

# Administrative Law News

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## The State Corporation Commission's New Commissioner

Earlier this year the Virginia State Corporation Commission ("SCC") swore in its thirty-second Commissioner. The Virginia General Assembly elected Mark C. Christie as Commissioner to replace Hulihan Williams Moore, who retired after twelve years of service as an SCC Commissioner. Judge Christie will serve with Theodore V. Morrison, the present Chairman, and Clinton Miller. Judge Christie was born in Bluefield, West Virginia and raised in Welch, W. Virginia. He was educated at Wake Forest University and the Georgetown University Law Center and teaches constitutional law, public policy, and government at Virginia Commonwealth University. Prior to joining the SCC, he served as counsel to the Speaker of the House of Delegates of the Virginia General Assembly from 2000 to 2004. Judge Christie was Counselor to the Governor and Director of Policy in the Governor's Office from 1996 to 1998 and Deputy Counselor to the Governor from 1994-1996. He was in the private practice of

law from 1989-1993 and again from 1998-1999. From 1997-2003, he was a member of the Virginia Board of Education serving as its president from 2002-2003. His service as an SCC Commissioner began in February of this year. A former officer in the U.S. Marine Corps, he is married to Anita Barnhart, a

teacher in Hanover County public schools.

Judge Christie has indicated his desire to be available to those practicing before the SCC as well as those the SCC serves. He stated "as a former member of the Administrative Law Section myself, I

look forward to meeting and interacting with the attorneys who practice before the SCC. I am a strong believer in the principle of due process for all parties and I welcome suggestions and comments from practitioners as to how we can improve the process and the administration of Virginia's regulatory statutes." ■

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*Borden Ellis, the out going Newsletter Editor,  
is an associate with LeClair Ryan.*

# Local Review of Utility Elections to Join RTOs: A Tale of Two States

*[Editor's Note: The following account of AEP's efforts to find a permanent RTO home and the interplay of Virginia and Kentucky concerns regarding cost and reliability impacts to local consumers has proved a cliffhanger. As this issue was going to press, a possible settlement was being considered that could stave off a full-blown court battle. In the article below, the author traces the major issues underlying the controversy and how the conflicting viewpoints and overlapping Federal and state jurisdictional claims shaped the debate. At the end, he briefly reviews an August 30, 2004 order of the SCC that did, in fact, accept the settlement and conditionally authorized AEP's participation in the PJM RTO.]*

## A. Introduction.

For Virginia, it certainly wasn't the best of times when the Federal Energy Regulatory Commission ("FERC") held, in a June 17 order, that the Virginia State Corporation Commission ("SCC") could have very little further say-so regarding whether AEP-Virginia<sup>1</sup> should join PJM,<sup>2</sup> a Regional Transmission Organization ("RTO"). Believing that the SCC had a jaundiced view of the issue, and was bottling up AEP's application for state approval as a result, FERC concluded it was time to wield a potent but seldom-used club: Section 205(a) of the 1978 PURPA legislation.<sup>3</sup> Section 205(a) says, in essence, that if a utility voluntarily elects to engage in coordination or "power pooling" with other utilities to obtain economic efficiencies and a state's laws or regulatory actions are impeding that end, FERC may trump the state's opposition by *exempting* the utility from having to satisfy the relevant state requirements. Virginia's sister state to the west, Kentucky, was likewise caught in the cross-hairs of PURPA Section 205(a) as a consequence of its questioning, halting review of AEP-Kentucky's plans to join the RTO. On the eve of a state hearing this spring, however, the Kentucky Public Service Commission ("KPSC"), AEP, and PJM struck a deal that would allow AEP-Kentucky to go forward with PJM under stipulated conditions.

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Hence, Kentucky elected to avert a head-on collision with FERC over a state's jurisdiction to weigh RTO participation, while Virginia continued to barrel down that path. On July 16, the Virginia parties<sup>4</sup> filed a request for rehearing that registered their continuing strong disagreement with FERC's use of Section 205(a) to shut down state proceedings. At bottom, what was at stake was the legal scope of *any* state's ability to independently review the merits, or compare costs against benefits (for that state's consumers), of a local utility's proposal to join a regional RTO. Joining an RTO means stepping up the level of coordinated operations, transactions, and long-range planning with other utilities, often in other states.<sup>5</sup> And joining PJM -- an RTO which, as FERC recommends, uses centralized, bid-based markets to set short-term energy prices and related transmission congestion and balancing charges -- also means allowing market forces to become increasingly important factors in determining the electricity costs consumers ultimately pay (although the nature and degree of that impact is itself a complex and debatable subject). Finally, RTO membership ushers in a new, still-evolving relationship between state commissions and their increasingly empowered counterpart, FERC -- as historically state-regulated utilities cede significant parts of their operational and planning roles to the federally-regulated RTO.<sup>6</sup>

— continued on page 16



1. American Electric Power's (AEP) subsidiary Appalachian Power Company does business as "AEP-Virginia," which name will be used throughout the course of this article.

