir. 1993) (noting that, when prior decisions are "readily distinguishable," the Commission "may distinguish precedent simply by emphasizing the importance of considerations not previously contemplated, and that in so doing it need not refer to the cases being distinguished by name.").


194. Id. at 1211.


196. Id.
priately compensates transmission owners and creates adequate incentives for system expansion when such expansion is efficient."

Order No. 2000. More recently, the Commission has addressed the need for incentive regulation to promote transmission expansion in connection with RTO formation. In Order No. 2000, the Commission acknowledged that transmission pricing reform is necessary as a result of industry restructuring, and that adjustments must be made to compensate for the special risks inherent in RTO participation that may discourage the voluntary formation of RTOs. Order No. 2000 states that "transmission pricing reform is needed as a result of the rapid restructuring of the industry that is underway, particularly with respect to changes in the ownership and control of transmission assets, and changes in the transmission services being provided in competitive generating markets." The Commission concluded that, "[a]s a result of these changes ... [it] needs to mitigate various 'disincentives' that may prevent transmission owners from efficiently operating their systems." Moreover, RTO participants "should be accorded transmission pricing that reflects the financial risks of turning facilities over to an RTO and that reflects other changes in the structure of the industry." The Commission also acknowledged the concerns of commenters who believe that investment in transmission is inadequate to support competition.

As noted, the regulatory text of Order No. 2000 specifically enumerates eight types of "innovative" or incentive rate treatments the Commis-

199. TTPS, supra note 198, at 31,149.
201. Id. For example:
Commenters cite to the potential that transmission owners will earn lower returns for providing unbundled transmission service than they earned for providing bundled service, even though risks associated with transmission ownership have increased ... One source of increased risk is the potential for bypass of transmission assets due to distributed generation and the phasing out of older generators from service. Other sources are directly related to RTO formation. For example, some commenters assert that stand-alone transmission companies (e.g., transcos) are riskier because they have a less-diversified portfolio of assets than a vertically integrated utility. Other commenters argue that participation in an ISO is inherently riskier, suggesting that increased risk comes from ownership of transmission assets that are needed for purposes of operational control to another, non-affiliated entity.

Order No. 2000, supra note 2, at 31,191.
202. Id. at 31,172.
203. Order No. 2000 states:
Other commenters argue that a reevaluation of transmission pricing is needed because it is absolutely critical that the transmission grid support competitive generating markets, and the only way that the Commission can ensure this will happen is to pursue pricing policies that encourage it. Some commenters suggest that because the contribution of transmission to total costs of energy is relatively small, overinvestment in transmission will not significantly affect delivered electricity prices. Further, the Commission should be much more concerned about underinvestment, not overinvestment, in the transmission grid. Stated another way, an efficient transmission grid is a prerequisite to achieving competitive generating markets ...

Id. at 31,191.
DCF methodology, we therefore assume that it is free to do so.214 The court noted, however, that the Commission "appears quite wedded to DCF analysis and to efficient market theory as its theoretical mainstay..."215 Accordingly, as a matter of administrative law, the Commission would be required to acknowledge a rejection of the DCF and "explain the change."216

American Electric Power. A recent initial decision by a FERC ALJ acknowledged the fact that the FERC is not constitutionally bound to use a particular method for calculating the ROE. In American Electric Power Co., Central and South West Corp.,217 the ALJ observed that "[a]pplying the [Bluefield and Hope] standards requires the analysis of all available data. Thus, rather than rely on a single methodology, [a witness for the applicant] considered several methods of determining the cost of common equity."218 Significantly, the ALJ rejected the "conventional" DCF methodology, at least as applied to the facts of this case, stating that it was based on "unrealistic assumptions" which produced ROEs so low (5.65% and 6.44%, respectively, for AEP and CSW) "as to conclusively demonstrate its invalidity."219 Instead, the ALJ accepted the utilities' alternative methodologies that produced a composite ROE of 11.75% for the merged company.220 Although the alternative methods were "modifications to [the] conventional DCF methodology," the case nevertheless illustrated the need to assess "all available data" and the fact that no specific method is required.221

