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REGULATING COMPETITION, BOTH THE FOREST AND THE TREES

David B. Spence*

ABSTRACT

At the heart of the ideological conflict between the American political parties lies a fundamental disagreement about regulation and the proper relationship between government and markets. That conflict is partly about the substance of regulatory policy and partly about the scope of regulatory policymaking discretion. Both of these dimensions are implicated in a series of relatively obscure disputes recently before the Federal Energy Regulatory Commission (FERC). The central question in these cases is whether it is fair and constitutional for FERC to enforce Federal Power Act prohibitions against energy market manipulation against the defendants, given that the trading at issue violated none of the specific market rules established by the overseers of the regional electricity market in which the defendants operated. This dispute gets to the heart of a recurring and fundamental conflict in modern regulatory politics: namely, that regardless of how aggressively Republicans and conservatives pursue deregulation and deconstruction of the administrative state, or how sharply Democrats and progressives react to those aspirations, both parties’ agendas remain constrained (at least for now) by extant legislative mandates. On the one hand, federal regulatory agencies remain bound by public interest and consumer protection obligations written into their enabling legislation; on the other, they seem unlikely to abandon entirely their recent embrace of competition and markets. This Essay argues that the fundamental challenge to regulation represented by defendants’ position in these cases is misguided, both legally and philosophically. It is legally misguided because it ignores established principles of law supporting an agency’s general power to enforce broad statutory mandates directly, on a case-by-case basis, even when defendants have complied with more specific market rules. Indeed, that regulatory prerogative is well established within electricity market regulation as well. The defense is also philosophically misguided because it ignores the reasons historically regulated markets were regulated in the first place: namely, because real world markets often fail to maximize

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welfare in the ways textbook markets suggest, and because market failures are very difficult for regulators to predict ex ante. In the modern world of light-handed regulation, the central task facing regulatory agencies is to capture the benefits of competition while steering competition toward public interest goals. Given the fluidity and complexity of today’s markets, and the magnitude of the particular changes facing robust, competitive, and “decarbonizing” electricity markets, that task is Herculean: without the broad authority to use adjudication to enforce public interest mandates, the task becomes Sisyphean. Therefore, unless and until Congress is willing to repeal the public interest mandates under which many regulatory agencies operate, the task of reconciling competitive markets with public interest mandates requires that agencies be able to enforce both broad statutory mandates and specific market rules simultaneously, because in complex, real world markets the market participants will always be several steps ahead of specific market rules in ways that defeat important public interest goals.
INTRODUCTION

At the heart of the ideological conflict between the American political parties lies a fundamental disagreement about regulation and the proper relationship between government and markets. This conflict is two-dimensional: it is partly about the substance of regulatory policy and partly about the scope of regulatory policymaking discretion. Both of these dimensions are implicated in a series of relatively obscure disputes recently before the Federal Energy Regulatory Commission (FERC). At first blush, these cases comprise a set of Federal Power Act\(^1\) enforcement proceedings ("the overcharge cases") that involve arcane rules governing reimbursement of energy traders for overcharges in electricity markets.\(^2\) At the same time, these cases implicate much more fundamental aspects of the government-market relationship concerning enforcement discretion, due process concerns, and how regulators can or should rely on markets to serve public ends. This Essay explains how the overcharge cases implicate these issues and argues that preserving the policy of using regulated competition to serve public ends is a worthwhile task; but it is one that requires regulators have the power and flexibility to monitor and tinker with market institutions nimbly and flexibly, consistent with their statutory mandates. The defenses being raised in these cases reflects a broader philosophy about government-market relations that would threaten that authority.

The last four decades have seen a trend toward lighter-handed regulation and more reliance on competition and markets across multiple sectors of the economy, including airlines,\(^3\) banking,\(^4\) telecommunication,\(^5\) natural gas,\(^6\) and electricity.\(^7\) That trend was driven in part by an increasing belief among policymakers that market competition can produce public benefits; that view, in turn, had its genesis in the work of public choice scholars whose

\(^1\) 16 U.S.C. § 824.


\(^3\) See Andrew R. Goetz & Timothy M. Vowles, The Good, the Bad, and the Ugly: 30 Years of US Airline Deregulation, 17 J. OF TRANS. GEOGRAPHY 251, 251–52 (2009).


critiques of government and advocacy of efficient markets ultimately commanded wide influence among conservative politicians and judges. The increased faith in markets and skepticism of government have driven the Republican Party’s sharp move to the ideological right, which has kept deregulation on the agenda for Republican policymakers right up to the present day. At the same time, the election of Donald Trump seems to be motivating increasing Democratic Party support for new regulatory interventions in markets, as economic inequality and climate policy have risen on Democrats’ policy priority list. Policy conflict between the parties around market-government relations is sharper than at any time in the modern regulatory era. Progressives and Democrats seek a more muscular regulatory state in the face of conservatives’ and Republicans’ aspirations to deconstruct it. However, whereas Democrats’ reconstruction project depends on gaining control of the policymaking branches, Republicans’ deconstruction project is gaining traction in the courts in the form of judicial interest in reviewing and revising doctrine governing judicial deference due administrative agencies as they discharge their statutory duties.

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9 This idea is more fully developed at infra notes 111–117 and accompanying text.

10 The Harvard Environmental Law Project tracks Trump Administration regulatory “rollbacks” on its website at https://eelp.law.harvard.edu/regulatory-rollback-tracker/.


13 A full exploration of these disputes over deference doctrines would (and does) require its own article-length treatment, and so is beyond the scope of this Essay. For a recent academic discussion of
But regardless of how aggressively Republicans and conservatives pursue deregulation and deconstruction of the administrative state, or how sharply Democrats and progressives react to those aspirations, all of these agendas remain constrained (at least for now) by extant legislative mandates. On the one hand, federal regulatory agencies remain bound by public interest and consumer protection obligations written into their enabling legislation; on the other, they seem unlikely to abandon entirely their recent embrace of competition and markets. It is this pro-regulatory default written into the missions of regulatory agencies—during the New Deal and the regulatory era stretching from the late 1960s through the 1970s—that motivates anti-regulatory activists to conflate the battles over the substance of regulatory policy with battles over regulators’ power. However, that conflation becomes a source of confusion when regulators pursue conservative policy ends or, as in the overcharge cases, choose to use markets and competition as part of how they discharge their regulatory missions.


16 The New Deal yielded an enormous amount of regulatory legislation, including the Federal Power Act, 16 U.S.C. § 791 et seq., which is a focus of discussion in this Essay. The latter period includes a spate of consumer protection and health, safety, and environmental legislation (including the creation of the EPA and almost all the statutory regimes it administers). One commentator dubbed this latter regulatory period “the environmental decade.” LETTIE MCSPADDEN WENNER & LAMBERT M. WENNER, THE ENVIRONMENTAL DECADE IN COURT (1982).
All of which poses a challenge for regulators and courts. When conservatives control the executive branch, agencies must answer to political overseers who profess allegiance to a vision of self-correcting, efficient markets and of relatively inept or corruptible regulators, a vision fleshed out by a half-century of public choice scholarship.\(^\text{17}\) Given the influence of the Federalist Society over recent federal judicial appointments, those same regulators may suspect that that vision will receive an increasingly sympathetic hearing when an agency’s actions are challenged in court.\(^\text{18}\) At the same time, agencies anticipate that courts will continue to hold them to statutory obligations designed to protect consumers from the harsher consequences of free market competition. Because real world markets differ from textbook markets in important ways, reconciling market competition with these statutory obligations can be difficult.\(^\text{19}\) This is a problem that law and the legal system must resolve, but doing so is difficult because it implicates the market-versus-regulation dispute that sits on the central fault line of the modern partisan divide.\(^\text{20}\)

The overcharge cases present a fundamental challenge to regulators’ authority to balance market competition with their statutory public interest obligations. The central question in the these cases is whether it is fair and constitutional for FERC to enforce Federal Power Act prohibitions against market manipulation against the defendants,\(^\text{21}\) given that the trading at issue violated none of the specific market rules established by the overseers of the regional electricity market in which the defendants operated—the PJM market.\(^\text{22}\) These cases have drawn public attention and support for the

\(^{17}\) Spence, supra note 8, at 986–95.


\(^{19}\) For a detailed explanation of the ways in which energy markets depart from textbook markets, see Spence, supra note 8.


\(^{21}\) For a detailed summary of FERC’s charges in each case, see infra notes 56–68 and accompanying text.