2. PJM Interconnection has provided power pooling services for many years primarily in (as the acronym implies) the states of Pennsylvania, New Jersey, and Maryland (plus the District of Columbia), although it became a FERC-approved RTO only in 2002. When FERC shut down the Alliance RTO formation effort, formerly Alliance-bound utilities in several states to the south and west of the historic PJM footprint sought PJM membership. These include certain utilities serving in Virginia and Kentucky -- more particularly, for purposes of this article, AEP's operating subsidiaries AEP-Virginia and AEP-Kentucky.

3. Public Utility Regulatory Policies Act of 1978 ("PURPA"), 16 USC § 824a-1(a)(2000).

4. These parties include, in addition to the SCC, the Governor and the Attorney General of Virginia.

5. It is important to understand that, at the most basic level, joining an RTO means transferring "operational control" of the transmission system to the RTO. But there is no clear dividing line between generation and transmission, when it comes to the functions of an RTO. FERC's prevailing economic theory is that transmission charges should reflect "congestion costs" -- which, in turn, reflect any differential between the market prices of generation at the "source" of the transaction and the "sink" (where it is consumed). Also, FERC expects the RTO, as "Transmission Provider," to coordinate via markets the supply of load balancing and other "ancillary services" based on market prices. And FERC strongly encourages RTOs to organize centralized, short-term (or "spot") energy markets to meet a portion of fluctuating local needs. Hence, what begins as coordinated *transmission* takes on numerous market-based generation aspects.

6. The extent to which market-based rates might displace cost-based rates could vary significantly depending on the retail industry structure the state legislature has chosen. States in the historic PJM footprint have already opted for competitive (*i.e.*, market-based) retail rates -- meaning PJM's centralized (and bilateral) wholesale markets will have a lot to do with ultimate ratepayer costs. Kentucky has thus far retained a regulated, cost-based model, meaning PJM's wholesale markets should have a much less sweeping effect on retail rates (though market-based *ancillary services* and *congestion charges*, which are components of transmission charges, can impact ultimate retail rates even in Kentucky). Virginia, like the original PJM states, has legislatively chosen competitive retail markets, meaning that, for systems that join PJM, PJM's centrally organized markets will eventually become significant drivers, along with bilateral markets, of ultimate costs. However, Virginia has built in a long transition period before competitively determined rates become the *sole* choice for consumers.

# The State Corporation Commission's Rules of Practice and Procedure

## Where, Among Other Things, 14 is More Than 16

The State Corporation Commission's ("Commission") current Rules of Practice and Procedure ("Rules") became effective June 1, 2001. This article touches on a few of the more interesting aspects of the Rules, including: (i) different rules for different types of cases; (ii) certification of matters to the Commission; (iii) limitations on correcting or updating the record; and (iv) waiver of the Rules.

It is important to remember that the Commission exercises broad jurisdiction. For example, some of the matters before the Commission are legislative, others are judicial. Consequently, the Commission's Rules provide for three types of proceedings: regulatory, adjudicatory, and other. Each type of proceeding has a different set of rules. In regulatory proceedings under 5 VAC 5-20-80, interested parties may enter the case by filing a notice of participation.<sup>1</sup> Public witnesses may appear in these cases, but they may not be parties or otherwise participate in the proceeding, nor can they be included on the service list.<sup>2</sup> In addition, the Commission Staff ("Staff") may participate in regulatory proceedings.<sup>3</sup> If Staff files testimony, exhibits, or a report, Staff must provide a copy of its working papers for public inspection by filing copies of its working papers with the Clerk of the Commission.<sup>4</sup>

Adjudicatory proceedings under 5 VAC 5-20-90 begin with a motion from Staff or the Commission and the issuance of a rule to show cause.<sup>5</sup> Answers must be filed within 21 days, unless otherwise ordered by the Commission.<sup>6</sup> In adjudicatory proceedings and when sitting as a court of record, "the common law and statutory rules of evidence shall be as observed and administered by the courts of record of the Commonwealth."<sup>7</sup> Further, there are special discovery rules for adjudicatory proceedings which permit: (i) discovery of materials in possession of Staff, (ii) depositions, and (iii) requests for admissions.<sup>8</sup>