Southern California Edison. Despite its acknowledged legal discretion, the Commission's trial staff, ALJs, and, to an extent, the Commission itself have tended to adhere to DCF methods.222 The 1999 Southern California Edison (SoCal Ed or Edison) proceeding223 provides a good illustration of both the Commission's flexibility and its "conservative" tendencies on the controversial issue of ROE calculations. In this case, the ALJ issued an initial decision (ID) recommending a rate of return on equity of 9.65% for Edison's transmission assets, approximately two percentage points below the return Edison previously received on these same assets from the State of California.224 The ALJ also would have denied Edison the right to recover about $20 million annually in overhead costs that state

211. Tennessee Gas Pipeline Co., 926 F.2d at 1211.
212. Id.
213. Tennessee Gas Pipeline Co., 926 F.2d at 1211. See also supra Part 3 for discussion of administrative law requirements for actions inconsistent with Commission precedent.
215. Id.
216. 80 F.E.R.C. ¶ 63,007.
217. Id.
218. 80 F.E.R.C. ¶ 63,007.
219. See, e.g., discussion of Tennessee Gas Pipeline Co. v. FERC supra at notes 211 and 212 and accompanying text.
221. Id.
does not signal an abandonment of DCF methods for determining the ROE under the just and reasonable standard. Indeed, the Commission emphasized the hoary status of the “standard” constant growth method. The Commission nevertheless acknowledged that “[s]hould circumstances in the industry change, in the future, we will reevaluate our methodology, as necessary.”

The more significant aspect of the Commission’s decision was its consideration of risk in choosing an ROE level within the zone of reasonableness established by the constant growth DCF method it employed. Although the Commission regarded much of the evidence presented on risk as “disputed” or “speculative,” it nevertheless acknowledged that the risks faced by Edison were higher than those in the proxy group of companies used in the Commission’s DCF analysis.22 Because the proxy companies were otherwise comparable but had not transferred their transmission assets to an ISO, the Commission adjusted Edison’s rate upward within the zone of reasonableness established on the basis of the constant growth DCF calculation.23

Order No. 2000. In Order No. 2000, the Commission acknowledged that traditional methods of calculating the ROE may no longer be adequate: “We . . . recognize that historical data typically used to evaluate ROEs may not be reliable since it reflects a different industry structure from the one that exists recently.”24 The Commission further acknowledged that “new approaches” to the ROE calculation are warranted.25 The regulatory text of the Order requires the Commission to consider rates of return that are “(a) formula; (b) consider risk premiums and account for demonstrated adjustments in risk; or (c) do not vary with capital structure . . . .”26

Formula Rates. A formula rate would “decouple a transmission owner’s earnings from its own equity valuation, and would tie it more to external standards such as industry-wide performance.”27 This approach would be “consistent with the benchmarking that may occur under PBR.”28 As discussed below, PBR-type “benchmarking” is consistent with the just and reasonable standard, provided that the end result is reasonable. Also, as discussed, the just and reasonable standard does not require the Commission to use a particular method or formula; a formula rate proposed by an RTO applicant would thus be permissible, provided that the

231. Id. at 61,261.
232. 92 F.E.R.C. ¶ 61,070, at 61,261.
233. Id.
235. Id. "The Order apparently would not, however, be used as a "vehicle for generic reform of the current discounted cash flow method for calculating return.")
236. 18 C.F.R. § 35.24(c)(2)(i).
238. Id.
tion 212(a), as summarized in the TPPS, requires transmission rates to permit the recovery of all "legitimate, verifiable and economic costs, including taking into account any benefits to the transmission system of providing the transmission service, and the costs of any enlargement of transmission facilities...."