\(^{22}\) PJM is a voluntary association of utilities in the mid-Atlantic and Midwestern states. Its members delegate to PJM, which manages the grid and oversees the operation of the wholesale market and within its members’ territory; as part of that responsibility it establishes the rules market participants must follow. The acronym “PJM” once represented the three states that comprised the original territory of the organization: Pennsylvania, New Jersey, and Maryland. PJM is no longer an acronym representing anything other than the organization itself.
defendants among economists, in part because FERC’s enforcement posture challenges the neo-Hayekian\textsuperscript{23} faith in the ability of markets to maximize welfare that has taken root across the ideological right. A decision upholding FERC’s enforcement posture would represent a defeat for that Hayekian vision of efficient markets and for the notion that regulatory interventions almost inevitably reduce efficiency and welfare. A decision overturning FERC’s decision (or a FERC reversal of its own decision) would represent a defeat for traditional notion that, irrespective of the extent to which regulators rely on markets, regulators’ statutory public interest mandate implies the need to intervene in markets. Therefore, these cases represent a kind of bellwether for this broader conflict over the proper relationship between government and markets.

This Essay argues that the fundamental challenge to regulation represented by defendants’ position in these overcharge cases is misguided, both legally and philosophically. It is legally misguided because it ignores established principles of law supporting an agency’s general power to enforce broad statutory mandates directly, on a case-by-case basis, even when defendants have complied with more specific market rules. Indeed, that regulatory prerogative is well established within electricity market regulation as well.\textsuperscript{24} The defense is also philosophically misguided because it ignores the reasons historically regulated markets were regulated in the first place: namely, because real world markets often fail to maximize welfare in the ways textbook markets suggest, and because market failures are very difficult for regulators to predict \textit{ex ante}. In the modern world of light-handed regulation, the central task facing regulatory agencies is to capture the benefits of competition while steering competition toward public interest goals. Given the fluidity and complexity of today’s markets, and the magnitude of the particular changes facing robust, competitive, and “decarbonizing” electricity markets,\textsuperscript{25} that task is Herculean: without the broad authority to use adjudication to enforce public interest mandates, the task becomes Sisyphean. Therefore, unless and until Congress is willing to repeal the public interest mandates under which many regulatory agencies

\textsuperscript{23} Friedrich Hayek was an Austrian economist sometimes credited as the (or a) father of public choice scholarship. \textit{See}, \textit{e.g.}, FREDERICK A. HAYEK, THE ROAD TO SERFDOM (1944); FREDERICK A. HAYEK, INDIVIDUALISM AND ECONOMIC ORDER (1948).

\textsuperscript{24} \textit{See infra} notes 51–55 and accompanying text.

\textsuperscript{25} The process of removing carbon emissions from the electricity sector implicates important tradeoffs between environmental performance, cost, and energy reliability that have long characterized the electric grid. Those tradeoffs are beyond the scope of this Essay, but can be understood by browsing the EnergyTradeoffs.com web site, http://www.energytradeoffs.com.
operate, the task of reconciling competitive markets with public interest mandates requires that agencies be able to regulate both the forest and the trees. That is, it requires that regulators be able to enforce both broad statutory mandates and specific market rules simultaneously, because in complex, real world markets the market participants will always be several steps ahead of specific market rules in ways that defeat important public interest goals.

I. THE COMPLEXITY OF COMPETITIVE ELECTRICITY MARKETS

The cases at issue here involve complicated trading strategies worthy of a Michael Lewis bestseller about Wall Street and are the latest chapter in a decades-long effort to bring the benefits of competition to energy markets. That effort was begun by the regulator itself: FERC first experimented with competition and market pricing in regulated energy markets on a case-by-case basis in the early 1980s. It later broke the monopoly/monopsony position held by natural gas pipelines in wholesale natural gas markets in 1986 by ordering the pipelines to offer transmission services on an open-access, common carrier basis. It did the same with the electricity sector a decade later. Both moves facilitated the transition away from traditional administrative rate-setting in wholesale energy markets to the sort of market pricing we see in much of the market today.
Indeed, FERC now oversees active and robust regional wholesale markets in both gas and electricity. These active wholesale markets cover most of the country, excluding the Southeast and the Mountain West. In these markets, electricity retailers acquire the power they need to serve their customers from wholesalers bidding for their business. FERC delegates much of the direct market oversight work to so-called regional transmission organizations (RTOs) or independent system operators (ISOs), utility membership organizations that do the actual work of keeping the lights on monitoring wholesale power markets. PJM, in whose market the overcharge cases arose, is one such RTO.

In competitive energy markets, FERC’s consistent goal throughout has been to capture the efficiencies of competition and to avoid the inefficiencies associated with traditional public utility regulation. In electricity markets that task is complicated by constant technological, economic, and political change, and by the fact that grid-based electric service must be provided collectively and in real time. Wholesalers cannot direct the electricity they produce to a specific buyer; rather, as generators dispatch power to the grid and consumers remove it from the grid, electric current follows the path of

30 For a summary of the competitive wholesale electricity markets under FERC jurisdiction, see FERC’s wholesale market web page at https://ferc.gov/industries-data/electric/power-sales-and-markets/rtos-and-isos.
31 Id.
32 Id.
34 Critiques of traditional regulation focused on the incentive of utilities to over-invest in capital, a phenomenon labeled the “Averch-Johnson effect,” after its scholarly proponents. See Harvey Averch & Leland L. Johnson, Behavior of the Firm Under Regulatory Constraint, 52 AM. ECON. REV. 1052, 1052 (1962) (arguing cost-of-service approach leads to overinvestment in capital); see also Leon Courville, Regulation and Efficiency in the Electric Utility Industry, 5 BELL J. ECON. & MGMT. SCI. 53 (1974) (demonstrating this effect for power plants). Market pricing and competition aimed to eliminate this perverse incentive.
least resistance, not any pre-designated “contract path.” And since electric energy cannot be stored in commercial quantities affordably, the operators of the grid (utility owners of the wires) must balance production and consumption almost instantaneously so as to avoid congestion-induced grid failures (blackouts).

Accordingly, the transition to competition in electricity markets has been a bumpy, iterative process, and FERC has struggled for more than two decades to erect an institutional structure within which competition can flourish. The largest bump in the road, but by no means the only one, was the California electricity crisis of 2000–2001, during which the newly competitive California wholesale electricity market failed spectacularly. Prices spiked to intolerably high levels, customers experienced rolling blackouts, and one major electric utility filed for Chapter 11 bankruptcy, after which the governor shut down the competitive market. While that market was poorly designed and experienced some very bad luck, its problems were exacerbated by manipulative trading strategies employed by energy traders. Traders used a series of mostly Enron-devised trading techniques to extract billions of dollars from California customers, triggering a mountain of litigation and tens of billions of dollars in penalties and refunds.

Two of the techniques used during the California crisis are relevant to this discussion: so-called “wash trades” and what might be called “sham trades.”

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36 Id. The grid operates at a frequency of 60Hz, and balancing supply and demand in real time is necessary to keep the grid at (or very near) that frequency. Significant departures from that frequency can cause outages, and loss of service. Id.
38 Id.
39 Id. For most of the crisis the California market allowed wholesale prices to move freely while retail prices were fixed. When supply was tight, demand for power did not change because retail customers’ prices remained the same even though wholesale prices skyrocketed. Id.
40 Id. California also experienced unusually acute shortages of hydroelectric power due to a drought in the Pacific Northwest, and of natural gas due to supply interruptions on pipelines. Id.
congestion relief trades.” Wash trades are simultaneous, mirror-image bilateral trades of equal volumes of energy at equal prices. Wash trades involve no actual exchange of money or energy, but rather paper exchanges of very large volumes of energy at aberrant prices—prices that often deviate significantly from the going rates. The purpose of such trades, which make no economic sense on their own, is often to influence index prices compiled by companies like Platts and Bloomberg. High volume price-aberrant trades can move the volume-weighted index price in the desired direction, thereby increasing the value of derivative contracts the traders hold, the settlement of which is tied to the index price. Sham congestion relief trades, as the name implies, involve scheduling future power deliveries with the intention of causing planners to predict congestion on the grid. If under the published market rules traders can earn compensation by forgoing those trades (so as to relieve congestion) before their execution, it makes economic sense to schedule congestion-inducing trades in order to earn the associated congestion-relief revenues. Traders could have lost money on these sorts of transactions if they mistakenly failed to trigger the congestion-relief opportunity and the underlying transaction entailed a loss, but that risk was presumably minimal.