Other proceedings under 5 VAC 5-20-100 include the

promulgation of general orders, rules, and regulations,<sup>9</sup> and petitions by persons having a cause before the Commission against a defendant, including the Commission or Staff.<sup>10</sup> Other proceedings also include petitions for a declaratory judgment.<sup>11</sup> Proceedings under 5 VAC 5-20-100 A have the distinction of being the only cases in which briefs may be filed by right.<sup>12</sup> Also, the Rules do not provide for interrogatories and requests for production of documents in proceedings under 5 VAC 5-20-100 A and C.<sup>13</sup>

Certification of issues to the Commission by a hearing examiner is provided in 5 VAC 5-20-120 B. Generally the Rule requires certification of rulings that deny further participation by a party in interest or the Staff. Further, the Rule permits an examiner to certify "any other material issue . . ." Defining the meaning of "other material issue" has been at the heart of rulings dealing with the application of this Rule. For example, the following language appears in an examiner's ruling which denied certification to the Commission of a discovery issue:<sup>14</sup>

A hearing examiner may certify only *other material issues*. As used here, an *other material issue*, like denying further participation, refers to an issue that has a direct bearing on the outcome or the conduct of a case. From a practical perspective, a ruling

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1. 5 VAC 5-20-80 B.
2. 5 VAC 5-20-80 C.
3. 5 VAC 5-20-80 D.
4. 5 VAC 5-20-270.
5. 5 VAC 5-20-90 A.
6. 5 VAC 5-20-90 B.
7. 5 VAC 5-20-190.
8. 5 VAC 5-20-280.
9. 5 VAC 5-20-100 A.
10. 5 VAC 5-20-100 B.
11. 5 VAC 5-20-100 C.
12. 5 VAC 5-20-200.
13. 5 VAC 5-20-260.

14. *Application of Virginia Electric and Power Company D/B/A Dominion Virginia Power, For a certificate of public convenience and necessity for facilities in Loudoun County: Beaumeade-Beco 230 kV Transmission Line and Beaumeade-Greenway 230 kV Transmission Line*, Case No. PUE-2001-00154, Hearing Examiner's Ruling at 2 (August 16, 2001).

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# The State Corporation Commission's Rules *(continued from page 3)*

on such an issue serves to decide the case. Rarely, if ever, would a discovery issue rise to the level of materiality envisioned in this rule (emphasis in the original).

The Rules contain provisions that limit correcting or updating the record after the completion of the hearing. Specifically, among other things, 5 VAC 5-20-240 provides: "With leave of the Commission and unless a timely objection is made, the Commission staff or a party may correct or supplement any prepared testimony and exhibits before or during the hearing. In all proceedings, all evidence must be verified by the witness before introduction into the record . . ." This language was used to exclude information offered as evidence after the close of a hearing, where the new information was offered to update financial information already in evidence.<sup>15</sup>

One major difference between the current Rules and those that were replaced is that 5 VAC 5-20-10 permits the Commission to waive or modify its Rules "to serve the ends of justice." Rule 5 VAC 5-20-220, which relates to petitions for rehearing or reconsideration, is the one exception to this Rule. Two examples in which the Commission used 5 VAC 5-20-10 to waive its Rules are Case No. PUC-2002-00088<sup>16</sup> and Case No. PUE-2002-00249.<sup>17</sup> In the first case, the Commission stated, "Although we find no bar to intervention under 5 VAC 5-20-100 B, we will, . . . invoke the provisions of 5 VAC 5-20-10 to waive any such limitation because of the important public policy issue concerning . . . policies and practices in provisioning DS-1 UNE loops."<sup>18</sup> In the second case, the Commission waived its Rules to permit discovery in a declaratory judgment case to clarify disputed facts.<sup>19</sup>

In conclusion, I commend the Rules to everyone that practices before the Commission. If there is any doubt about the need to review the Rules frequently, Rule 5 VAC 5-20-140 should be brought to mind. This Rule states: "When a period of fifteen days or fewer is permitted to make a filing . . . , intervening weekends or holidays shall not be counted in determining the due date." Thus, under the Commission's Rules, a fourteen-day period (*i.e.*, fourteen business days) is longer than a sixteen-day period (*i.e.*, sixteen calendar days). ■