Incremental Pricing. Traditionally, the cost basis for transmission rates consisted of the "rolled-in embedded cost" of the transmission facilities on a non-distance-sensitive or "postage stamp" basis, including the costs of new facilities or improvements to existing facilities. As the 1994 TPPS notes, the Commission began in the early 1990s to "address the industry's changing needs by modifying its historical transmission pricing policy...." Specifically, the Commission began to permit certain types of "incremental" cost pricing, whereby utilities were allowed to charge transmission-only customers either the embedded costs for the entire system, including improvements, or incremental expansion costs, but not both. This has been called "or" pricing or Northeast Utilities Pricing, referring to the Commission decision that established this policy.

In 1994, the TPPS declared that "the Commission is prepared to move beyond 'or' pricing to consider other pricing alternatives." For example, the Commission expressed willingness to consider including "various combinations" of the following pricing approaches: (1) a traditional contract path approach or a flow-based approach; (2) costs aggregated at the utility level, at a zonal level, or at the line-by-line level; and (3) various cost concepts for rate design, such as embedded cost, 'or' cost, incremental cost, or short-run marginal cost. The TPPS also expresses openness to certain methods that would "exceed the traditional revenue requirement," such as "replacement cost methods" and "long-run marginal cost methods."

The TPPS emphasized, however, that "[n]ot all of these possible combinations, however, would necessarily satisfy our principles. Specifically, the Commission named "postage-stamp and pricing" as an example of an "unacceptable" pricing method. "And" pricing means setting rates that compensate a transmission provider for both the costs of existing facilities (embedded average costs) and the additional costs of expansion (incremental cost), for the use of a given facility by a transmission-only

Billey, Appendix B, § 11, Dec. 23, 1999. Curiously, however, Chairman Hoecker did not express support for the proposed section 217; instead he recommended deleting the pricing reform provision from the bill "to avoid confusion and unnecessary litigation." Id.

247. TPPS, supra note 198, at 31,140.
248. Id. at 31,137.
249. TPPS, supra note 198, at 31,137.
250. Id. at 31,133 (citing Northeast Utilities Serv. Co., 32 F.E.R.C. 61,070).
251. TPPS, supra note 198, at 31,133
252. Id. at 31,143.
253. TPPS, supra note 198, at 31,137.
254. Id. at 31,143.
255. TPPS, supra note 198, at 31,146.
would not necessarily be an unjust end result. On the contrary, the fact that transmission customers must pay both the incremental cost of new construction and a share of embedded costs arguably does not necessarily run afoul of the just and reasonable standard, for three reasons. First, the transmission-only customers are both the occasion for the new construction (and should, therefore, be responsible for incremental costs), and are users of the existing system (and should pay for a pro rata share of such use). Second, the method may be a superior approach to ensuring that transmitting utilities are justly compensated for their opportunity costs when lines are congested and encouraging the expansion of transmission facilities while such congestion remains an obstacle to system efficiency. 264

Third, as TAPS makes clear, there is nothing inherently unjust or unreasonable in charging different rates for different categories of customers, provided an adequate policy rationale exists. 265 In TAPS, certain petitioners claimed that the FERC acted arbitrarily and capriciously by “determining that just and reasonable transmission rates include retail stranded cost recovery in some circumstances but not others.” 266 The court rejected this argument, citing the broad discretion of the Commission to fashion rates that reasonably serve its policy objectives. “In making this argument, the [petitioners] ignore the wide discretion the FPA affords [the] FERC to determine what constitute ‘just and reasonable rates’ and ‘undue discrimination,’ as well as the unusual circumstances created by an industry change as fundamental as Order [No.] 888’s open access requirement.” 267 Furthermore, “[j]ust because some transmission rates include retail stranded costs while others do not alone make Order [No.] 888 arbitrary and capricious; rather, petitioners must show that there is no reason for the difference.” 268 Similarly, under Order No. 2000, the Commission would include incremental costs in some rates, but not others. This distinction, provided it is supported with reasoned justification, would not be unjust or unreasonable. 269