FERC recognized the benefits of allowing speculators (non-energy firms) to participate in energy markets, but concluded that these two trading techniques served no energy market need; rather, each involved trades created by the traders solely to earn money under rules designed (poorly, it turned out) to promote market efficiency. FERC ultimately concluded that both practices were contrary to the Federal Power Act’s

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44 Id.
45 Id.
46 Energy derivatives are merely contracts through which the parties agree to exchange money in the future depending upon the relationship between the actual future price of energy, and a price or prices specified in the contract. They are essentially bets on the future price of energy, but they enable the power plant owner to guarantee a maximum future price for natural gas purchases, and a minimum sale price for future electricity sales.
49 Id.
requirement that rates be just, reasonable, and nondiscriminatory, imposing hefty fines on traders who used them.\textsuperscript{50} In the years after the California crisis, FERC tried a variety of different ways to disincentivize manipulative behavior in electricity markets. These experiments included proposing (and later abandoning) a single, standard market design for all regional wholesale markets,\textsuperscript{51} using different methods of detecting seller market power,\textsuperscript{52} and imposing a series of behavioral rules on market participants,\textsuperscript{53} among others. In 2005, Congress addressed this issue by incorporating into the Federal Power Act regime the anti-fraud language of the Securities Act of 1934,\textsuperscript{54} which prohibits the use of any “manipulative or deceptive device or contrivance.”\textsuperscript{55} Subsequent agency prosecutions of market manipulation, including the ongoing cases discussed here, charge violations of this requirement.

\section*{II. The Overcharge Cases}

The central question in the recent overcharge cases is the following: Can FERC penalize trading behavior that serves no commercial purpose related to the purchase, sale, or delivery of energy (or of hedging risk associated with energy transactions), but was nevertheless incentivized by specific market rules? At first blush, the cases bear some factual similarities to the California trading techniques. Both the California market and the PJM

\begin{footnotesize}
\textsuperscript{50} Id.
\textsuperscript{53} Order Amending Market-Based Rate Tariffs and Authorizations, Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 105 F.E.R.C. ¶ 61,218, 62,142 (Nov. 17, 2003), reh’g denied, 107 F.E.R.C. ¶ 61,175 (May 19, 2004); Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations; Order Proposing Revisions to Market-Based Rate Tariffs and Authorizations, 70 Fed. Reg. 71,484 (Nov. 29, 2005).
\end{footnotesize}
market use a two-stage auction to set spot prices: market participants submit
day-ahead bids (to supply or purchase power, or to provide hedges for energy
firms), which are cleared in the real-time market the next day. In the
Powhatan case, a hedge fund trader, Dr. Houlian Chen, found a way to
exploit rules published by the PJM wholesale power market that reimburse
market participants for overcharges associated with so-called “line losses”
(energy lost during transmission). The trading involved bets on prices at
different nodes (locations) on the PJM grid at different stages of the PJM
auction; traders expected congestion to influence those prices. Chen
discovered that by scheduling large volumes of mirror image trades
(reminding wash trades) across the two stages of the PJM auction, he could
qualify for compensation under the PJM line loss reimbursement scheme,
and did so, earning large profits in a relatively short period of time. FERC
subsequently charged Chen with violating the anti-maneuplation provisions
of the Federal Power Act and imposed a $30 million fine, representing
disgorgement of profits plus penalties. The other two overcharge cases,
City Power Marketing and Coaltrain Energy, involved the use of the very
same techniques to exploit the very same PJM rule. The defendants in these
cases are at loggerheads with FERC over whether the mirror image trading

57 FERC v. Powhatan Energy Fund, L.L.C., 949 F.3d 891, 895–96 (4th Cir. 2018). In PJM’s view,
overcharges were necessary to send efficient market signals to buyers and sellers of power, necessitating
the need for reimbursement method after the fact. Id.
58 Spot prices for wholesale power on the PJM grid are set by the competitive market: that is, buy
bids submitted by buyers and sellers of wholesale power. But buyers and sellers need access to the
transmission grid to consummate their deals, and transmission services are not competitively priced.
PJM’s spot power prices reflect not only the cost of supplying power to a node, but also congestion costs,
so as to dissuade market participants from scheduling transactions over congested lines. PJM
INTERCONNECTION L.L.C., Market for Electricity, https://learn.pjm.com/electricity-basics/market-for-
59 Chen’s trades involved a PJM product called “up to congestion” price, which is a virtual
product—that is, a derivative. They did not involve the purchase or sale of actual power. Because these
instruments are derivatives, one might expect CFTC to have exclusive jurisdiction over them. Hunter v.
FERC, 711 F.3d 155 (D.C. Cir. 2013). However, CFTC has exempted these and other transmission
derivatives from its regulatory jurisdiction because of their close connection to FERC-jurisdictional
power markets. Final Order in Response to a Petition from Certain Independent System Operators and
Regional Transmission Organizations to Exempt Specified Transactions Authorized by a Tariff or
Protocol Approved by the Federal Energy Regulatory Commission or the Public Utility Commission of
Texas From Certain Provisions of the Commodity Exchange Act Pursuant to the Authority Provided in
31, 2015).
strategy at issue, once perfected, posed a real risk of loss for the traders; in any case, defendants dispute FERC’s characterization of these trades as wash trades. More importantly, defendants contend that (i) because no specific PJM market rule prohibited the trades at the time they were made, it is statutorily and constitutionally unfair to penalize the trading; and (ii) the trades lack the element of fraud and deception required to prove manipulation claims under the statute. Each of the three defendants has sought judicial review of FERC enforcement actions in federal court. All three proceedings survived motions to dismiss filed by the defendants. Since their inception the cases have been embroiled in years of litigation over defendant Powhatan’s demand for a trial de novo on the merits, such that the underlying merits of the cases have yet to be addressed by the court.

The defendants contend that even if the mirror image trading strategy at issue in the overcharge cases does not serve any energy market need, it serves another important policy purpose: to expose poorly designed market rules, in much the same way a hacker exposes the vulnerability of computer security systems. To punish traders like Chen for exploiting flaws in the market design, they say, is to impede the development of better market rules by dissuading discovery of those flaws (via their exploitation). Furthermore, Powhatan’s filings and public statements reflect a kind of incredulity about FERC’s rejection of this argument, calling the FERC staff report on which the charges are based as a “gotcha narrative” that is “so off-base” that “the Staff simply cannot be reasoned with here.” Powhatan describes “finding loopholes” as “a time honored American tradition,” and charges FERC with government overreach and a misunderstanding of how markets work.

63 Id. at 30–34.
64 The cases have been bogged down for years in a separate procedural dispute about de novo judicial review of FERC decisions. Those procedural disputes have prevented judicial review of the merits of the cases to date. For the procedural posture of this case as of this writing, see Joint Notice of Procedural Status, FERC v. Powhatan Energy Fund, LLC, 286 F. Supp. 3d 751, No. 3:15-cv-00452 (E.D. Va. 2017), http://ferclitigation.com/wp-content/uploads/Joint-Notice-of-Procedural-Status-05-08-20.pdf.
65 Motion to Dismiss, supra note 62.
68 Id. at 4–5.
69 Defendants’ argument is eerily reminiscent of the fictional Wall Street icon Gordon Gekko, from Oliver Stone’s 1987 film “Wall Street.” The most oft-quoted line from the movie is “Greed . . . is good.
These statements reflect a view of markets as a kind of maximization game played according to a system of clear, well-defined rules in which behaviors that are not specifically prohibited by the rules must be permitted. The players (traders) can be expected to do their very best (to make as much money as they can) within the letter of the rules. According to this view, Chen was only doing his job; it is up to the designers of market rules to steer his maximizing behavior in more productive directions. After he revealed the flaw in the rules, regulators were able to close that loophole—a favor they returned not with gratitude, but with punishment. Beneath this markets-as-maximization-game idea is a broader, more philosophical claim about economic freedom and how to maximize social welfare: one reminiscent of Adam Smith’s invisible hand, Milton Friedman’s admonition that the only “social responsibility of business . . . [is] to increase its profits . . . within the rules of the game,” and Friedrich Hayek’s expectation that markets best maximize social welfare on their own through a process he called “spontaneous order.”

Perhaps because the overcharge cases make such a basic claim about the relationship between government and markets, they have periodically attracted the attention of a roster of eminent electricity and financial market experts, many retained by defendant Powhatan. Many of these experts have

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Greed is right. Greed works.” WALL STREET (20th Century Fox 1987). But the Gekko character also makes the case for greed in ways that foreshadow the defendants in the overcharge cases:

This is America. And there is nothing wrong with [exploiting a loophole] even if the person exploiting the loophole may think that the market would probably be better off as a whole without the existence of the loophole. . . . Traders do not make the rules; they merely follow them. They obviously have no obligation to forego profit opportunities just because the rule makers promulgated some rules that arguably should be changed. . . . [T]raders who aggressively exploit loopholes do both the market and the rule makers a service by highlighting the inefficiency of the rules, thereby leading the rule makers to fix whatever problem may exist.

Id. For a fuller account of the growing popularity of the Gekko philosophy on Wall Street after the release of the movie, see Michael Lewis, Greed Never Left, VANITY FAIR (Apr. 1, 2010), http://www.vanityfair.com/hollywood/2010/04/wall-street-201004.

