

WILL THE SUPREME COURT LOSE PATIENCE WITH PRUDENCE?

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As a result of the ongoing conflict concerning federal versus state regulation of interstate power transactions among affiliates, "prudence" is fast becoming the most misused term in utility regulation. In the now-famous *Pike County* case,¹ a Pennsylvania intermediate appellate court held that, notwithstanding the *Narragansett* rule of federal preemption,² a state commission can disallow the cost of power purchased under a FERC-approved rate if it finds that the purchasing utility acted imprudently in buying the power instead of choosing less expensive alternatives. *Pike County* has been followed in at least two state supreme court decisions,³ and its rationale was adopted by the Federal Energy Regulatory Commission (FERC or Commission) in a series of administrative decisions starting with *Philadelphia Electric Co.*⁴ There the FERC held that in finding a particular wholesale power transaction to be just and reasonable, it did not intend to adjudicate the prudence of the buyer in entering into the transaction. That issue, the Commission said, was a matter for state commissions, or the FERC itself, in determining whether to allow recovery of the purchased power expense in the purchaser's retail or wholesale rates. The Supreme Court, while affirming the *Narragansett* doctrine in its 1986 *Nantahala* opinion,⁵ lent some credence to the *Pike County* exception when Justice O'Connor assumed, *arguendo*, the validity of the

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1. *Pike County Light and Power Co. v. Pennsylvania Pub. Util. Comm'n*, 77 Pa. Commw. 268, 465 A.2d 735 (1983).

2. *Narragansett Elec. Co. v. Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978); *see also* *New Orleans Pub. Serv., Inc. v. Council of New Orleans*, 833 F.2d 583 (5th Cir. 1987); *Arkansas Power & Light Co. v. Missouri Pub. Serv. Comm'n*, 829 F.2d 1444 (8th Cir. 1987); *Utah v. FERC*, 691 F.2d 444 (10th Cir. 1982); *Public Serv. Co. v. Public Util. Comm'n*, 644 P.2d 933 (Colo. 1982); *Washington Gas Light v. Public Serv. Comm'n*, 508 A.2d 930 (D.C. 1986); *Peoples Counsel v. Public Serv. Comm'n*, 444 A.2d 975 (D.C. 1982); *City of Chicago v. Illinois Commerce Comm'n*, 13 Ill. 2d 607, 150 N.E.2d 776 (1958); *Office of Pub. Counsellor v. Indiana & Mich. Elec. Co.*, 416 N.E.2d 161 (Ind. Ct. App. 1981); *Eastern Edison Co. v. Department of Pub. Util.*, 388 Mass. 292, 446 N.E.2d 684 (1983); *Northern States Power Co. v. Minnesota Pub. Serv. Comm'n*, 344 N.W.2d 374 (Minn.), *cert. denied*, 467 U.S. 1256 (1984); *Northern States Power Co. v. Hagen*, 314 N.W.2d 32 (N.D. 1981); *Citizens Gas Users Ass'n v. Public Util. Comm'n*, 165 Ohio St. 536, 138 N.E.2d 383 (1956); *Peoples Natural Gas Co. v. Pennsylvania Pub. Util. Comm'n*, 141 Pa. Super. 5, 14 A.2d 133 (1940).

3. *In re Sinclair Mach. Prods., Inc.*, 126 N.H. 822, 498 A.2d 696 (1985); *Spence v. Smyth*, 686 P.2d 597 (Wyo. 1984); *see also* *Kentucky W. Va. Gas Co. v. Pennsylvania Pub. Util. Comm'n*, 650 F. Supp. 659 (M.D. Pa. 1986), *aff'd*, 837 F.2d 600 (3d Cir. 1988).

4. *Philadelphia Elec. Co.*, 15 F.E.R.C. ¶ 61,264 (1981); *e.g.*, *Southern Co. Servs., Inc.*, 26 F.E.R.C. ¶ 61,360 (1984); *Pacific Power & Light Co.*, 27 F.E.R.C. ¶ 61,080 (1984); *see* *Hobelman, The Narragansett Decision and its Aftermath*, 6 ENERGY L.J. 33, 48-52 (1985).

5. *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986).

exception.⁶

The right of a state commission to examine prudence in the *Pike County* context has rarely been challenged. However, the proponents of increased state regulation over interstate transactions have been attempting, sometimes successfully, to push the *Pike County* rule far beyond its limited boundaries. Under the banner of "prudence," they are seeking to impose state regulation on matters that are not legally subject to, and are not practically amenable to, such regulation.

An example is the article by Walter W. Nixon III and Dr. Robert E. Johnston entitled *Nantahala Affirms Narragansett—Whither Pike County?*⁷ Nixon and Johnston analyze the *Nantahala* decision and the still-pending FERC preemption disputes from a state regulator's viewpoint. While decrying *Nantahala* as a bad "omen" signaling increased FERC preemption of state regulatory prerogatives, they see the Court's reference to a possible *Pike County* exception as an "opportunity" to avoid some of the adverse effects of the decision.⁸ According to Nixon and Johnston:

What *Nantahala* leaves undecided for the present, it appears, are the following questions:

1. In what situations can the states, in setting retail rates, determine that a purchaser was imprudent in agreeing to buy wholesale power at a FERC-approved rate?
2. Can the FERC compel anyone to purchase at rates it has found to be just and reasonable?
3. To what extent does affiliation with a public utility holding company or membership in a multi-state power pool affect the answers to questions 1 and 2?⁹

Generally, Nixon and Johnston advocate aggressive use by state commissions of prudence inquiries as a means of asserting jurisdiction over interstate power transactions. They believe such actions are necessary because they perceive state regulation as more attentive to consumers' interests than federal regulation.

Since the Nixon & Johnston article was written, the Mississippi Supreme Court has decided, and the United States Supreme Court has accepted review of *State ex rel. Pittman v. Mississippi Public Service Commission*¹⁰—a case which promises to answer the questions identified by Nixon and Johnston as

6. Justice O'Connor said:

Without deciding this issue, we may assume that a particular *quantity* of power procured by a utility from a particular source could be deemed unreasonably excessive if lower-cost power is available elsewhere, even though the higher-cost power actually purchased is obtained at a FERC-approved, and therefore reasonable, *price*.

Nantahala, 476 U.S. at 972 (emphasis in original).

7. Nixon & Johnston, *Nantahala Affirms Narragansett—Whither Pike County?*, 8 ENERGY L.J. 1 (1987).

8. *Id.* at 2-3.

9. *Id.* at 2 (emphasis in original).

10. *State ex rel. Pittman v. Mississippi Pub. Serv. Comm'n*, 506 So. 2d 978 (Miss. 1987). On October 6, 1987, the U.S. Supreme Court agreed to hear the case, postponing further consideration of the question of jurisdiction to the hearing on the merits. *Mississippi Power & Light Co. v. State ex rel. Pittman*, 108 S. Ct. 63 (1987).

unresolved by the *Nantahala* decision. Oral argument was heard on February 22, 1988, and a decision is imminent.