- 15. *Application of Virginia-American Water Company, For a general rate increase*, Case No. PUE-2002-00375, Hearing Examiner's Ruling (February 26, 2003).
- 16. *Petition of Cavalier Telephone, LLC, For injunction against Verizon Virginia Inc. for violations of Interconnection Agreement and for expedited relief to order Verizon to Provision Unbundled Network Elements in Accordance with the Telecommunications Act of 1996*, Case No. PUC-2002-00088, Order Granting Interventions (November 26, 2002).
- 17. *Petition of Montvale Water, Inc., For declaratory judgment*, Case No. PUE-2002-00249, Order (August 9, 2002).
- 18. Case No. PUC-2002-00088, Order Granting Interventions at 3.
- 19. Case No. PUE-2002-00249, Order at 2.

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# The Liberalization of Standing in Virginia after *State Water Control Board v. Crutchfield*

The federal government had to resort to threats to get the Virginia General Assembly to loosen the state's restrictive judicial review requirements for environmental permitting actions. Still, the General Assembly did not make the changes without a struggle.<sup>1</sup> In the end, Virginia lost its fight. In 1996 the General Assembly adopted an amended standing provision<sup>2</sup> that brings the state's water permitting programs in line with federal law by granting standing if the requirements of Article III of the United States Constitution are met.<sup>3</sup>

The Virginia Supreme Court had its first opportunity to interpret the amended standing provision in *State Water Control Board v. Crutchfield*<sup>4</sup> and used this opportunity to liberalize standing for parties wishing to challenge environmental permitting decisions made by state agencies.

## I. The Amended Standing Provision

According to the CWA, "the discharge of any pollutant by any person shall be unlawful."<sup>5</sup> The CWA does allow for such discharges, but only with a permit. The Environmental Protection Agency ("EPA") generally issues these permits, called National Pollutant Discharge Elimination System ("NPDES") permits;<sup>6</sup> however, the EPA has granted Virginia and several other states the authority to manage their own permitting systems pursuant to the CWA.<sup>7</sup> Virginia's permits are known as Virginia Pollutant Discharge Elimination System ("VPDES") permits.

Virginia has established a set of laws, the State Water Control Law, which guide the state's Department of Environmental Quality ("DEQ") in permitting decisions.<sup>8</sup> This law contains a judicial review provision that determines whether a party has standing to challenge a state permitting decision.<sup>9</sup>

The EPA granted Virginia the authority to administer its VPDES permitting system even though, at the time, it was much more difficult to obtain standing under Virginia law than it was under federal law.<sup>10</sup> Because of Virginia's very stringent standing requirements, the EPA later increased the standards a state must meet to manage their own permitting system.<sup>11</sup> One of the changes

was to mandate that states relax their standing provisions so that they resemble the standing requirements under the CWA.<sup>12</sup> A state's authority to administer its own permitting system can be taken away by the EPA if the state doesn't grant standing where it would be provided under federal law.<sup>13</sup>

Virginia challenged these new standing requirements in federal court, but ultimately lost.<sup>14</sup> The General Assembly then made the required changes in order to retain control over the VPDES permitting process.<sup>15</sup>

Prior to the recent amendments to the State Water Control Law, Virginia's law essentially limited standing to the "owner aggrieved." Virginia courts had found that this entitled only the permittee to judicial review.<sup>16</sup> The amended version of the State Water Control Law significantly expands standing to challenge VPDES permitting decisions to bring Virginia law in line with federal law. This amended provision determined standing in the *Crutchfield* case.

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1. See *Commonwealth v. Browner*, 80 F.3d 869 (4th Cir. 1996), cert. denied, 519 U.S. 1090 (1997). See also Henry R. Pollard, V, *Annual Survey of Virginia Law, Environmental Law*, 30 UNIV. OF RICHMOND L. REV. 1393, 1427-30 (1996) (discussing the *Browner* case).

2. Act of April 17, 1996, ch. 1032, 1996 Va. Acts 1412.

3. Compare VA. CODE ANN. § 62.1-44.29 (Michie 1950 as amended) (Virginia's standing provision), to Clear Water Act ("CWA") §509(b)(1), 33 U.S.C. § 1369(b)(1) (standing provision under the CWA). The CWA provision broadens the categories of injuries that may be used to support standing from what is normally required under federal law by granting standing to "any interested person," yet the minimal requirements of Article III of the U.S. Constitution must still be met.

4. 265 Va. 416, 578 S.E.2d 762 (2003).