In addition to “and” pricing, Order No. 2000 lists two other novel rate treatments related to cost calculation: (1) “[n]on-traditional depreciation schedules for new transmission investment;” 270 and (2) “[t]ransmission rates based on levelized recovery of capital costs.” 271

Non-Traditional Depreciation Schedules. Specifically, the Commission is willing to consider accelerated depreciation as a means of recover-

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264. See generally id. at 31,343 (discussing opportunity costs when lines are congested).
266. Id. at 42.
268. Id. (citing 40 C.F.R. 824 F.2d at 1009).
269. As noted, a rate treatment filed by an RTO applicant must include a detailed explanation of why the treatment is just and reasonable. Such explanation would assist the Commission in articulating a reasoned justification for its rate order.
270. 18 C.F.R. § 35.54(e)(2)(iii).
271. Id.

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regulation in that it . . . divorce[s] rates from the underlying cost-of-service.\textsuperscript{202} Incentive regulation is consistent with the Commission's authority under the FPA, provided the end result is "just and reasonable."\textsuperscript{203} As the Commission stated "[I]ncentive ratemaking is consistent with our general ratemaking authority. The Commission is not required to follow any specific type of ratemaking formula and is not limited to designing rates based upon traditional cost-of-service ratemaking under either the Natural Gas Act (NGA) or the Federal Power Act (FPA)."\textsuperscript{204} In the same policy statement, the Commission recognized the benefits of incentive regulation: "[I]n order to enhance productive efficiency in non-competitive markets, the Commission will allow utilities to propose incentive rate mechanisms as alternatives to traditional cost-of-service regulation. Such proposals should result in lower rates to consumers, and provide utilities the opportunity to earn higher returns.\textsuperscript{205} The Commission cited numerous natural gas cases in support of its authority to implement incentive rates.\textsuperscript{206}

Subsequently, in the TPPS, the Commission acknowledged that "the electric utility industry is continuing to evolve and we must ensure that our policies do not impede the continued development of competitive bulk power markets, or the development of new market structures and transmission arrangements."\textsuperscript{207} It also expressed openness to "consider pricing proposals necessary to accommodate such developments," noting that "[s]ome of the proposals discussed in this proceeding may exceed the traditional embedded cost revenue requirement."\textsuperscript{208}

Order No. 2000. In Order No. 2000, the Commission recapitulated its previous statements of support for incentive pricing: "the Commission has been receptive to PBR proposals, at least since issuance of the Policy

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\textsuperscript{202} Incentive Ratemaking for Interstate Natural Gas Pipelines, Oil Pipelines, and Electric Utilities, 61 F.R.C. \textsuperscript{203} 61,168, 61,533 (1992).\textsuperscript{205} As the Court observed in Permian Basin, "a regulatory method that excluded as immaterial all but current or projected costs could not properly serve the consumer interests placed under the Commission's jurisdiction." Permian Basin Area Rate Case, 390 U.S. 747, 815 (1968). See also supra Part I discussion of Permian Basin and non-cost factors in Part I.\textsuperscript{204} 61 F.R.C. \textsuperscript{205} 61,168, 61,593.\textsuperscript{206} Id. at 61,597.\textsuperscript{207} "These cases affirm that the Commission is not required to follow any specific type of ratemaking formula and is not limited to designing rates for the utilities it regulates based on traditional cost-of-service ratemaking. The Commission is free to set rates to provide incentives so long as there is a correlation between the incentive and the result induced." 61 F.R.C. \textsuperscript{208} 61,168, 61,594 (citing, e.g., Public Serv. Comm'n, State of N.Y. v. FPC, 457 F.2d 1043 (D.C. Cir. 1972); City of Charlottesville v. FERC, 641 F.2d 945, 949 (D.C. Cir. 1981) ("The Natural Gas Act fails to prescribe specific standards for ratemakers to follow"); Farmer's Union Cent. Exchange Co. v. FERC, 731 F.2d 1464 (D.C. Circuit), cert. denied sub nom. 469 U.S. 1053 (1985) (stating that "changing characteristics of regulated industries may justify the agency's decision to take a new approach to the determination of just and reasonable rates . . . and thus non-cost factors may legitimize departure from a rigid cost-based approach").\textsuperscript{209} TPS, supra note 195, at 31,147.\textsuperscript{210} Id.
rates are essentially a form of cost-based ratemaking.\textsuperscript{24} Although the incentive lies partly in the opportunity to trim costs below the initial cost baseline, and thus widen profit margins, the incentive rate nevertheless presupposes a traditional cost baseline. Under incentive plans, the utility remains subject to Commission rate determinations, albeit under terms allowing greater flexibility. Under negotiated or market based rate plans, by contrast, the regulator must (within limits) withdraw from rate review, allowing the market or at least arms-length transactions between certain qualified parties to dictate the price of the utility’s service.