In *State ex rel. Pittman*, the Mississippi Supreme Court reversed the Mississippi Public Service Commission's (Mississippi PSC) order allowing Mississippi Power and Light (MP&L) to recover the costs of the Grand Gulf nuclear plant allocated to MP&L by the FERC in its Opinion Nos. 234 and 234-A.¹¹ The court remanded the matter to the Mississippi PSC for a "prudency" review. However, it is not clear what the prudence review ordered by the Mississippi Supreme Court would encompass. Several possible issues are mentioned by the court. First, the court directed an inquiry into the "prudency" (i.e., justness and reasonableness) of the cost allocation agreements among the members of the Middle South System. The court stated that the Mississippi PSC "had the authority, indeed the duty, to inquire into the prudency of these suspect agreements."¹² Second, the court raised the question of whether it was prudent for MP&L to buy Grand Gulf power when "lower cost power is available elsewhere (in fact, by plants owned by MP&L)."¹³ Third, the court discussed the question of the prudency of the cost of constructing Grand Gulf.¹⁴ Fourth, the court raised the question of the prudency of having built and/or completed the plant in the first place.¹⁵

Significantly, none of these issues bears any real relationship to the type of prudence-of-choice inquiry contemplated by *Pike County* and its progeny. *Nantahala* established that the first type of prudence inquiry is beyond a state commission's jurisdiction under all circumstances. The *American Electric Power (AEP)* cases discussed below made clear that the second topic bears only a superficial relationship to the classic *Pike County* situation. The third and fourth prudence issues relate to the reasonableness of costs underlying the wholesale rate paid by MP&L for Grand Gulf power. *Narragansett* and its progeny established, and the *Pike County* line of cases concedes, that state commissions lack authority to conduct such a reexamination of underlying costs.¹⁶

On its face, the *State ex rel. Pittman* decision appears to contradict the Supreme Court's decision in *Nantahala*, which held that states, in setting retail rates, are preempted from disregarding FERC-approved allocations. Nevertheless, since the Mississippi Supreme Court's decision uses the magic word "prudency" and invokes Justice O'Connor's language from *Nantahala* regarding the *Pike County* exception, this case appears to offer a vehicle for the

11. *Middle S. Energy, Inc.*, 31 F.E.R.C. ¶ 61,305 (1985); *Middle S. Servs., Inc.*, 32 F.E.R.C. ¶ 61,425 (1985).

12. *State ex rel. Pittman*, 506 So. 2d at 988.

13. *Id.* at 985.

14. *Id.* at 986.

15. *Id.* On this point, the court appears to make some factual findings of its own, stating that "[s]urely, it became obvious to MSU management, at least by the early 1980's, that both the cost and demand projections related to Grand Gulf were terribly incorrect. . . . [A]nd [yet] management proceeded doggedly along." *Id.*

16. *Id. Pike County*, 77 Pa. Commw. at 274, 465 A.2d at 738; *accord In re Sinclair Mach. Prods., Inc.*, 498 A.2d at 702; *Spence v. Smyth*, 686 P.2d at 600.

Supreme Court properly to circumscribe the limits of any prudence exception to the *Nantahala* rule.

This article will analyze the various issues claimed by the Nixon & Johnston article and the Mississippi Supreme Court to be subject to review by state regulators, and explore whether the Federal Power Act and *Nantahala* reserve these issues for the exclusive jurisdiction of the FERC. Contrary to the view held by proponents of expanded state jurisdiction, the *Pike County* exception cannot create parallel state review of allocation agreements found by the FERC to be just and reasonable.

I. PIKE COUNTY PRUDENCE-OF-CHOICE

In the *Pike County* situation, a utility purchases power from Supplier X when cheaper power is available from Supplier Y. *Pike County* stands for the proposition that a state commission has the power to judge the prudence of such a situation just as it would if it found a utility to be using gold-plated paper clips. The fact that both Supplier X and Supplier Y's rates for the power are wholesale rates, regulated by the FERC, is irrelevant if the utility had the ability to choose between the suppliers. The corollary to this, as developed in the FERC's decisions, is that in determining the justness and reasonableness of a wholesale rate, the FERC does not determine the prudence of the purchaser in entering into the transaction. An inquiry into all of the various sources of power that might be available to the purchaser is regarded by the FERC as beyond its duties under the Federal Power Act.

The validity of the *Pike County* exception to the *Narragansett* doctrine has not been endorsed by the Supreme Court, but the more recent litigation over these issues has not focused upon the validity of the exception. What mainly has been challenged are efforts by state regulators to disregard the FERC orders which establish the relationships among members of integrated interstate holding company systems.

II. PRUDENCE-OF-CHOICE IN THE HOLDING COMPANY CONTEXT — THE AEP CASES

The *AEP* cases pose the question of whether *Pike County* type prudence-of-choice concepts can reasonably be applied to questions regarding the allocation by or subject to review by the FERC of costs among members of an affiliated holding company system. After some initial ambivalence on the subject, the FERC found that such concepts do not apply. The Nixon & Johnston article characterizes the *AEP* decisions as a reversal of prior positions on the FERC's part, and speculates that the "new" FERC, as a next step, will completely abrogate the position of the "old" FERC on prudence-of-choice issues.¹⁷ The article errs in its conclusions. First, the *AEP* cases are not inconsistent with the FERC's earlier pronouncements on prudence. Second, contrary to Nixon and Johnston's concerns, the FERC has recently reaffirmed the applicability of its earlier precedents to non-pool situations.¹⁸

17. Nixon & Johnston, *supra* note 7, at 5-34.

18. Monongahela Power Co., 39 F.E.R.C. ¶ 61,350 (1987). The FERC further elaborated on its

The *AEP Service Corp.*¹⁹ case provides the clearest example of the inapplicability of *Pike County* concepts to questions regarding the allocation of costs among members of interstate power pools. The major operating companies of the American Electric Power System (AEP System), an integrated interstate holding company system, filed a Transmission Agreement (Agreement) with the FERC. Prior to the Agreement, each pool member had owned and borne the cost of the bulk transmission facilities located in its state or service territory. Under the new Agreement, those pool members whose investments in bulk transmission facilities are surplus to their demand-allocated shares of the system's total investment receive payments from those members whose investments are deficit. In order to cushion the effect on the deficit or paying companies, the Agreement is phased in over a five-year period.

Predictably, state commissions and customer representatives from all of the states served by the AEP System intervened in the FERC proceedings. The intervenors from the states served by companies who would be making payments under the Agreement either argued that the Agreement should be rejected in its entirety or proposed alternative allocations which would result in the companies in their states paying less. Those in states which would receive payments urged approval of the Agreement or alternatives which would increase their payments, and opposed the five-year phase-in to the new system.