70 ADAM SMITH, WEALTH OF NATIONS 349 (1804).
71 MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962).
72 David Rehr, Hayek’s Legacy of Spontaneous Order, FED. RSRV. BANK MINNEAPOLIS POL’Y PAPERS (1992), http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=3747 (discussing Hayek’s notion of “spontaneous order” as the further development of Adam Smith’s “invisible hand” idea).
73 That list has changed over time as experts have been added and subtracted from the litigation. As of this writing, however, it includes Harvard Kennedy School professor William Hogan, who is perhaps the leading academic advisor to designers and regulators of competitive electricity markets, and Craig Pirrong, who has written extensively about the manipulation of commodities markets. For the full current list of experts Powhatan has enlisted to its cause, and their respective biographies, see FERC V.
lined up in opposition to FERC’s enforcement position, supporting the mechanical view of markets and limited role for regulators advanced by the Powhatan defense. That is worrying, because neither the legal nor the philosophical case for Powhatan’s position is persuasive. To the contrary, Powhatan’s legal arguments ignore precedents generally supporting an agency’s right to use adjudication to enforce its statutory public interest obligations directly, and FERC’s particular history of treating trades that intentionally undermine market efficiency as manipulative. Furthermore, the philosophical proposition that the invisible hand will maximize social welfare in electricity markets is also disputable. Like many historically regulated markets, electricity markets depart from textbook markets in systematic and predictable ways that demand both regulatory attention and regulatory flexibility if the agency is to fulfill its public interest obligation—in this case, to ensure that market rates remain just and reasonable.

III. THE LEGAL ISSUES: MANIPULATION AND FAIRNESS

At the heart of the defense in the overcharge cases is the proposition that open, undisguised trading behavior that abides by specific market rules cannot be manipulative because (i) behavior that is not prohibited by specific market rules is, by definition, legal; and (ii) such behavior lacks the element of fraud necessary to support a manipulation claim. Moreover, to impose liability in that case would violate defendants’ (fairness and due process) rights to prior notice that its conduct was illegal. This Part addresses each of these claims in turn.

A. What Is “Manipulation”?

FERC and the defendants agree that not all financial trading (speculation) in energy markets constitutes manipulation. To the contrary, traders from hedge funds and other financial institutions serve important and under-appreciated functions in energy markets, in particular by providing counterparties for energy firms looking to hedge price risk. For example, a power plant owner seeking to lock in a future price at which to buy natural gas may have a difficult time finding a willing counterparty among natural gas producers and marketers. Traders from financial institutions may have different views about the future of the market than traders representing energy firms, or they may have a greater appetite for financial risk. For either

or both of those reasons, financial institutions may be willing to sell energy
derivatives that meet a firm’s needs when other energy firms will not. In that
way banks and hedge funds provide liquidity in energy derivative markets,
and help energy firms reduce price risk. Financial traders undertake risks
in doing so: they sometimes make mistaken bets on the future direction of
prices, and lose money in the process. Their presence is particularly helpful
in two-stage auction markets like those common in spot markets for
electricity, including PJM’s, at least theoretically. In these two-stage
markets, competition from financial traders theoretically impedes the ability
of pivotal suppliers to exercise market power and promotes price
convergence by identifying arbitrage opportunities in the market, though
some scholarship challenges that conclusion. FERC and the defendants
disagree, however, over whether speculation can ever be manipulative if it is
undertaken openly and in compliance with published market rules.

The underlying trades that qualified Chen and other traders for line loss
reimbursement—bets on the spot price of electricity at either end of
potentially congested transmission line segments—may have posed a risk of
loss for the traders under a low-probability set of circumstances. But even if
it did, it does not necessarily follow that those trades were therefore not
manipulative trades under the Federal Power Act. The congestion relief
trading strategies employed by Enron during the California electricity crisis
also entailed a risk of loss for the traders, yet FERC deemed them
manipulative at the time. Indeed, many of the trading techniques covered
by the anti-manipulation language of the Federal Power Act (and the
Commodities Exchange Act) entail the risk of loss: trades undertaken with
the full expectation that the trader will lose money in one market, but with
the simultaneous hope and expectation that she will recover those losses and
additional profits in another market. Traders undertake uneconomic trades
in physical markets to influence the closing price of a product, thereby
making their derivative contracts—which are essentially bets on that

74 Response to Order to Show Cause, supra note 66, at 5–6.
75 See, e.g., Ruoyang Li, Alva J. Svoboda & Shmuel S. Oren, Efficiency Impact of Convergence
Bidding on the California Electricity Market, 48 J. REG. ECON. 245, 247 (2015); John Birge, Ali Hortacsu,
Ignacia Mercadal & Michael Pavlin, Limits to Arbitrage in Electricity Markets 1 (MIT Ctr. for Energy &
76 FERC, Staff White Paper on Anti-Market Manipulation Enforcement Efforts Ten Years After
marketmanipulationwhitepaper.pdf. Traders looking to be paid to relieve congestion risked losses if their
anticipation of receiving compensation for congestion relief was not realized (that is, if they guessed
wrong and scheduled transactions over uncongested lines) and those transactions risked losses.
physical market price—more valuable. Many FERC and CFTC prosecutions involve exactly this type of cross-market activity.\textsuperscript{78}

Shortly after Congress added its anti-manipulation language to the Federal Power Act in 2005, FERC issued its Order 670,\textsuperscript{79} making it illegal to “use or employ any device, scheme, or artifice to defraud” and to engage in “any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity” in connection with the purchase or sale of energy subject to FERC’s jurisdiction.\textsuperscript{80} This language was borrowed from Securities and Exchange Commission’s (SEC) Rule 10b-5,\textsuperscript{81} and FERC indicated that it would incorporate case law interpreting securities law jurisprudence into its understanding of Order 670, where appropriate and relevant.\textsuperscript{82} At the time FERC stated its belief that the statutory amendments and Order 670 would have covered most of the forms of anticompetitive conduct witnessed in the California markets, including the use of wash trades and the artificial creation and relief of transmission congestion.\textsuperscript{83}

The focus on fraud in the regulatory language, however, invites the inference that conduct must be deceptive in order to be manipulative. Indeed, most cases charging manipulation of securities markets involve deception,\textsuperscript{84} and there is even some securities law precedent supporting the notion that open market activity (involving no deception) cannot be “manipulative.”\textsuperscript{85} Traders like Chen did not conceal their activity from regulators or from market overseers. In that sense, their conduct was not deceptive or fraudulent. On the other hand, the trades served no purpose related to the proper functioning of energy markets (other than to show how those markets could be exploited).\textsuperscript{86} These trades did not facilitate the purchase, sale, or

\textsuperscript{78} See Order Assessing Civil Penalties, Barclays Bank PLC, Daniel Brin, Scott Connelly, Karen Levine & Ryan Smith, No. IN08-8-000, 144 FERC ¶ 61,041 (July 16, 2013) (imposing a fine on Barclays for uneconomic trades in the physical market for electricity in California to improve the value of derivatives Barclays held); see also WESTERN MARKETS INVESTIGATION, supra note 48.


\textsuperscript{80} 18 CFR § 1c.2(3) (2006).

\textsuperscript{81} 17 CFR § 240.10b-5(c) (2005).

\textsuperscript{82} See FERC Order 670, supra note 79.

\textsuperscript{83} See id. at 4,254.

\textsuperscript{84} See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976) (defining “manipulative” as “virtually a term of art when used in connection with securities markets” that “connotes intentional or willful conduct designed to deceive or defraud investors”); see also Schreiber v. Burlington Northern, Inc., 472 U.S. 1, 6 (1985); Chiarella v. United States, 445 U.S. 222, 226 (1980); Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 472 (1977).

\textsuperscript{85} GFL Advantage Fund Ltd. v. Colkitt, 272 F.3d 189 (3d Cir. 2001).

\textsuperscript{86} To be precise, the trades show how the specific market rules could be exploited if regulators lack
delivery of energy, nor did they provide counterparties for energy companies looking to hedge risk. Rather, each trade was scheduled solely for the purpose of qualifying for overcharge refunds under the PJM market rules. In that sense, the underlying trades were a fiction, and therefore (at least, arguably) deceptive.

Moreover, despite the focus on deception in the securities case law, the relevant language in both the securities and electricity statutes prohibits “manipulative or deceptive devices,” language that clearly implies that a trading technique may be manipulative without being deceptive. If that were not the case, then a firm that openly cornered a market would be free to set its own price unless and until new entrants were able to undercut that price. Thus, FERC’s contention that the trades at issue here are manipulative is not undercut by the conclusion that they were not deceptive. Nevertheless, courts have yet to address directly whether deceit is an essential element of an anti-manipulation claim under the Federal Power Act. Given the conflicting precedent, the resolution of that legal issue in these cases is uncertain.