As competition has developed in the wholesale power markets, the Commission has begun to accept rates that are negotiated between the parties without using the seller’s cost basis as a required baseline. These rates apply only to wholesale electric power transactions, not to transmission services. It has been the conventional wisdom that transmission is a “natural monopoly,” and that market-based transmission rates would therefore not be possible under the just and reasonable standard.\textsuperscript{25} Accordingly, the Commission has not approved market based rates for transmission services on interconnected alternating current (AC) grids.\textsuperscript{26}

The Commission has nevertheless recognized the possibility of market-based rates for transmission services on interconnected facilities in the future. The TPCS addresses this issue as follows, “[t]he electric utility industry of today is very different from the electric utility industry that existed only [twenty] years ago and even five years ago. Just as we today change our policies to reflect recent changes, we must remain flexible if we are to respond to future changes.”\textsuperscript{27} Moreover, “it is clear that there is no single appropriate ratemaking method under the FPA. The end result is the appropriate yardstick against which to measure the legality of a rate order, not the ratemaking method.”\textsuperscript{28}

\textsuperscript{24} Order No. 2000 emphasized that the Commission, by providing rate treatments to encourage RTO formation, is not “abandoning the fundamental underpinnings of our traditional transmission pricing policies, i.e., that transmission prices must reflect the costs of providing the service.” While many aspects of transmission pricing reform are labeled incentive pricing, many are aimed at eliminating disincentives to the efficient use and expansion of regional transmission grids. . . .” Order No. 2000, supra note 2, at 31,173.

\textsuperscript{25} “Because transmission remains a natural monopoly, we believe it will be difficult for transmission owners to support such pricing under the FPA, particularly market-based transmission rates.” TPCS, supra note 198, at 31,140.

\textsuperscript{26} “It should be noted, however, that in the recent proceeding of TransEnerg, U.S., Ltd. v. F.E.R.C., 61230 (2000), the Commission approved market based rates for a direct current (DC) line connecting control areas of the New York Independent System Operator (New York ISO) and the New England Independent System Operator (New England ISO). The Commission found that "competitive conditions exist in the markets served by both ends of the [DC line], and that the independent line is neither part of the integrated AC grid, it does nothing to constrain those competitive conditions," id. at 61,836. Although this decision should not be construed as signaling imminent change in the Commission’s policy concerning market-based rates, it suggests that the transmission service on interconnected AC grids is increasingly subject to limited competition in the form of substitute connections that bypass the grids.”

\textsuperscript{27} TPCS, supra note 198, at 31,140.

\textsuperscript{28} Id. at 31,141.
In Order No. 2000, the Commission reiterated its position that market-based rates (for wholesale sales) can be appropriate under certain conditions: "The Commission has a responsibility under FPA sections 205 and 206 to ensure that rates for wholesale power sales are just and reasonable, and has found that market-based rates can be just and reasonable where the seller has no market power."