In August 1984, the FERC accepted the Agreement for filing, and allowed it to go into effect subject to refund pending determination of its justness and reasonableness. Hearings were held and, in an initial decision, the FERC Administrative Law Judge (ALJ) Howe recommended approval of the Agreement with some modifications.²⁰ The matter is now pending, on exceptions, before the FERC.

While the case was still before the ALJ, certain intervenors from the paying states filed motions asking the FERC to declare that in determining the justness and reasonableness of the Agreement, it would not decide the issue of the prudence of the member companies in entering into the Agreement. They cited the *Philadelphia Electric* line of cases as precedent. In its September 13, 1985 order on those motions, the FERC stated that the prudence of being a party to the AEP Transmission Agreement cannot be considered separately from the prudence of being a party to the entire AEP pool relationship. While opining that the latter question is a federal matter, the FERC declined to address it because membership in the AEP pool had not been challenged by any party.²¹

Beyond such a basic inquiry, the FERC noted that a state commission

position in this regard in its April 17, 1987 brief *Amicus Curiae* in *Kentucky W. Va. Gas Co. v. Pennsylvania Pub. Util. Comm'n*, 650 F. Supp. 659 (M.D. Pa. 1986), *aff'd*, 837 F.2d 600 (3d Cir. 1988).

19. *American Elec. Power Serv. Corp.*, 37 F.E.R.C. ¶ 63,032 (1986).

20. *Id.*

21. *American Elec. Power Serv. Corp.*, 32 F.E.R.C. ¶ 61,363, at 61,818 (1985). The FERC noted the jurisdiction of the Securities and Exchange Commission over the formation and dissolution of interstate holding companies under the Public Utility Holding Company Act, 15 U.S.C. §§ 79a(c), 79e (1982). *American Elec. Power*, 32 F.E.R.C. at 61,819 n.4.

could not inquire into the prudence of a member company in entering into the Agreement without invading the FERC's jurisdiction by ruling on the merits of the Agreement itself.²² After all, a party can hardly be found to be imprudent in entering into an agreement that is just, reasonable and nondiscriminatory as it relates to that party. The FERC thus recognized that the issue was not really one of prudence, but of the moving parties' dissatisfaction with the allocation of costs under the Agreement—the very matter being litigated before the FERC.²³ Consequently, the FERC found inapplicable its precedents leaving to state commissions the question of the prudence of a buyer in making a particular purchase.

After the FERC accepted the Agreement for filing and allowed it to go into effect, Appalachian Power Company, a deficit pool member which makes payments under the Transmission Agreement, had its payments disallowed in retail rates by the West Virginia Public Service Commission (West Virginia PSC) because the Agreement had not received its approval under West Virginia statutes regulating transactions among affiliates. The West Virginia PSC asserted that the affiliated transactions statute was not preempted by the FERC's jurisdiction over the Agreement because the West Virginia PSC was conducting a *Pike County* prudence review.²⁴ About the same time, the Kentucky Public Service Commission (Kentucky Commission or Kentucky PSC) excluded from surplus pool member Kentucky Power's retail rate base all EHV transmission in excess of its demand-allocated share of the system total, on the ground that the "surplus" was not used and useful for *Kentucky customers*.²⁵ While the rate base exclusion precludes Kentucky Power from recovering the carrying costs of its "surplus" investment from its retail customers, the phase-in feature of the Agreement as accepted by the FERC precludes full compensation for that investment from the other pool members during the phase-in period. In effect, for retail ratemaking purposes, the Kentucky Commission pretended as if the Transmission Agreement was in immediate effect, ignoring the five-year phase-in feature.

The AEP companies challenged both the West Virginia and Kentucky Commissions' actions in court. In March 1987, the U.S. Court of Appeals for the Fourth Circuit, in *Appalachian Power Co. v. Public Service Commission*,²⁶ upheld a federal district court's finding that the West Virginia Commission's actions regarding the Transmission Agreement under state affiliated transaction statutes and its disallowance of Appalachian Power Company's (APC) costs incurred under the Agreement were preempted by the FERC under the Federal Power Act.²⁷ The court recognized, as had the FERC, the inapplicability of the *Pike County* rationale:

22. *Id.* at 61,818.

23. *Id.*

24. Appalachian Power Co., No. 83-697-E-42T (Pub. Serv. Comm'n of W. Va. Dec. 28, 1984) (Order on Rehearing).

25. Kentucky Power Co., No. 9061, slip op. at 18-20 (Ky. Pub. Serv. Comm'n Dec. 4, 1984) (Opinion and Order). In this same rate order, the Kentucky PSC disallowed the cost of power purchased under the Rockport Unit Power Agreement, discussed *infra*.

26. Appalachian Power Co. v. Public Serv. Comm'n, 812 F.2d 898 (4th Cir. 1987).

27. *Id.* at 900.

While *Pike County* does recognize a realm of state authority to consider interstate agreements that FERC, in a slightly different context, also considers, we do not believe the facts of the instant case permit invocation of that state authority even if the *Pike County* analysis be accepted. On a practical level, the *Pike County* inquiry is meaningless here because there is no alternative source of power for APC to choose other than that available through the AEP system, and the only access to that power is over the EHV lines whose costs are allocated by the [Transmission Agreement]. Because the essence of the *Pike County* inquiry is whether a particular choice was wise, the lack of choice here makes such an inquiry an empty one.²⁸

The Kentucky PSC's order has been upheld by the Franklin Circuit Court, Franklin County, Kentucky,²⁹ and is currently pending on appeal before the Kentucky Court of Appeals.

The actions taken by the West Virginia and Kentucky Commissions regarding the Transmission Agreement illustrate the dilemma posed by state regulators' refusal to recognize the FERC's jurisdiction over interstate cost allocation questions. Interstate power pools cannot long exist being thus pulled in opposite directions by their state regulators. This can be further illustrated by a simple example. Suppose Utilities *A* and *B* operate together as an integrated system (the *A-B* System) in adjoining states. Utility *A*'s annual production costs are one million dollars and Utility *B*'s are three million dollars. Their power pooling agreement, filed with the FERC, requires each company to bear its own costs. Now suppose Utility *B*'s state regulatory commission decides that it is unfair for *B* to bear three million dollars per year in costs while *A* pays only one million dollars. Instead of petitioning the FERC for a change in the pooling agreement, however, the state commission decides to treat *B*, for retail ratemaking purposes, as if its production costs were only two million dollars per year, on the ground that *B* was "imprudent" in entering into the existing arrangement. The combined enterprise is now losing one million dollars annually. Could this loss be erased by entering into a new pooling agreement which would result in both utilities bearing two million dollars of costs per year?³⁰ Not if the state commissions can ignore that agreement for purposes of setting retail rates. Utility *A*'s state commission might just as well disallow retail recovery of its new one million dollar payment on the ground that *A* was imprudent in agreeing to make a payment where none was required before.³¹ Simply put, when the question is how to divide a pie among states, each state cannot reasonably be given the right to determine the size of its own slice. As the United States Court of Appeals for the District of Columbia Circuit said, in affirming the FERC's jurisdiction over Middle South's Grand Gulf allocation controversy:

[W]hen, as here, affiliated operating companies in an integrated regional system enter into agreements for wholesale power sales in interstate commerce which

28. *Id.* at 903.