5. CWA § 301(a), 33 U.S.C. § 1311(a).

6. See CWA § 402(a), 33 U.S.C. § 1342(a).

7. Currently all States except Alaska, Idaho, Massachusetts, New Hampshire, and New Mexico manage their own permitting systems. The District of Columbia also does not have control of its permitting system. See National Pollutant Discharge Elimination System State Program Status (April 14, 2003), available at <http://cfpub2.epa.gov/npdes/statstats.cfm>. The power for EPA to delegate permitting authority is granted by CWA § 402(b), 33 U.S.C. § 1342(b).

8. VPDES permitting decisions are actually made by an appointed panel, the State Water Control Board, but both the DEQ and the State Water Control Board are referred to as "the DEQ" since that is the agency that oversees the VPDES permitting program.

9. VA. CODE ANN. § 62.1-44.29.

10. Virginia's VPDES permitting program was approved by the EPA on March 31, 1975. See Memorandum of Understanding Regarding Permit and Enforcement Programs between the State Water Control Board and the Regional Administrator, Region III, EPA (on file with the EPA or the DEQ). The applicable standing provision at that time was VA. CODE ANN. § 62.1-44.29 (Repl. Vol. 1973). This provision only granted standing to the "owner aggrieved."

11. See Amendment to Requirements for Authorized State Permit Programs Under Section 402 of the Clean Water Act, Fed. Reg. 14,588 (1995) (codified at 40 C.F.R. pt. 123.30) (proposed Mar. 17, 1995).

12. See 40 CFR § 123.30.

13. See CWA § 402(c)(3), 33 U.S.C. § 1342(c)(3).

14. *Commonwealth v. Browner*, 80 F.3d 869 (4th Cir. 1996), cert. denied, 519 U.S. 1090 (1997).

15. See VA. CODE ANN. § 62.1-44.29 (Repl. Vol. 2001 & Cum. Supp. 2003) (Virginia standing provision in the State Water Control Law). The state's air and waste permitting statutes were similarly revised. See VA. CODE ANN. § 10.1-1457(B) (Repl. Vol. 1998 & Cum. Supp. 2003) (revised judicial review provision in the Waste Management Act) and § 10.1-1318(B) (Repl. Vol. 1998) (revised judicial review provision in the Air Pollution Control Act).

16. See, e.g. *Env'tl. Defense Fund v. Va. State Water Control Bd.*, 12 Va. App. 456, 463, 404 S.E.2d 728, 732 (1991), reh'g en banc denied.

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# Commission Holds that Transfer of Certain Utility-Type Assets Not Subject to Approval Requirements of the Utility Transfers Act

Upon motion of the Virginia State Corporation Commission ("Commission") Staff, in *Application of the Joline K. Gleaton Family Trust, et al., for authority to transfer utility assets under Chapter 5 of Title 56 of the Code of Virginia*, Case No. PUE-2004-00005, the Commission recently dismissed an application to transfer utility assets pursuant to the Utility Transfers Act, Chapter 5 of Title 56 of the Code of Virginia, finding that the transfer did not require Commission approval. The assets to be sold were a mobile home park which included four parcels of real estate, certain easements and improvements, and water and sewerage systems providing service to tenants of the park. The water system consisted of three wells, a 5,000 gallon pressure tank, a distribution system, and a greensand filtration system to serve 133 connections. The sewerage system was a gravity fed underground collection system with treatment facilities and authorized to discharge 19,800 gallons of treated effluent per day. The mobile home park did not bill separately for the water or sewerage service, but rather charged only a rental charge for each lot.

The Commission Staff filed a motion to dismiss the application, arguing that the legislature never intended such a broad interpretation of the Utility Transfers Act as to require Commission approval of the transaction. Staff also noted that

there was no "sale" of water and sewerage service and that numerous businesses would arguably fall within the jurisdiction of the Commission should this application require approval under the Utility Transfers Act.

The Commission agreed and dismissed the application, stating that "[o]ur jurisdiction under the Utility Transfers Act is limited to those transactions where a 'public utility' transfers 'utility assets' to another company." The Commission reasoned that the mobile home park was not a public utility selling water and sewerage service to the public as that business relationship is currently understood. The Commission conceded that the facilities used to provide water and sewerage services were comparable to facilities operated by public utilities in the Commonwealth, but determined that the "fundamental nature" of Applicants' type of business is entirely different from the "traditional business model of a public utility." The Commission stressed that the provision of water and sewerage services was "merely incidental" to the company's primary business of renting mobile home lots. The Commission concluded that, under the circumstances, there was "no mercantile relationship" between a public utility and customers which would trigger the approval requirements of the Utility Transfers Act.