Conclusion of Part 4. This Part provided an overview of the Commission's rate-making policies to show that the Commission has advocated reform in numerous areas over the past decade. Recent attention to the apparently ever-widening transmission investment gap, however, suggests that the Commission's project of reform is far from complete. Order No. 2000 challenges practitioners and utilities to propose innovative rates. Significantly, the Commission has demonstrated its openness to certain reforms in specific proceedings. The next section, Part 5, discusses legislative options for encouraging or directing the Commission to implement such reforms as may be needed to promote new investment in transmission infrastructure.

PART 5. LEGISLATIVE OPTIONS

The preceding parts of this Article discussed the boundaries of the FERC's legal authority to reform its transmission pricing policies. This Article concludes that the Commission has very broad discretion to use new pricing methods that will better reflect the risks and circumstances of the restructured transmission industry. The Commission has made strong statements and taken significant actions towards meaningful pricing reform, particularly in Order No. 2000. It has been argued, however, that much remains to be done. What if internal political or ideological divisions, or simply inertia, prevent the Commission from implementing an effective reform policy? If the Commission lacks the resources to reform its policies, what external actions could encourage the Commission to act more quickly and decisively?

New commissioners appointed by a new President could change the Commission's policies substantially. Beyond changes in the composition

FPC v. Texaco was in the context of lack of effective competition and that a determination by the Commission that such competition exists was sufficient justification for permitting market-based rates; and (2) that the just and reasonable standard does not require use of "any one pricing formula." Elizabeth River Gas Co., 10 F.3d at 870 (quoting Mobil Oil Exploration Co. v. United Dist. Co., 493 U.S. 211, 214 (1991)).
303. Order No. 2000, supra note 2, at 31, N.J.
304. See, e.g., International Transmission Company, 92 F.E.R.C. ¶ 61,376 (2000). In this proceeding, the Commission permitted, contingent upon the satisfaction of several significant conditions, "innovative rates" for the International Transmission Company (ITC). Such rates would be no higher than the wholesale rates of the ITC's predecessor in interest, Detroit Edison Company, by 0.5 mills per kWh, according to intervenors, 45%. Significantly, one of the conditions for approval is that ITC become a "fully independent transco," defined as a transco with no active or passive ownership interests by market participants.
305. See also Chevron v. Natural Resources Defense Council, 467 U.S. R.17, 165 (1984) (agency may legitimately take into account the views of the "incumbent administration" in revising its policies)
promote "the economically efficient transmission... the expansion of transmission networks, the introduction of new transmission technologies, and the provision of transmission services by regional transmission organizations." Subsection (c) further requires that such rates shall prevent cost-shifting to non-jurisdictional services and be "just and reasonable and not unduly discriminatory or preferential."

These provisions require the Commission to permit recovery of "all" transmission-related costs. Does this include costs that the Commission deems to have been imprudently incurred, or does it otherwise provide a perverse incentive for a utility to "pad" its transmission-rate base? No. This provision must be read in light of the further requirement that such rates be "just and reasonable." Under the just and reasonable standard, the Commission is free to exclude costs that it deems imprudently incurred or otherwise unreasonable. It should also be noted that the essentially identical term "all the costs" appears in FPA section 212(a).

Otherwise, the "all costs" provision simply directs the Commission to do what it has always done in reviewing rates under the FPA: permit the utility to recover its costs. Such costs must include the costs of enlargement of transmission facilities. This would be consistent with the usage of FPA sections 211 and 212. As noted, the Commission's 1994 Transmission Policy Statement embraced the cost recovery requirements of section 212(a) for all transmission rates.

The requirement that the Commission take into account the "incremental cost and benefit to interconnected transmission systems" is essentially the same as the policy set forth in the 1994 TPPS, which recognized the need for incremental cost pricing and closely tracks the language of section 212(a). The requirement that rates promote "economically efficient transmission" closely tracks the requirements of FPA section 212(a).