29. *Kentucky Power Co. v. Public Serv. Comm'n*, No. 84-CI-1760 (Franklin Cir. Ct. Mar. 24, 1984).

30. There is some doubt that the FERC would accept such a state-coerced filing in any event, see *Western Mass. Elec. Co.*, 23 F.E.R.C. ¶ 61,025 (1983).

31. The fact that a portion of the three million dollar cost could be imprudently incurred, and therefore not properly recoverable from ratepayers, is a separate issue (*see* Section III, *infra*) which neither creates state jurisdiction over the pooling agreement, nor solves the underlying allocation problem.

allocate costs, FERC jurisdiction has additional merits. As ALJ Head observed, "the Commission is perhaps in the best position to reach the most equitable result and to act in the public interest, rather than to be controlled by the necessarily parochial concerns of the States."³²

Returning to the *State ex rel. Pittman v. State of Mississippi* case, the reader will recall that the Mississippi Supreme Court held that the Mississippi PSC could review, de novo, the interstate agreements among the Middle South companies, including the Unit Power Sales Agreement which, as reformed by the FERC, allocated thirty-three percent of the costs of the Grand Gulf plant to MP&L. In doing so, the court went so far as to assert state jurisdiction over the parent holding company and the generating company. Moreover, it appeared to dictate a preordained conclusion to the forthcoming investigation, noting that "clearly the allocation of [thirty-three] percent of Grand Gulf power is unreasonably excessive."³³ Similar attempts to override federal jurisdiction already have been rejected in *Nantahala* and *Appalachian Power*. Accordingly, the Supreme Court should find that the state action in this regard violated the Supremacy Clause.

A more subtle approach, however, is evidenced by the court's statement that "[i]n this case, there is no doubt . . . that lower cost power is available elsewhere (in fact, by plants owned by MP&L)."³⁴ The court has thus attempted to avoid preemption by positing a *Pike County*-type choice among power supply options; but the resemblance to *Pike County* is only superficial. In fact, the court's statement about the availability of less expensive power involves the exact type of interstate cost allocation issue addressed by the courts in *Nantahala* and *Appalachian Power* because it begs the question of whether an operating company member of an interstate integrated holding company system can "choose" to be responsible only for the lower cost power resources on the system, and allow the other members of the system, in other states, to account for the higher cost resources.

This exact question was resolved by the FERC in *AEP Generating Co. and Kentucky Power Co.* (Opinion Nos. 226³⁵ and 266-A³⁶). The underlying dispute was the same as that resolved by the FERC on the Middle South System in Opinion Nos. 234 and 234-A, i.e., which of the members of a holding company system should bear the costs of a new power plant? In AEP's case, the plant involved is the Rockport plant—a 2600-megawatt coal-fired plant built near Rockport, Indiana. As the newest plant, Rockport represents the most expensive generating capacity on the AEP System—hence the battle over its allocation. Nevertheless, the plant was built at a very economical cost by

32. *Mississippi Indus. v. FERC*, 808 F.2d 1525, 1549 (D.C. Cir.) (quoting *Middle S. Servs., Inc.*, 30 F.E.R.C. ¶ 63,030, at 65,151 (1985)), *modified on other grounds*, 822 F.2d 1104 (D.C. Cir.), *cert. denied sub nom. Arkansas Pub. Serv. Comm'n v. FERC*, 108 S. Ct. 500 (1987).

33. *State ex rel. Pittman v. Mississippi Pub. Serv. Comm'n*, 506 So. 2d 978, 985 (Miss. 1987).

34. *Id.*

35. *AEP Generating Co. and Ky. Power Co.*, 38 F.E.R.C. ¶ 61,243 (1987) [hereinafter Opinion No. 266].

36. *Kentucky Power Co.*, 39 F.E.R.C. ¶ 61,158 (1987) [hereinafter Opinion No. 266-A], *appeal docketed sub nom. Kentucky Pub. Serv. Comm'n v. FERC*, No. 87-3643 (6th Cir. July 10, 1987); *Kentucky Indus. Util. Customers v. FERC*, No. 87-3644 (6th Cir. July 10, 1987).

industry standards.³⁷ The AEP experience is therefore useful, because the underlying issue is not clouded by cries of cost overruns, or the swirl of controversy surrounding the cost and safety of nuclear generating facilities.

It has been the practice of the AEP System, over the years, to rotate ownership of new generating plants among the member companies. Rockport was and is being built by Indiana Michigan Power Company³⁸ (I&M) with financing assistance by AEP Generating Company, but pool member Kentucky Power was a logical candidate to participate in the new plant. Kentucky Power, in supplying generating capacity to the AEP pool, is proportionally the most deficit member. It has not added generating capacity in almost twenty years, and its existing capacity is inadequate to meet its own customers' requirements with an adequate reserve margin. As a result of these facts, coupled with its membership in the AEP pool, Kentucky Power's electric rates are among the lowest in the nation. The dispute which led to Opinion Nos. 266 and 266-A arose when the Kentucky Public Service Commission (Kentucky PSC) attempted to close off Kentucky's borders to the higher cost Rockport power by refusing to allow Kentucky Power to participate in the rotation.

Kentucky Power first sought the Kentucky PSC's permission to own fifteen percent of the plant. After several reversals of position, over a period of years, the Kentucky PSC ultimately denied the certificate for partial ownership of Rockport. The basis for its denial was its interpretation of the AEP System Interconnection Agreement (Pool Agreement) as allowing Kentucky Power the "option" to either take responsibility for a portion of Rockport, or to continue to rely on the AEP pool for less expensive power. The Nixon & Johnston article disavows any interest on the part of state regulators in playing "beggars-thy-neighbor" games,³⁹ but the Kentucky PSC's "interpretation" of the AEP System Interconnection Agreement constitutes a classic example of such a game. Obviously, *each* AEP pool member cannot have the "option" to require the *other* members to take responsibility for the higher cost of new generating capacity.