The same cannot be said, however, for the defendants’ claim that FERC’s direct enforcement of the statute violates defendants’ due process right to notice of the illegality of its behavior.

B. The Right to Prior Notice

Powhatan argues it had no prior notice of the illegality of its trading behavior because it was not specifically prohibited by (PJM) market rules, and FERC therefore erred by applying the statutory prohibition against manipulation to that behavior. In so doing, Powhatan argues, FERC violated Powhatan’s constitutional right to prior notice under the Due Process Clause.

the power to enforce the broader statutory prohibition against market participants who follow the specific market rules.


88 Steve Thel has built a strong case in support of this view in the securities context, concluding from the legislative history of the securities acts that “[t]he SEC’s authority to regulate the use of manipulative devices and contrivances under section 10(b) extends to all practices that contribute to disorder in the market or that give voice to speculative sentiment there.” Steve Thel, Regulation of Manipulation Under Section 10(b): Security Prices and the Text of the Securities Exchange Act of 1934, 1988 COLUM. BUS. L. REV. 359 (1988); see also Steve Thel, $850,000 in Six Minutes—The Mechanics of Securities Manipulation, 79 CORNELL L. REV. 219 (1994).

89 For a summary of the case law on the legality of openly manipulative trading behavior under the securities acts’ “fraud” standard, see Spence & Prentice, supra note 52, at 180–88.
Of course, the Due Process Clause does impose prior notice requirements and limits on the retroactive imposition of criminal liability, and imposes lesser, similar limits on administrative agencies’ civil enforcement of statutory mandates. However, as described in the previous section, there is a strong argument that the overcharge case defendants had (at least constructive) notice that FERC considered the kind of trading in which they engaged to be manipulative.

The defendants contend that by failing to prohibit their trading strategy, the specific PJM market rules effectively authorized it. However, courts have long been clear that statutory standards and mandates can have independent legal force apart from (and beyond the scope of) individual rules enacted by regulators to guide their enforcement. Indeed, neither wash trading nor the congestion-relief strategies employed by Enron during the California crisis were specifically prohibited by California market rules at the time. Yet both FERC and the courts concluded that the language of the Federal Power Act and associated regulations prohibited those trades. If FERC is correct that Congress intended for the anti-manipulation language in the 2005 amendments to cover those behaviors, neither the presence of risk in a trading strategy nor its openness necessarily contradicts the conclusion that the trades were manipulative. Thus, the regulator’s authority to enforce statutory mandates need not be defined exclusively by the agency’s own rules; it can flow directly from the statute as well.

The idea that an agency’s public interest obligations may entail the direct enforcement of broad statutory prohibitions against defendants—even when defendants have complied with more specific rules governing their conduct—is a long-standing principle governing the application of anti-fraud provisions of the securities laws, from which the Federal Power Act’s anti-manipulation provisions are drawn. In United States v. Simon, the Second

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91 See General Electric Corp. v. EPA, 53 F.3d 1324, 1328, 1333 (D.C. Cir. 1995) (holding that because “[d]ue process requires that parties receive fair notice before being deprived of property,” the Environmental Protection Agency could not penalize General Electric for asserted regulatory violations when General Electric lacked “fair warning of [EPA’s] interpretation of the regulations”); see also Shell Offshore Inc. v. Babbitt, 238 F.3d 622 (5th Cir. 2001) (concluding that because the U.S. Department of Interior’s change in the way it calculated offshore oil leases constituted a change in a longstanding interpretation of the Department’s existing rules, the new policy required notice and comment).
92 See, e.g., Motion to Dismiss, supra note 62, at 5.
93 WESTERN MARKETS INVESTIGATION, supra note 48.
94 Order Approving Settlement Agreements with Conditions, 155 F.E.R.C. ¶ 61,376, 62,142 (June 28, 2006).
Circuit upheld a criminal prosecution of auditors for violating the applicable anti-fraud provisions of the Securities Act of 1934 even though the auditors had complied literally with all applicable Generally Accepted Accounting Principles (GAAP) and Generally Accepted Auditing Standards (GAAS) rules in their preparation of the audit report in question.95 The court inferred from the statutory prohibition against fraud a general duty of auditors not to submit misleading reports of the audited company’s financial health irrespective of any additional duty to comply with more specific GAAP and GAAS rules.96 Interestingly, the Simon principle loomed large as Congress crafted the Sarbanes-Oxley legislation in the wake of the Enron accounting scandal of the early 2000s.97 Because traders are less likely to be aware of statutory standards than specific market rules, the Simon principle offends not only the defendants in the overcharge cases, it also offends the sense of fairness of some conservatives in Congress.98 Nevertheless, courts continue to follow the Simon rule,99 and it has been applied to prosecutions under Section 10(b) of the Securities Act100—the specific section on which the anti-fraud provisions of the Federal Power Act are based.

Powhatan claims further that because “[n]o PJM tariff provision and no [prior] Commission order ever alerted Powhatan that the trading at issue could be unlawful,”101 FERC’s enforcement action violates its constitutional right to prior notice of the illegality of the trades at issue. Putting aside the question of whether prior FERC orders provided Powhatan notice of the illegality of their trades, the Simon line of cases suggests that the statutory mandate against manipulation provided defendants with constructive notice.

96 Id. at 805–06.
98 Floyd Norris, An Old Case is Returning to Haunt Auditors, N.Y. TIMES (Mar. 1, 2002), https://www.nytimes.com/2002/03/01/business/an-old-case-is-returning-to-haunt-auditors.html (quoting Rep. Cliff Stearns (R-FL), who said he is “troubled” by the idea that one could violate the law while complying with GAAP, and calling the standard “burdensome”).
99 See United States v. Ebbers, 458 F.3d 110, 125–26 (2d Cir. 2006) (rejecting a challenge to a jury instruction based on its failure to allege violation of GAAP rules); United States v. Rigas, 490 F.3d 208, 220 (2d Cir. 2007) (rejecting defendants’ argument that Simon applies “only to cases where no specific accounting provision speaks to the alleged accounting malfeasance”); SEC v. Seghers, 298 Fed. Appx. 319, 331 (5th Cir. 2008) (“GAAP violations are neither necessary nor sufficient to prove securities fraud.”); Vista Outdoor Inc. v. Reeves Fam. Tr., 234 F. Supp. 3d 558, 566 (S.D.N.Y. 2017) (concluding that defendants “conflate GAAP with the distinct issue of whether the defendants acted in bad faith”).
101 Response to Order to Show Cause, supra note 66, at 8.
Moreover, the notion that agencies retain the kind of enforcement flexibility to which Powhatan objects gets further support from the familiar *Chenery* principle, which establishes that regulators are free to articulate the policies that form the basis of their decisions on a case-by-case basis, within the context of administrative adjudications.\(^{102}\) Of course, *Chenery* did not dispense with constitutional notice requirements, but rather suggested that those requirements can be satisfied by methods other than application of previously published rules.\(^{103}\) Indeed, it specifically endorsed the SEC’s announcement and simultaneous application of a new policy, based upon the agency’s duty to be faithful to the statutory design.\(^{104}\) In other words, if the policy is implied by the statutory design, the agency can announce it and apply it simultaneously.

The *Chenery* principle applies in a wide variety of administrative adjudications.\(^{105}\) Nevertheless, the problem of ensuring that the defendant has prior notice of the agency policy seems especially acute in the context of administrative enforcement actions. Indeed, this concern motivated Justice Jackson’s dissent in *Chenery*,\(^{106}\) and has attracted some scholarly commentary as well.\(^{107}\) However, there is nothing in the critique of the *Chenery* majority to suggest that FERC’s enforcement posture in the overcharge cases violates constitutional notice requirements. The defendants in the overcharge cases ought not to have been misled by the PJM rules, just as Enron and others could not argue persuasively that they were misled by GAAP rules during the financial crisis of 2001. In the words of the Fifth Circuit, “it is possible to violate GAAP, yet not commit fraud, and it is

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\(^{102}\) *SEC v. Chenery Corp.*, 332 U.S. 194, 202 (1947) (finding that regulatory agencies may craft policy on a case-by-case basis through adjudication and are not obligated to use rulemaking to create policy).

\(^{103}\) *Id.* at 199–200. For an argument that the *Chenery* rule trumps the *General Electric* rule as long as the agency is not applying “quasi-criminal” sanctions for violating the new interpretation, see Harold J. Krent, *Reviewing Agency Action for Inconsistency with Prior Rules and Regulations*, 72 CHI.-KENT L. REV 1187, 1222–23 n.202 (1997).

\(^{104}\) *Chenery*, 332 U.S. at 203.