Using the legislative history of section 212(a) as a guide, this provision would apparently encourage, but not require, the Commission to withdraw from review in cases where negotiated ratemaking would achieve a just and reasonable result. This provision should not, however, be construed

311. H.R. 2944, supra note 309.
312. Id.
313. See generally Jersey Cent. Power & Light Co. v. FERC, 870 F.2d 1150 (D.C. Cir. 1989) (allowing recovery of certain costs deemed imprudently incurred).
315. Section 212(a) in reference to increasing transmission capacity, states: Any electric utility, federal power marketing agency, or any other person generating electric energy for sale for resale, may apply to the Commission for an order under this subsection requiring a transmitting utility to provide transmission services (including any enlargement of transmission capacity necessary to provide such services) to the applicant.
316. FPA, § 212. See supra Part 4.

Adding the modifier "economically" to the word "efficient" calls to the FERC's attention that
without this language, all rates would still be subject to the just and reasonable standard under sections 205 and 206. It has been suggested that the transmission pricing provisions of H.R. 2944 could be an unwarranted departure from the established FPA standards, and that the language would somehow violate the FPA's just and reasonable standard or force the FERC to set transmission rates that go beyond the "zone of reasonableness." The standards set forth in the proposed section 217 are, on the contrary, wholly consistent with the just and reasonable standard as it is set forth in the text of the Act and as it has been interpreted by the courts. Use of the phrase just and reasonable in the proposed section 217 removes any doubt regarding the consistency of such standards with the historic just and reasonable standard, emphasizing that the clarifications of subsections (a) and (c) would not "preempt" that standard, or in any way require the Commission to exceed the bounds of the standard as previously interpreted by the courts. Thus, such additional specifications would be consistent with the just and reasonable standard.

At most, such additional requirements would constitute a limitation or channeling of the FERC's discretion within the historic bounds of the just and reasonable standard, not a grant of new or broader authority. The new standards certainly would not require the Commission to approve "unjust" or "unreasonable" rates. Nor would these standards authorize the Commission to set rates that fall outside the zone of reasonableness under current law; rather, they would simply require that the Commission take into account, within the "zone of reasonableness," the need for expanded and improved transmission facilities in determining what constitutes a just and reasonable rate.

It should be noted that section 212(a) also provides that rates set pursuant to section 211 "shall promote the economically efficient transmission and generation of electricity and shall be just and reasonable, and not unduly discriminatory or preferential." It should be noted that the just and reasonable language of this section was drawn verbatim from the original just and reasonable language of FPA sections 205 and 206. Thus, the additional requirements of the section do not override the just and reasonable standard, as the legislative history confirms. On the contrary, sec-

322. The official section-by-section summary of H.R. 2944, issued by the House Commerce Committee after the markup, suggests that the proposed pricing provisions are potentially inconsistent with current law:

it is unclear how FERC should balance current law and the new provisions. For example, under current law FERC has authority to approve rates that range from confiscatory to monopoly rents, the "zone of reasonableness." The pricing provisions added by the Sawyer amendment appear to require FERC to approve rates that are higher than it would approve under current law — and closer to monopoly rents — if such rates promote the economically efficient transmission of electric energy or promote expansion.


324. See id. supra Part 2.

325. According to Senator Johnson, section 212(a), including the language requiring that rates

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Similarly, the cost recovery provisions of H.R. 2944 would channel the FERC's discretion, but would not require or authorize the FERC to set transmission rates at levels beyond or outside the zone of reasonableness or otherwise inconsistent with the just and reasonable standard.