When the ownership question was still pending before the Kentucky PSC, Kentucky Power brought the matter to the FERC. Kentucky Power entered into and filed with the FERC a provisional Unit Power Agreement (UPA) for the purchase of fifteen percent of the output of the plant. After the Kentucky PSC's denial of ownership, the FERC was asked to, and did, accept the UPA, unconditionally, as a rate schedule. The Kentucky PSC later disallowed retail recovery of some twenty-three million dollars per year in costs incurred by Kentucky Power under the UPA on the ground that Kentucky Power was imprudent in entering into the UPA given its alleged right to push

37. Rockport Unit No. 1 (which went into service in December 1984) cost \$855/kW to build, while contemporaneous coal-fired plants cost in the neighborhood of \$1250-\$1500/kW. Unit No. 2 currently is scheduled for service in 1989. The average embedded cost of all steam generation on the AEP System currently is about \$320/kW.

38. Formerly Indiana & Michigan Electric Company.

39. Nixon & Johnston, *supra* note 7, at 32-33.

the costs of the new plant onto the other pool members.⁴⁰ The Nixon & Johnston article characterized the UPA as a blatant exercise in forum shopping, but clearly the Kentucky PSC is an inappropriate forum to determine the rights and responsibilities of the AEP pool members vis-a-vis one another.

The Kentucky PSC and allied intervenors asked the FERC to declare that in determining the justness and reasonableness of the UPA, it would not determine the prudence of Kentucky Power in entering into the Agreement.⁴¹ The Commission's initial reaction was to agree with the Kentucky parties, based upon the *Philadelphia Electric* line of cases, which hold that in approving a wholesale power purchase the FERC does not address the buyer's prudence in entering into the transaction. On rehearing, however, the Commission recognized that the *Philadelphia Electric* rationale was inapplicable to the type of intra-pool allocation of costs question presented by Kentucky Power's dispute with the Kentucky PSC. The Commission said:

We recognize that the November 23, 1984 order in this proceeding stated that the prudence of [Kentucky Power Company's] decision to enter into the Rockport agreement, in light of the availability of alternative power supplies, was not an issue. . . . The continuing controversy that has ensued, however, makes it clear that where, as here, the transaction involves affiliated, jurisdictional utilities, which are members of an integrated, interstate holding company arrangement, performing diverse functions on a coordinated basis, and particularly where differing interpretations are advocated concerning the parties' rights and obligations under the basic system agreements, the relevant issues may not be so readily segregated. Under these circumstances, more complex, interrelated questions arise and, whether one characterizes the questions as related to prudence, interpretation, or cost allocation, they are clearly matters most appropriately resolved by this Commission as part of its overriding authority to evaluate and implement all applicable wholesale rate schedules.⁴²

The Commission had agreed to resolve, via a petition for a declaratory order, whether the AEP Pool Agreement provided Kentucky Power with the option to refuse to accept Rockport unit power. It answered this question in the negative in Opinion No. 266, and in doing so explored the essence of an integrated power system:

The AEP system arrangement is, as noted, a "power pool" whose members engage in coordinated planning and operation of their systems in order to maximize reliability, economies of scale, and efficiencies. Many pools consist of unaffiliated companies which have entered into their pooling agreement via contract. The AEP "Pool" is different, however, in that it exists in the first instance, not due to contract, but pursuant to the provisions of the [Public Utility Holding

40. The Kentucky PSC's disallowance order (which also included the Transmission Agreement disallowance discussed earlier, see *supra* note 23) was challenged in federal district court, but the district court dismissed the case on abstention grounds and its dismissal was upheld on appeal. *American Elec. Power Co. v. Kentucky Pub. Serv. Comm'n*, 787 F.2d 588 (6th Cir. 1986), cert. denied, 107 S. Ct. 1910 (1987); see also Section V, *infra*. On appeal in the state court system, the Kentucky PSC's order was upheld by the Franklin Circuit Court. *Kentucky Power Co. v. Kentucky Pub. Serv. Comm'n*, No. 84-CI-1760 (Franklin Cir. Ct. Mar. 24, 1986). This case is currently pending on appeal before the Kentucky Court of Appeals.

41. *AEP Generating Co.*, 29 F.E.R.C. ¶ 61,246 (1984). This interlocutory order was influential in the Franklin Circuit Court's affirmance of the Kentucky PSC's disallowance order, and may have influenced, as well, the federal district court's decision to abstain.

42. *AEP Generating Co.*, 36 F.E.R.C. ¶ 61,226, at 61,550 (1986).

Company Act]. That act limits the operations of a holding company system to a single integrated public-utility system. 15 U.S.C. § 79k(b). . . . By virtue of this integrated and unified operation, the AEP System or “pool” achieves a higher degree of coordination in planning and operation than is usually realized by pools of unaffiliated entities.⁴³

The Commission explained that in any power pool, affiliated or not, the underlying principle is a mutual sharing of benefits and burdens and, therefore, “[i]n such circumstances, once AEP decides to build a new plant and assign a portion to [Kentucky Power], the latter does not have the ‘option’ of refusing that assignment.”⁴⁴

In Opinion Nos. 266 and 266-A, the Commission also reiterated its exclusive jurisdiction over the underlying dispute. Certain of the Kentucky parties had moved to dismiss the proceeding on the ground that the Kentucky PSC had already interpreted the AEP System Interconnection Agreement, and the FERC was therefore bound by *res judicata* principles. The FERC held that it was not bound because the Kentucky PSC’s determination was beyond its jurisdiction. On rehearing, the FERC elaborated on this point, speaking directly to the inapplicability of the *Pike County* line of cases:

[W]hile we agree that the lack of autonomy on the part of individual members of a registered public-utility holding company system heightens the need for regulatory scrutiny over arrangements such as the Rockport unit power sales agreement, that scrutiny can only take place at the Federal level. State commissions may intervene and participate in proceedings before this Commission, raising whatever objections they may have. However, they may not disallow the costs of power purchased under arrangements such as the Rockport agreement, in retail rate proceedings, by finding that the decision of an individual operating company to enter into the agreement was imprudent.⁴⁵

The *Pike County* exception involves a situation in which, in Justice O’Connor’s words, “lower-cost power is available *elsewhere*.”⁴⁶ In the *AEP* and *State ex rel. Pittman* cases, the lower cost power that allegedly is available comes from the integrated system. The question of which of the members of the interstate integrated system is entitled to the lower-cost power, and in what proportions, is a question that legally and practically must be answered by the FERC. Thus, the element of “choice,” presented in *Pike County*, cannot exist in these cases.

III. PRUDENCE OF CONSTRUCTION AND COSTS

The final aspects of prudence mentioned by the court in the *State ex rel. Pittman* case were the two questions of the prudence of the cost of and the decision to construct Grand Gulf. The court said:

Several aspects of prudence have never been addressed with respect to Grand Gulf, either by state or federal authorities. Specifically, we have yet to see MP&L, MSEI or MSU justify putting Grand Gulf on line and its exorbitant cost to ratepayers. . . . [The FERC] was never presented with the question of whether

43. Opinion No. 266, 38 F.E.R.C. at 61,815 (footnotes omitted).

44. *Id.* at 61,818.