\(^{105}\) See, e.g., Charles H. Koch, Jr., *Policymaking by the Administrative Judiciary*, 25 J. NAT’L ASS’N ADMIN. L. JUDGES 49, 54 (2005) (“*Chenery II* dispelled the notion that . . . an agency (where the standard is unclear) . . . [must] make a general rule before proceeding through case-by-case enforcement adjudications.”).

\(^{106}\) *Chenery*, 332 U.S. at 210 (Jackson, J., dissenting) (arguing that the majority opinion “makes judicial review of administrative orders a hopeless formality”).

\(^{107}\) See, e.g., William D. Araiza, *Agency Adjudication, the Importance of Facts, and the Limitation of Labels*, 57 WASH. & LEE L. REV. 351, 355 (2000) (detailing the ways lower courts have cabined the discretion conferred in *Chenery*).
possible to commit fraud without violating GAAP."

Similarly, it is possible to manipulate electricity markets in contravention of the Federal Power Act without violating PJM market rules. Accordingly, defendants had constructive notice that FERC would punish the kind of trading in which they engaged.

In sum, *Simon* and *Chenery* clearly demonstrate that one can violate a broad statutory prohibition without violating specific rules enacted under that same statutory prohibition. This principle is important to the management of volatile electricity markets, and more broadly to the use of competition and market pricing as a regulatory option. Ever since the California electricity crisis, FERC has consistently embraced both competition and market pricing on the one hand, and the prohibition (as manipulative) and punishment of trading behavior that serves no legitimate market purpose, on the other. Given the complexity and fluidity of electricity markets—and their particular susceptibility to the exercise of market power—this approach makes sense. Neither the Constitution nor principles of basic fairness suggest that regulators must ignore the forest for the trees.

IV. REGULATION AND MARKETS: A QUESTION OF FAITH

FERC’s enforcement posture in the overcharge cases is a natural outgrowth of the statutory public interest mandates that animated public utility regulation in the first place and the longstanding principle that regulators’ statutory duty to protect the public interest requires more than mere passive arbitration of private disputes. That this approach now

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109 See, e.g., High Desert Power Project, Order Approving Stipulation and Consent Agreement, No. IN20-6-000, 173 FERC ¶ 61,087 (2020) (approving settlement and imposing penalty for electricity market bidding behavior that took advantage of a software error to trigger compensation to the bidder, without serving any legitimate market purpose); Barclays Bank, Order Approving Stipulation and Consent Agreement, No. IN08-8-000, 161 F.E.R.C. ¶ 61,147 (2017) (settlement of enforcement action charging Barclays with manipulation in connection with loss-generating trades of electricity markets in order to generate increased value of derivatives held by Barclays); J.P. Morgan, Order Approving Stipulation and Consent Agreement, Nos. IN11-8-000 & IN13-5-000, 144 F.E.R.C. ¶ 61,068 (2013) (settlement of enforcement action charging J.P. Morgan with manipulation in connection with bidding strategies that in electricity markets).


attracts such vigorous opposition in the overcharge cases is emblematic of a more fundamental divide at the heart of regulatory policy—one that can be stated in the form of a question. Which is the more misplaced faith: faith in the ability of free markets to maximize social net benefits, or faith in government to maximize social net benefits by intervening in response to market failure? As financial institutions have come to play a more central role in energy markets, these two world views will clash more often because the Smithian ideal of the invisible hand and the Hayekian ideal of self-organizing markets have many adherents in the world of finance. It also seems to dovetail with Republican hostility to the administrative state. This clash of perspectives is not limited to electricity markets. Recent and ongoing policy disputes over net neutrality, repeal and replacement of the Affordable Care Act, congressional Republicans’ proposals to privatize Social Security and Medicare, and the Trump Administration’s repeal of “job-killing” environmental rules are justified by the assertion that unregulated markets can deliver better results than regulated markets. As support for bolder and more aggressive policy interventions grows among the ranks of progressive and Democratic politicians, these worldviews will

the Commission’s public interest role “does not permit it to act as an umpire blandly calling balls and strikes for adversaries appearing before it” but rather “the public must receive active and affirmative protection at the hands of the Commission”).

112 Cf. Lewis, supra note 69.


116 Congressional Republicans’ antipathy to the legislation, which they call “socialism,” has been well documented. See, e.g., Michael McAuliff, House Passes 56th Anti-Obamacare Measure, HUFFINGTON POST (Feb. 3, 2015), http://www.huffingtonpost.com/2015/02/03/obamacare-repeal-obamacare_n_6607080.html.

clash more frequently, sharply, and openly than they do in the relatively obscure dispute represented by the overcharge cases.

But “market-versus-regulation” is a false choice. The real question is one of degree, as evidenced by two obvious truths: (i) competitive wholesale electricity markets were created by federal regulators, most of whom have embraced the benefits of competition; and (ii) regulation (enforceable legal rules) are a predicate to the very existence of markets and their efficient operation. This may be one reason why the evangelists of each faith are sometimes tempted to offer up idealized versions of their preferred method of social organization (markets or policies) for comparisons against real world, warts-and-all versions of their disfavored method. Indeed, as with religious faiths, the zeal of the disciples often exceeds that of the founders. Both Adam Smith and Friedrich Hayek recognized a role for government to provide “intelligently designed and continuously adjusted legal institutions” to ensure markets work efficiently—that is, to address public goods and externality problems, and to incentivize investment where markets fail to supply enough of a good that society needs. Neither Smith nor Hayek subscribed to blunt condemnations of “government qua government” or “regulation qua regulation.” Rather, Smith and Hayek condemned the particular types of authoritarian market interventions they

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118 See supra Part I.

119 It is axiomatic that the ability to enforce property rights and contracts facilitates investment and gains from trade, and that nongovernmental enforcement regimes that exist tend to be ad hoc and local. Broad regional markets require regulation.

120 See Boyd, supra note 110, at 1657 (“[C]omparing an ideal view of markets to real-world regulation was never going to go in regulation’s favor and . . . there were plenty of problems with existing practices of utility regulation to provide fodder for . . . critics.”); see also Spence, supra note 8 (detailing the various ways in which public choice scholars’ idealized view of markets depart from real-world energy markets).

121 HAYEK, ROAD TO SERFDOM, supra note 23, at 29.

122 Here is Hayek (quoting Smith) on the importance of “intelligently designed and continuously adjusted” legal institutions in an efficient market:

"To create conditions in which competition will be as effective as possible, to supplement it where it cannot be made effective, to provide the services which, in the words of Adam Smith, “though they may be in the highest degree advantageous to a great society, are, however of such a nature, that the profit could never repay the expense to any individual or small number of individuals” – these tasks provide, indeed a wide and unquestioned field for state activity. In no system that could be rationally defended with the state just do nothing. An effective competitive system needs an intelligently designed and continuously adjusted legal framework as much as any other. Even the most essential prerequisite of its proper functioning, the prevention of fraud and deception (including exploitation of ignorance), provides a great and by no means yet fully accomplished object of legislative activity."

Id. (emphasis added).
witnessed at the time they wrote (for Smith, collusive power of guilds; for Hayek, centrally planned fascism and communism). \(^{123}\) It is a sizeable leap from Smith’s and Hayek’s criticisms of those sorts of government interventions to the idealized vision of free markets governed not by general standards, but only by specific mechanical rules prescribed in advance offered by the defendants in the overcharge cases. \(^{124}\)

As markets become more fluid and complex, the need for regulatory flexibility grows. Ever since Federal Reserve Chair Alan Greenspan’s remark in anticipation of the continued “irrational exuberance” behind financial market bubbles in the twenty-first century, \(^{125}\) it has been fairly obvious that faith in the efficiency of financial markets is often misplaced. Price does not always transmit information to financial markets fully or accurately. The same is true of electricity markets, which have struggled to emulate textbook markets over the last two decades in ways their designers had hoped. Indeed, the twenty-five-year history of competition and market pricing in electricity markets is one of constant tinkering with the market rules to deter the exercise of market power, incentivize investment in electricity supply and transmission, and push economic actors’ behaviors in socially-desirable directions. This process of learning and iterative experimentation is continuous and necessary.

Consider, for example, the California crisis and its aftermath. \(^{126}\) The crisis precipitated a long search by FERC for ways to prevent sellers in wholesale markets for electricity from capturing monopoly rents by acquiring market power—the very thing the original public utility statutes were enacted to prevent. \(^{127}\) The process of investigating that breakdown produced lessons, beyond those aimed at the manipulative trading techniques used by Enron and others. In textbook markets, high prices beget rapid reductions in demand and increases in supply. But in California, there was no reactive reduction in demand because the retail rates consumers paid were

\(^{123}\) Id.; SMITH, supra note 70.