H.R. 2944: Voluntary Innovative Pricing Provisions. Subsection (d) would require the Commission to “encourage innovative pricing policies voluntarily filed by transmitting utilities,” including policies that (1) provided incentives to transmitting utilities to participate in RTOs; (2) limit charging of multiple rates for transmission service by RTOs; (3) minimize cost-shifting among existing customers within an RTO; (4) encourage “efficient and reliable operation” of transmission networks through congestion management, performance-based or incentive ratemaking, and “other measures;” and (5) encourage “efficient and adequate investment in and expansion of” RTO transmission facilities.

These provisions are consistent with the policy of Order No. 2000 to promote efficient use of and investment in RTO transmission facilities. The Commission has ample legal authority to implement incentive or performance-based rate treatments. Rate treatments that encourage efficiency, reliability, and transmission investment and expansion are consistent with the requirements of the Hope and Bluefield cases that rates be adequate to attract capital needed for the discharge of a utility’s public duties. Such treatments would also advance the FPA policies in favor of adequate and reliable transmission. By incenting RTO formation, these policies would also further the purposes of FPA section 202(a), which directs the Commission to “encourage the voluntary interconnection and co-ordination of facilities for the generation, transmission, and sale of electric energy....”

It should be noted that the innovation pricing provisions of H.R. 2944 require only that the Commission consider such treatments. It does not require that they be approved, even if they were to meet the standards set forth in Order No. 2000. Also, the burden of development of such rate treatments remains on the RTO applicant and no special provision is made for advance declaration by the Commission of whether a particular rate treatment would be approved. These provisions would nevertheless send a clear signal that Congress intends the Commission to give serious consideration to such treatments for all transmitting utilities applying to participate in RTOs.

H.R. 2944: Negotiated Rates and Effective Competition. Sections (e) and (f), respectively, provides that the Commission “may permit” negotiated transmission rates (without regard to costs) between willing parties and where the Commission finds effective competition. market-based transmission rates. These sections do not require the Commission to permit such rates, and in the case of market-based rates, would permit such

329. See text supra Part 4.
330. 16 U.S.C. 824d et al.
cannot seriously be contended that the Constitution prevents state legislatures from giving specific instructions to their utility commissions. We have never doubted that state legislatures are competent bodies to set utility rates."

The same reasoning applies, a fortiori, to Congress's authority over the Commission. Alternative legislative approaches within Congress' authority could include codifying Order No. 2000's incentive rate provisions or other standards clarifying the application of the just and reasonable standard to transmission rates. Congress could also enact procedural provisions to reduce the uncertainties related to voluntary filings. For example, the Commission could be required to issue declaratory orders advising prospective RTO applicants of whether their proposed innovative rate filings would be consistent with applicable standards.

CONCLUSION

This Article is intended to inform or, more likely, remind the reader that the constitutional and statutory requirements for ratemaking by the Commission remain constant, even if, as has been the case over the last decade, there is major change in the circumstances in which those requirements are applied. The fundamentals are clear. Rates must be sufficient to attract the capital necessary for the "proper discharge of public duties," but the time-honored just and reasonable standard is flexible. The Commission must permit rates that will enable the transmission provider to remain healthy enough to discharge its public duties, but it has ample discretion to employ any ratemaking method it chooses, even to permit "market-based rates," so long as it supports its choice by substantial evidence. Both the FPA and governing principles of administrative law repose significant authority with the Commission. In light of changes in the electric industry structure in recent years, and the growing consensus that the transmission investment gap threatens both reliability and competition, the Commission has recognized its ability to adopt new methods for judging rates. The Commission has even invited transmission providers to submit innovative rates. This situation presents a challenge for transmission providers, their advocates, and policymakers, specifically for Commissioners and Members of Congress. Practitioners should reexamine the contours of the Commission's constitutional and statutory mandate as outlined in cases that may be so familiar as to be overlooked. Closing the transmission investment gap should strengthen reliability of electric service, spur development of new technology to improve transmission operations, and permit more vigorous competition. To accomplish this goal through transmission rate policies will require rigorous discovery of the facts and a fresh application of the time-honored just and reasonable stan-

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