45. Opinion No. 266-A, 39 F.E.R.C. at 61,627.

46. *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 972 (1986) (emphasis added).

the completion of Grand Gulf, or its continued operation, was prudent.⁴⁷

The questions of prudence of construction and costs are conventional utility issues that can be determined by either the FERC or the state commission, in connection with matters that are properly within their respective spheres of jurisdiction. The question of the prudence of the costs and construction of Grand Gulf could have been raised by the Mississippi Commission or other intervenors at the FERC, and the FERC then would have been responsible for examining that issue in connection with its finding of the justness and reasonableness of the Unit Power Sales Agreement for the sale of Grand Gulf power to the operating companies.⁴⁸ The fact that no intervenor raised the issue at the FERC does not confer jurisdiction over the underlying transaction upon the state commission.

Nixon and Johnston find fault with the FERC's handling of prudence of cost and construction issues. They do not, however, contend that the FERC does not have the authority to review those issues—only that, in their opinion, states can do a better job. According to Nixon and Johnston:

[T]he FERC exercises neither foresight nor hindsight in these matters; rather it appears to take, as *givens*, the need for construction, the costs incurred (no matter how great), and the entitlement of utility stockholders to complete costs recovery from retail ratepayers.⁴⁹

The authors also note that "in contrast to state utility commissions, the FERC has *never* disallowed any fraction of electric utility investment in a new power plant on the grounds of excess capacity, and despite 'hundreds of requests' to do so, the FERC has found imprudence only two times in relatively minor cases."⁵⁰

The likely, though unstated, reason for the authors' dissatisfaction with the FERC prudence reviews is that the FERC refuses to apply hindsight to such reviews of the costs of constructing a facility. In *New England Power Co.*,⁵¹ the Commission recently reiterated its standards for judging prudence of management decisions:

In performing our duty to determine the prudence of specific costs, the appropriate test to be used is whether they are costs which a reasonable utility management (or that of another jurisdictional entity) would have made, in good faith, under the same circumstances, and at the relevant point in time. We note that while in hindsight it may be clear that a management decision was wrong, our task is to review the prudence of the utility's actions and the costs resulting therefrom based on the particular circumstances existing either at the time the challenged costs were actually incurred, or the time the utility became committed to incur those expenses.⁵²

As for the failure of the FERC to exclude plant from cost-of-service on the

47. State *ex rel.* Pittman v. Mississippi Pub. Serv. Comm'n, 506 So. 2d 978, 986 (Miss. 1987).

48. For a concise discussion of the FERC's responsibility to assure that the costs underlying "just and reasonable" rates are prudently incurred, see Tennessee Gas Pipeline Co., 40 F.E.R.C. ¶ 63,008, at 65,072-73 (1987) (Megan, ALJ, initial decision).

49. Nixon & Johnston, *supra* note 7, at 33 (emphasis in original).

50. *Id.* at 31 (emphasis in original) (footnotes omitted).

51. New England Power Co., 31 F.E.R.C. ¶ 61,047 (1985).

52. *Id.* at 61,084.

ground of "excess capacity," what the authors are really complaining about is the fact that when the FERC applies a prudence test in determining this issue, it reaches a result with which they do not agree.

In addition, some state commissions go beyond the prudence issue and allow recovery of costs only if the capacity is presently needed. Capacity prudently forecast at the time, therefore, can be excluded from rate base.⁵³ An apparent desire to apply such a "no fault" excess capacity standard lies behind the Kentucky PSC's actions in the *AEP* dispute. The AEP System's alleged overcapacity situation was used as a rationale for why Kentucky Power could and should attempt to walk away from taking responsibility for a portion of the Rockport plant. However, as the FERC noted in Opinion No. 266, no party had ever established or even alleged that the AEP System was imprudent in constructing Rockport.⁵⁴

In any event, the fact that a state commission would apply a stricter standard or the notion that it would do a better job in scrutinizing underlying costs has never been deemed sufficient, even under the *Pike County* line of cases, to justify the state's redetermination of the reasonableness of FERC-approved rates.

IV. "IMPUTED" PRUDENCE—THE *COMMONWEALTH ELECTRIC* CASE

The *Commonwealth Electric* case,⁵⁵ discussed in the Nixon & Johnston article,⁵⁶ involved the application by the Massachusetts Department of Public Utilities (DPU or Department) of the novel concept of imputed imprudence. As such, the case does not involve the type of interstate cost allocation questions present in the *Middle South* and *AEP* disputes. However, in upholding the DPU's action, the Massachusetts Supreme Court invoked the *Pike County* doctrine, thereby attempting to extend that doctrine beyond the issues of choice.

Commonwealth Electric purchased eleven percent of the power and energy produced by the Pilgrim nuclear plant which is owned and operated by Boston Edison Company. The unit power agreement, a FERC rate schedule, contains the standard provision that Commonwealth Electric Company (Commonwealth Electric or Company) must purchase power elsewhere when the unit is not running. In 1981 and 1982, Boston Edison experienced an

53. See, e.g., *Central La. Elec. Co. v. Louisiana Pub. Serv. Comm'n*, 508 So. 2d 1361 (La. 1987); see also *Kansas Gas & Elec. Co. v. State Corp. Comm'n*, 239 Kan. 483, 720 P.2d 1063 (1986), which affirmed the Kansas Corporation Commission's exclusion from the rate base portions of the owners' investments in the Wolf Creek nuclear plant. In addition to disallowing part of the cost of Wolf Creek as imprudently incurred, the Commission excluded additional amounts on the basis of "excess physical capacity" and "excess economic capacity" (which it defined as the cost per kilowatt in excess of the cost of a hypothetical coal-fired plant). The owners appealed to the United States Supreme Court which noted probable jurisdiction. *Kansas Gas & Elec. Co. v. State Corp. Comm'n*, 107 S. Ct. 1281 (1987). However, the appeal was later dismissed as the result of a settlement. *Kansas Gas & Elec. Co. v. State Corp. Comm'n*, 107 S. Ct. 2171 (1987).

54. Opinion No. 266, 38 F.E.R.C. at 61,825 n.5.

55. *Commonwealth Elec. Co. v. Department of Pub. Utils.*, 397 Mass. 361, 491 N.E.2d 1035 (1986), *cert. denied*, 107 S. Ct. 1971 (1987).

56. Nixon & Johnston, *supra* note 7, at 24-26.

extended outage of the Pilgrim unit. The DPU subsequently found that a portion of the outage was due to Boston Edison's negligence, and the Commission disallowed recovery by Boston Edison of the cost of its replacement power.