\(^{124}\) The late Judge Richard Cudahy, perhaps the foremost expert on energy markets on the federal bench during his lifetime, expressed deep skepticism to this idealized vision, characterizing it as “folklore.” Richard D. Cudahy, The Folklore of Deregulation (with Apologies to Thurman Arnold), 15 YALE J. REG. 427, 427 (1998).


\(^{126}\) The facts of the crisis are recounted briefly at supra notes 37–42 and accompanying text.

\(^{127}\) See supra notes 51–53 and accompanying text.
fixed: they remained unchanged even as wholesale prices skyrocketed. Consequently, finding ways to incentivize demand responsive behavior has been a focus of considerable academic and regulatory attention in the years since, producing new ways of pricing power at retail and changes to wholesale market rules to compensate providers of demand reduction during periods of scarcity, to name just two examples.

Nor did the supply side of the market react as textbook markets do. In the electricity generation sector, market entry is neither costless nor quick. Consequently, different ISOs/RTOs employ different bidding and pricing rules in spot markets to try to address (and prevent) the problem of supply scarcity. Many rely on either state utility regulation or “capacity markets” to provide revenue guarantees to providers of reserve generating capacity; some market overseers worry about buyer-side market power in these capacity markets and tinker with capacity market institutions to mitigate that power. Other RTOs/ISOs rely on scarcity pricing to incentivize investment in reserve generation to enter into ad hoc contractual arrangements with owners of individual plants to make sure that they will be available to supply power when called upon, or to discourage the closure

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128 See CONG. BUDGET OFF., supra note 37.
129 For a review of these efforts, see Ahmad Faruqui & Jennifer Palmer, Dynamic Pricing and Its Discontents, 34 REG. 16 (2011); Paul L. Joskow & Catherine D. Wolfram, Dynamic Pricing of Electricity, 102 AM. ECON. REV. 381 (2012).
130 For a review of programs aimed at compensating these kinds of “demand response” services, and the FERC rules that encourage them, see Joel B. Eisen, Demand Response’s Three Generations: Market Pathways and Challenges in the Modern Electric Grid, 18 N.C. J.L. & TECH. 351 (2017).
131 For a critical analysis of capacity markets, see Joshua C. Macey & Jackson Salovaara, Rate Regulation Redux, 168 U. PA. L. REV. 1181 (2020).
133 The Texas market has eschewed capacity markets in favor of incentivizing investment in reserve generation by letting wholesale electricity prices move as high as $9,000/MWh when supplies are scarce. See Joshua Rhodes, Summer Price Spikes Are a Feature of Texas’ Power Market, Not a Bug, AXIOS (Aug. 15, 2019), https://www.axios.com/summer-price-spikes-are-a-feature-of-texas-power-market-not-a-bug-2963882dcf-52e0-4f80-860f-5414e22f8e9b.html.
of the plant. No wholesale market overseers trust the price signal alone to ensure long-term efficiency. They fear a shortage and a massive market power-driven transfer of wealth from customers to sellers as in the California crisis. So they experiment and tinker with market rules to nudge the market toward welfare maximizing outcomes. These are regulatory experiments that may never be completed. Over time, some of what seems to work in one market will be adopted in others; what doesn’t work will be discarded.

These are but a few illustrative examples of the myriad challenges FERC faces in its efforts to steer energy markets toward socially productive ends: that is, to execute its statutory responsibilities to ensure that (i) electricity prices remain just, reasonable, and non-discriminatory across hundreds of pricing nodes in tens of sub-regional wholesale markets; and (ii) no market participants are manipulating prices in those markets. The task of steering electricity markets toward socially productive ends will only grow more complex and difficult as policy and technological change push a transformation of the grid away from fossil fuels and toward heavier reliance on intermittent wind and solar generation, and toward integration of distributed energy resources like rooftop solar and battery storage.


136 See supra note 26 (discussing the statutory origins of this obligation in Federal Power Act sections 205 and 206).

137 The most dramatic development is the fact that utility-scale wind and solar energy are the least expensive forms of electric generation on a levelized cost basis, which in turn is driving rapid deployment of both technologies. See Lazard Levelized Cost of Energy and Levelized Cost of Storage – 2020, LAZARD (Oct. 19, 2020), https://www.lazard.com/perspective/levelized-cost-of-energy-and-levelized-cost-of-storage-2020/.

138 Rapid technological advancements in extraction of oil and gas, the efficiency of solar panels and batteries, and telecommunications (“smart grid”) have created sharp change in energy markets over the last fifteen years; presumably more change is to come. Accordingly, a small-but-growing number of states have established aggressive goals to eliminate or drastically reduce their carbon emissions in the next few decades. For example, in California, then-Governor Jerry Brown signed a bill mandating 50% of California’s electricity to be powered by renewable resources by 2025 and 60% by 2030, while calling for a “bold path” toward 100% zero-carbon electricity by 2045. Cal. Pub. Util. Code § 399.11 (2019); Cal. Pub. Util. Code § 399.15 (2019); Cal. Pub. Util. Code § 399.30 (2019). Hawaii has established a goal of 100% renewable electricity sources by 2045. Haw. Rev. Stat. § 269-92 (2016). New York State’s Climate Leadership and Community Protection Act calls for all the state’s electricity to come from carbon-free sources by 2030, and for 70% of which must be from renewable sources. N.Y. Env’t Conserv. Law § 75-0103 (McKinney 2014). The State of Washington’s 2019 Clean Energy Transformation Act requires all electric utilities in Washington to transition to carbon-neutral electricity by 2030. Wash. Rev. Code Ann. § 19.285.040 (West 2019). New Mexico has mandated that the state’s publicly regulated utilities receive all of their electricity from carbon-free sources by 2045. Energy Transition Act, 2019 NM S.B. 489 (official classification pending). And other states are establishing ambitious goals that
Maintaining an affordable, reliable electricity supply is already consuming a large share of FERC’s attention. This transformation is uncharted territory for the electricity sector, entailing a multitude of high-stakes contested decisions about where and when to build new infrastructure and how to balance competing values and interests—all in a complex, fast-moving market. As that transformation continues apace, it will require FERC to be able to react nimbly to police and shape the market toward statutory objectives.

Moreover, Powhatan errs when it insinuates that FERC’s power to enforce the statute as it has is somehow un-American or contrary to constitutional design. The tone of the pleadings and of Powhatan’s public posture about the litigation reflects a misplaced sense of outrage at the notion that any executive branch agency might ever enforce statutes as FERC has in this case. In this sense, the Powhatan attack on FERC echoes recent Republican critiques of delegation and the dangers of the “deep state”; like those critiques, it misapprehends the purpose, origins, and inevitability of the modern administrative state. The administrative state is both constitutional and inevitable. The framers appreciated that Congress could nevertheless stop short of complete elimination of carbon emissions: for example, Minnesota law establishes a goal of reducing greenhouse gas emissions by 80% by 2050. Minn. Stat. § 216H.02 (2007).

This is no small feat as intermittent renewable generation commands an increasing share of the generation market. For a sample of the kinds of tradeoff choices a zero carbon emission grid poses, see, e.g., Jesse D. Jenkins, Fernando J. de Sisternes & Richard K. Lester, The Role of Firm, Low-Carbon Electricity Resources in Deep Decarbonization of Power Generation, 2 JOULE 2403 (2018) (modeling the cost of a low-carbon grid); Scott P. Burger, Jesse D. Jenkins, Samuel C. Huntington & Ignacio J. P., Why Distributed? A Critical Review of the Tradeoffs Between Centralized and Decentralized Resources, 17 IEEE POWER & ENERGY MAG. 16 (2019) (analyzing the cost and regressive nature of particular policies designed to incentivize distributed generation).

See Orders 764 and 745, supra note 33.

141 Powhatan seemed to reserve special enmity for then-FERC Chair Norman Bay, going so far as to create a parody Twitter account, which it used to mock Chairperson Bay. As of this writing, the account still exists, but has been inactive since June 2020. See Norm Bay’s Parody Account (@Norm_Bay_Parody), TWITTER, https://twitter.com/norm_bay_parody.

142 Powhatan’s Twitter account has retweeted others citing Philip Hamburger’s work criticizing the demise of the nondelegation doctrine. Hamburger has been perhaps the most consistent critic of delegation, and his criticisms have quite rightly fallen on mostly deaf ears in the courts. For a recent summary of the century-old debate over nondelegation in the courts and legal academy, and Hamburger’s position within it, see Kristin E. Hickman, Gundy, Nondelegation, and Never-Ending Hope, REG. REV. (July 8, 2019), https://www.theregreview.org/2019/07/08/hickman-nondelegation/.