Later, the DPU refused to allow recovery by Commonwealth Electric of its replacement power incurred during the same portion of the outage. The Department imputed Boston Edison's negligence to Commonwealth Electric. Commonwealth Electric appealed to the Massachusetts Supreme Court arguing, inter alia, that the fact that it is required to buy replacement power when Pilgrim 1 is not running was part of a FERC-approved tariff which must be given full effect for retail ratemaking purposes. Commonwealth Electric cited the court's 1983 decision in *Eastern Edison v. Department of Public Utilities*⁵⁷—one of the leading cases in the *Narragansett* line. Nevertheless, the Supreme Judicial Court of Massachusetts affirmed the DPU, declaring the case to fall within the *Pike County* doctrine:

In short, while the DPU cannot inquire into the reasonableness of wholesale rates filed by FERC, *Eastern Edison, supra*, the DPU may inquire whether a purchaser, such as the Company, is warranted in agreeing to purchase at such a rate considering its alternatives.⁵⁸

The court's use of the *Pike County* rationale is rather puzzling. It had not been found by the DPU that there were cheaper alternative sources of replacement power available to Commonwealth Electric. To the contrary, the Department found that "it is not the level of replacement power costs rates that the Department takes issue with, it is the need for the Company to rely on replacement power costs at all."⁵⁹ Nor did the Department find or even suggest that there was a better deal available to Commonwealth Electric than the unit power purchase from Pilgrim. In short, no *Pike County* type prudence-of-choice issue was ever presented at the administrative level. That being the case, it is impossible to reconcile *Commonwealth Electric* with the court's earlier decision in *Eastern Edison*. Unfortunately, the Supreme Court denied review.⁶⁰

V. THE ABSTENTION QUESTION

The related procedural issue of federal court enforcement of *Narragansett* rights unfortunately remains unsettled. The Supreme Court had an opportunity to address this issue in *American Electric Power Co. v. Kentucky Public Service Commission (AEP)*⁶¹ and *New Orleans Public Service, Inc. v. City of New Orleans (NOPSI)*,⁶² which arose out of the AEP/Rockport and Middle South/Grand Gulf controversies, respectively. In both cases, the circuit

57. *Eastern Edison Co. v. Department of Pub. Utils.*, 388 Mass. 292, 446 N.E.2d 684 (1983).

58. *Commonwealth Elec. Co.*, 491 N.E.2d at 1045 (citation omitted).

59. *Commonwealth Elec. Co.*, No. 1003-G-6, at 20 (Mass. DPU Sept. 22, 1982) (Order).

60. *Commonwealth Elec. Co. v. Department of Pub. Utils.*, 107 S. Ct. 1971 (1987).

61. *American Elec. Power Co. v. Kentucky Pub. Serv. Comm'n*, 787 F.2d 588 (6th Cir. 1986), *cert. denied*, 107 S. Ct. 1910 (1987).

62. *New Orleans Pub. Serv., Inc. v. City of New Orleans*, 782 F.2d 1236 (5th Cir.), *modified*, 798 F.2d 858 (5th Cir. 1986), *cert. denied*, 107 S. Ct. 1910 (1987).

courts had upheld district court decisions to abstain in cases where state commission rate orders were challenged on federal preemption and Commerce Clause grounds. The *AEP* and *NOPSI* decisions created a clear and widespread conflict among the circuits,⁶³ and the decisions themselves evidenced a degree of uncertainty.

In the *AEP* case, the Sixth Circuit, in a *per curiam* opinion, found abstention to be inappropriate under the rationale of *Burford v. Sun Oil Co.*,⁶⁴ but appropriate under the rationale of *Younger v. Harris*.⁶⁵ Despite this holding, two members of the three-judge panel, concurring, voiced the opinion that the *Burford*-type abstention was appropriate. In the *NOPSI* case, the Fifth Circuit initially held abstention to be improper, saying:

The *Burford*-type abstention invoked by the district court below is appropriate when a case involves an essentially local issue arising out of a complicated state regulatory scheme. . . . When Congress has created a statutory scheme, such as the Federal Power Act, which arguably preempts the local regulation complained of, a fundamental element of *Burford* abstention is thrown into doubt, for we must question whether the case indeed involves an essentially local issue. When the claim presented is predicated upon federal preemption, "it is well established that 'the basic premise of abstention—avoiding needless federal court intervention into important matters within a State's jurisdiction to regulate—obviously is lacking.'"⁶⁶

However, some five months later the court reversed itself, *sua sponte*, substituting the following language:

Given the facts before us and the structure of the Federal Power Act, which leaves jurisdiction over retail rates to the states, we conclude that the district court did not abuse its discretion in finding *Burford* abstention appropriate here. As with the regulatory scheme at issue in *Burford*, the regulation and adjustment of local utility rates is of paramount local concern and a matter which demands local administrative expertise. The regulatory scheme is complex. In addition, the Louisiana state courts are fully able to address *NOPSI*'s complaints about Council actions⁶⁷

The Supreme Court asked the Solicitor General of the United States for the Government's opinion regarding the petitions for certiorari in *AEP* and *NOPSI*. In March 1987, the Solicitor General submitted a brief which not only recommended that the Supreme Court decide the issue, but voiced the

63. Holding squarely against abstention are the Third and Eighth Circuits, *Arkansas Power & Light Co. v. Missouri Pub. Serv. Comm'n*, 829 F.2d 1444 (8th Cir. 1987); *Kentucky W. Va. Gas Co. v. Pennsylvania Pub. Util. Comm'n*, 791 F.2d 1111 (3d Cir. 1985); *Middle S. Energy Inc. v. Arkansas Pub. Serv. Comm'n*, 772 F.2d 404 (8th Cir. 1985), *cert. denied sub nom. Ratepayers Fight Back v. Middle S. Energy*, 106 S. Ct. 884 (1986). The Fourth Circuit has held abstention to be proper in *Aluminum Co. of Am. v. Utilities Comm'n*, 713 F.2d 1024 (4th Cir. 1983), *cert. denied*, 465 U.S. 1052 (1984) (which involved the dispute ultimately resolved by the Supreme Court, on appeal, in *Nantahala*), but upheld the district court's denial of abstention in *Appalachian Power Co. v. Pub. Serv. Comm'n*, 614 F. Supp. 64 (S.D.W. Va.), *aff'd*, 770 F.2d 159 (4th Cir. 1985).

64. *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943).

65. *Younger v. Harris*, 401 U.S. 37 (1971).

66. *New Orleans Pub. Serv., Inc.*, 782 F.2d at 1243 (quoting *South Cent. Bell Tel. Co. v. Louisiana Pub. Serv. Comm'n*, 744 F.2d 1107, 1123 (5th Cir. 1984) [quoting *Aluminum Co. of Am. v. Utilities Comm'n*, 713 F.2d 1024, 1030 (4th Cir. 1983)], (emphasis in original).

67. *New Orleans Pub. Serv., Inc. v. City of New Orleans*, 798 F.2d 858, 862 (5th Cir. 1986), *cert. denied*, 107 S. Ct. 1910 (1987) (emphasis in original).

opinion that the Fifth and Sixth Circuits were wrong. The Solicitor General said:

The basic issue in both cases is the scope of federal law and federal policy. There has been a Congressional determination that terms for the allocation of power and costs among members of a multi-state public utility holding company should be conclusively resolved by a neutral federal administrative forum (FERC) in accordance with federal law. The question whether a particular FERC allocation must be honored by a state utility commission in a particular context is itself a federal question . . . *Younger* abstention is also inappropriate. The most "vital consideration" prompting *Younger* abstention is the "notion of comity," that is . . . the belief that the national government will fare best if the states and their institutions are left free to perform their separate functions in separate ways . . . [T]he notion of comity loses much of its force, however, where as in both *AEP* and *NOPSI*, the interests of several states are at odds because of their participation in a multi-state "common pool" in which a decision by the institution of any one state in favor of its citizens has or is at least likely to have a corresponding direct adverse effect on citizens of the other participating states.⁶⁸

In light of the conflict among the circuits, the uncertainty within the circuits and the advice of the Solicitor General (who, under the present administration, can hardly be accused of anti-states' rights sympathies) it appeared that Supreme Court review might be forthcoming. But the Supreme Court, on April 20, 1987, denied certiorari in both cases.⁶⁹

It is, of course, impossible to determine the Supreme Court's rationale in denying certiorari in those cases. It has been suggested that the *AEP* and *NOPSI* cases were caught in the wake of *Pennzoil Co. v. Texaco, Inc.*,⁷⁰ decided just two weeks earlier in which the Supreme Court again expanded the reach of the *Younger* abstention doctrine. In any event, the Supreme Court's refusal to resolve an issue that is so unsettled and so likely to recur is disheartening. As a practical matter, access to federal courts is essential for resolution of these fundamentally interstate questions.

V. CONCLUSION

The Nixon & Johnston article dismisses FERC regulation as being too lenient, and portrays increased state regulation of interstate transactions, on prudence grounds, as necessary for the protection of consumer interests. In fact, however, their position is anti-consumer because, taken to its ultimate conclusion, it jeopardizes several decades' progress in the interstate interconnection and coordination of electric facilities, which the federal government, under the Federal Power Act, is charged to "promote and encourage."⁷¹ It would seriously jeopardize the economies that have been made possible by such interstate coordination.

It is universally accepted that interconnection and coordination of the

68. Brief for the United States and the Federal Energy Regulatory Commission as Amici Curiae at 17-18, *American Elec. Power Co. v. Kentucky Pub. Serv. Comm'n*, 107 S. Ct. 56, *cert. denied*, 107 S. Ct. 1910 (1987).

69. *See supra* notes 55 and 56.

70. *Pennzoil Co. v. Texaco, Inc.*, 107 S. Ct. 1519 (1987).

71. 16 U.S.C. § 824a (1982) (the Act empowers the FERC to exempt electric utilities from any state law, rule or regulation that would prohibit or prevent interstate pooling arrangements).

facilities of separate electric companies is in the public interest. Among the most obvious benefits of such coordination are: (1) the exploitation of economies of scale in building generating and transmission facilities; (2) the avoidance of unnecessary duplication of facilities; (3) the ability to place generating facilities at the most advantageous sites, regardless of ownership; (4) increased reliability because of the availability of emergency support from interconnected systems; and (5) operating economies which can be achieved by dispatching the lowest cost generation, regardless of ownership, to serve demands on the interconnected and coordinated systems.

Because of these and other considerations, numerous coordination and power pooling arrangements have been entered into over the years between and among electric utilities. These range from simple agreements to exchange emergency and economy energy to complex power pooling arrangements which allow several companies in different states to operate as a single integrated electric system. In this latter category are the holding company systems. The holding companies, through their interstate power pooling arrangements, have achieved a high degree of efficiency and economy in their multi-state operations.⁷²

Federal regulation of interstate power pooling agreements is not only a legal reality, it is a practical necessity. Any successful power pooling arrangement requires the participants, to some extent, to subordinate their individual interests to the interests of the pool as a whole. A pooling arrangement simply will not work if each participant continually seeks to maximize its own benefits or minimize its own costs at the expense of the other participants. Yet there is strong, politically-appealing sentiment that the local companies should not be concerned with what is fair to all members of the pool, but should act as advocates on behalf of the customers in their own states. Further, when two or more states are affected by a power pooling agreement, the probability is that they will have differing opinions concerning the overall fairness of that agreement. There is an obvious need for an impartial body, such as the FERC, to umpire these disputes among state jurisdictions, and to arrive at power pooling arrangements that are fair to all participants and not unduly discriminatory or preferential with respect to any participant.

The scheme of regulation presently provided for in Part II of the FPA fills this need. Under section 308 of the FPA,⁷³ any interested state commission is allowed intervention in any FERC proceeding. In their role as intervenors in the FERC proceedings, the state commissions can, and do, act as advocates for the customers within their respective jurisdictions. But this well-designed regulatory scheme will not work if the state commissions are not bound to abide by the FERC's final determinations.

Further, if the expanded view of state jurisdiction over prudence issues reflected in the Nixon & Johnston article and the *State ex rel. Pittman* decision prevails, the result could well be the breakup of the integrated systems. Our

72. The Public Utility Holding Company Act recognized the value of integrated power systems by allowing electric utility holding companies to continue to exist insofar as they operate as integrated systems in geographically contiguous areas. 15 U.S.C. §§ 79b(29), 79k (1982).

73. 16 U.S.C. § 825g (1982).

hypothetical *A-B* System cannot exist for long when whichever way it turns it loses money. *A-B*'s ultimate defense is to spin off into two stand-alone, locally regulated companies. This would enhance local control, but at the expense of economic efficiency.⁷⁴

Part II of the Federal Power Act was enacted in recognition of the rapid development of the electric utility industry along lines that transcend state boundaries.⁷⁵ Certainly, the interstate character of power flows is more pronounced today than it was in 1935. In fact, the electric utility industry is much more highly interconnected and much more of a national business today than it was fifty years ago. Indeed, there is a substantial body of fresh authority to the effect that one future trend in the electric utility industry will be toward consolidations of the many existing systems into larger, stronger and fewer systems and that such integration will result in improved efficiency, and thus is in the overall public interest. "The necessity for federal leadership in securing planned coordination of the facilities of the industry which alone can produce an abundance of electricity at the lowest possible costs"⁷⁶ is, therefore, more evident now than it was in 1935 when Congress enacted Part II of the Federal Power Act. To revert to state regulation of interstate power transactions would be to turn back the clock to the early days of the century, when electric systems operated as isolated, essentially local businesses. Politically, it would constitute a return to the unworkable Articles of Confederation which preceded the United States Constitution.

74. Ironically, many state commissions have been investigating the possibilities of increased coordination and statewide power pooling while pursuing policies that are destructive of interstate coordination.

75. S REP. NO. 621, 74th Cong., 1st Sess. 17 (1935).

76. *Id.*