143 In the words of one Trump White House lawyer: “Article I is the Congress, Article II is the President. Article III are the courts. And then there’s this administrative state, combining all three . . . . They make the law, they enforce the law, and then they decide who violates the law, destroying the constitutional separation of powers that was designed to protect individual liberty.” Miller, supra note 12.
not and **should** not execute the laws, and so vested that power in the executive branch.\(^{144}\) As courts have recognized, the delegation of policymaking discretion to regulatory agencies is therefore consistent with the founders’ objective to design a policy process that minimizes political rent-seeking\(^{145}\) and favors deliberation—one that insulates policymaking from the passions of faction and pushes it toward “the permanent interests of the community.”\(^{146}\) The courts have allowed the scope of that delegation to be broad because good decisions require the application of expertise and deliberation to difficult policy problems.\(^{147}\) It would be inefficient to allocate all important discretionary decisions about the regulation of markets to Congress. Congress lacks the time and resources to develop the necessary issue-specific expertise and to deliberate over such an enormous range of important issues. These are some of the good reasons why the founders put that task in the hands of the Executive and authorized the President to appoint subordinates to manage that task. They are also part of the reason why the long-dormant nondelegation doctrine withered over time.\(^{148}\) Government is an organization, and delegation is the natural (indeed, inevitable) response as organizations grow in size and complexity to match the growth and complexity of tasks they have been assigned. Thus, when Congress delegates to FERC the power to make decisions about how to ensure just, reasonable, and nondiscriminatory rates—and the associated power to define and punish

\(^{144}\) Article II of the Constitution explicitly contemplates that Congress will create executive branch offices to be filled by the president’s appointees and that those “public Ministers and Consuls [and] other Officers” will execute the laws. U.S. CONST. art. II, § 2.

\(^{145}\) The very notion of executive independence arose in response to the corruption and rent-seeking that plagued the patronage-based system of the American republic’s first 100 years. As a political scientist in the nineteenth century, Woodrow Wilson authored one of the more thorough arguments for insulating the executive branch from political influence. See Woodrow Wilson, *The Study of Administration*, 2 POL. SCI. Q. 197 (1887); see also Frank Goodnow, *Politics and Administration* (1900); Max Weber, *Bureaucracy*, in *CLASSICS OF PUBLIC ADMINISTRATION* 63 (Jay M. Shafritz & Albert C. Hyde eds., 1978). While these advocates of an apolitical “science of administration” never realized their ambition of purging politics from the executive function (nor could they have), the notion that expertise and deliberation produce better decisions, all else equal, remains axiomatically true.

\(^{146}\) David B. Spence & Frank Cross, *A Public Choice Case for the Administrative State*, 89 GEO. L.J. 97, 142 (2000); see also John Rohr, *To Run A Constitution: The Legitimacy of the Administrative State* (1986) (making the argument that the executive branch now provides the deliberation that the Senate no longer can).

\(^{147}\) The literature on delegation and the nondelegation doctrine is far too large to cite here. For a brief explanation of the moribund nature of the nondelegation doctrine and its possible resurrection as part of the conservative project to transform the administrative state, see Hickman, *supra* note 142. For a review of the political science literature on delegation, see Spence & Cross, *supra* note 146, at 99–102.

\(^{148}\) Hickman, *supra* note 142.
manipulation of markets—it is fulfilling (not contradicting) the constitutional design.149

Of course, using delegation to limit or mitigate the deleterious effects of political influence over executive branch deliberations poses the risk that those deliberations will produce decisions that are undemocratic—that is, decisions that are inconsistent with the public interest and unresponsive to expressions of that interest. That concern is answered by elementary principles of administrative law, which establish that the courts ensure accountability to the public interest in two ways: first, by ensuring that agency decisions remain within the boundaries of their enabling legislation; and second, by holding those decisions to the various procedural requirements of the Administrative Procedures Act.150 The former requirement ensures that the agency responds to the only legislative expression of the public interest that has the force of law (the statute);151 the latter requirement affords the public the right to participate in administrative processes and requires agencies to respond to that participation in various ways.152

In this way, recent critiques of the regulatory state conflate unhappiness with the substance of regulation—congressionally authorized interference in the market—with the wisdom of delegation. Courts should not fall prey to that same confusion. If administrative law doctrines advising judicial deference to executive branch agencies are indeed evolving in ways that portend less room for the exercise of discretion by agencies, that would hamstring future regulators irrespective of their ideological inclination.153

149 See Spence & Cross, supra note 146; see also Anthony M. Bertelli & Christian R. Grose, The Lengthened Shadow of Another Institution? Ideal Point Estimates for the Executive Branch and Congress, 55 AM. J. POL. SCI. 767 (2011) (suggesting that polarization has upset the original constitutional design, one that was based on the interaction of deliberation and a strong electoral connection).

150 5 U.S.C. § 551 et seq.

151 Given that no other form of congressional action entails commitment to a position by the full body, one can argue that enacting legislation represents the only way that Congress expresses any recognizable version of the majority will.

152 The Administrative Procedures Act not only affords the public notice and the right to comment on certain agency actions, it also established judicial review standards that force the agency to make decisions based upon the public record and to respond to public comment. See 5 U.S.C. §§ 551–57 (establishing notice and participation rights for the public); 5 U.S.C. §§ 701–06 (establishing general standards of judicial review of agency action, apart from those contained in agencies’ enabling legislation).

153 Considerable academic attention has been devoted recently to the evolution of the so-called Chevron and Auer deference doctrines, and the “major questions” doctrine. Some of that commentary addresses the possibility that the Supreme Court may be ready to narrow the permissible scope of administrative agency discretion. See Chevron, U.S.A., Inc. v. Nat’l Res. Def. Council, Inc., 467 US 837.
Opposition to judicial deference or to broad delegations of discretion to agencies is sometimes premised on the assumption that agency discretion is most often exercised in favor of liberal (read: pro-regulatory) policy objectives. But in the context of agency efforts to steer competitive energy markets in socially desirable directions, the proper scope of the agency’s discretionary decision-making authority is orthogonal to the ideological component of its policy objectives at any point in time. This is because what FERC considers socially desirable in electricity markets changes over time: different FERC commissioners weigh the tradeoffs between reliability, cost and environmental performance differently, and differently under different circumstances. Consequently, FERC sometimes intervenes in markets to pursue left-wing policy objectives (such as greening the electric grid), and sometimes it intervenes in order to pursue right wing objectives (such as preservation of fossil fuel resources).

Commissioners of all ideological stripes seem satisfied with market pricing and competition, appreciative of the volatility and complexity of electricity markets, and wary of the kind of calamity that befell the California market in 2000–2001. Their ideological differences play out in other ways, but they all need to retain the authority and flexibility to respond to an ever-changing market.

CONCLUSION

Sometimes obscure cases implicate fundamentally important principles. The overcharge cases involve arcane rules of energy trading; indeed, the particular rules at the heart of the dispute have already been changed. Yet the cases reflect a more important and fundamental divide: the polarization-
driven conflict between competing faiths that has beset the regulatory state. That conflict presents a false choice. Regulation that empowers regulators to regulate the forest as well as the trees—not the abandonment of markets or the neutering of regulators—is the one true faith, at least for electricity markets. This faith may be ideologically impure or muddled, but it has many adherents because it works. Institutional changes precipitated by FERC (not courts or politicians) have: (i) opened up the electricity generation sector to competition that reduced wholesale market rates; 156 (ii) allowed market participants to look to the financial sector to hedge price risks; 157 and (iii) opened electricity markets to greener energy resources. 158 FERC engages in institutional tinkering and enforcement actions limiting the ability of market participants to engage in manipulative trading that extracts value from consumers without providing a commensurate benefit. This is as it should be.

Neither idealized textbook notions of self-correcting markets nor caricatures of inept or corrupt regulators ought to steer the courts away from established principles of law that grant agencies like FERC the power to regulate both the forest and the trees. If courts deny regulators the discretion to regulate flexibly—to adapt, to react nimbly and quickly to the machinations of financial players like the defendants in the overcharge cases—buyers and sellers of energy may grow dissatisfied, sensing that they have become the “dumb money” 159 in the market. State regulators and politicians may not view competitive markets as the best way to realize the objectives of state energy policy. For all of these reasons, federal courts ought to reject the idea that the only way regulators can enforce the law is by promulgating specific ex ante rules outlawing specific behaviors. In electricity markets (and perhaps in most markets), that is a prescription for

156 See Order 888, supra note 29 and accompanying text.
159 This term refers to the unsophisticated players in securities markets. See Daniel Gross, You and Your Dumb Money, SLATE (Aug. 11, 2005), https://slate.com/business/2005/08/why-you-are-dumb-money.html (explaining why individual investors are the dumb money in a stock market, and banks and institutional investors are the “smart money”).
rent-seeking that renders the agency’s statutory mandate impossible to fulfill.