This decision should provide comfort to hotels, shopping centers, camp grounds, marinas, hospitals and a host of other businesses with central and sewerage systems that provide service free of charge and which is incidental to the company's primary business. ■

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## SUBMIT AN ARTICLE AND GET A CHANCE AT FREE CLE

*All individuals submitting articles will have their names placed in a drawing for a free registration for the National Regulatory Conference or the Virginia State Bar Annual Meeting. Names are drawn for each edition of the Administrative Law News. This edition's winner is Kiva Pierce. If interested, please contact Brian Greene at (804) 691-4155 or at [bgreene@cblaw.com](mailto:bgreene@cblaw.com).*

## The Liberalization of Standing in Virginia *(continued from page 5)*

The amended statute retains standing for "owners aggrieved;"<sup>17</sup> however, the amended law allows for parties besides the permittee to also obtain the standing necessary to contest VPDES permits. For a party other than the "owner aggrieved" to obtain standing, that person must meet two requirements. First, the party must have participated in the public comment process regarding the final decision of the State Water Control Board that is being challenged. Second, the challenging party must meet the standards for review established under Article III of the United States Constitution.

The requirements for Article III standing are set forth in the statute as follows:

A person shall be deemed to meet such standard if (i) such person has suffered an actual or imminent injury which is an invasion of a legally protected interest and which is concrete and particularized; (ii) such injury is fairly traceable to the decision of the Board and not the result of the independent action of some third party not before the court; and (iii) such injury will likely be redressed by a favorable decision by the court.<sup>18</sup>

### II. Interpretations of Article III Requirements

Despite tightening standing requirements in cases throughout the 1990s,<sup>19</sup> the federal courts are now quite liberal in granting standing in environmental permitting cases.<sup>20</sup> The federal liberalization of standing began with the U.S. Supreme Court's decision in *Friends of the Earth v. Laidlaw*.<sup>21</sup>

The *Laidlaw* case was a huge victory for environmentalists.<sup>22</sup> There the Court considered Article III standing requirements, spoke specifically to "environmental cases," and said a plaintiff need merely establish his personal use of the area and that he is a person "for whom the aesthetic and recreational values of the area will be lessened" by the agency's actions.<sup>23</sup> However, even in *Laidlaw*, the Court held that for purposes of Article III standing it is not sufficient to merely allege injury to the environment. Instead, there must be injury to the party challenging the agency's action.<sup>24</sup>

The *Crutchfield* case was the Supreme Court of Virginia's first opportunity to interpret Virginia's new standing provision. The controversy in *Crutchfield* began when Hanover County sought a VPDES permit to build a wastewater treatment plant that would

dump up to ten million gallons of wastewater per day into the Pamunkey River. The wastewater was to discharge into the river approximately fifty yards upstream from Frances Broaddus Crutchfield's and Henry Ruffin Broaddus's boat ramp and picnic-swimming area.<sup>25</sup> Mr. Broaddus and Mrs. Crutchfield opposed the issuance of this permit and filed a legal challenge when the permit was granted by the DEQ.<sup>26</sup>

Though Mr. Broaddus and Mrs. Crutchfield clearly alleged injury to the public's recreational interest in their initial petition, one of the major issues in the circuit court and on appeal was whether they sufficiently alleged interference with their own recreational use of the river so as to confer standing. The only claim of harm to Mr. Broaddus and Mrs. Crutchfield personally was contained in a letter they had submitted during the public comment process and attached to their petition. This letter stated that the area downstream from the proposed discharge had been used for recreation for many years and that "[t]hose using this area are not limited to the property owners."<sup>27</sup>

The circuit court did not find sufficient allegations of harm to Mr. Broaddus's and Mrs. Crutchfield's recreational interests to confer standing and refused to grant them leave to amend their petition to include more particularized claims of injury related to their recreational interests.<sup>28</sup>

The Court of Appeals reversed, finding that the original petition "sufficiently alleged the elements of standing."<sup>29</sup> The court based standing on Mr. Broaddus's and Mrs. Crutchfield's status as riparian owners as well as the harm to their recreational interests.<sup>30</sup>

The Supreme Court of Virginia upheld the Court of Appeals'

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17. VA. CODE ANN. § 62.1-44.29.

18. *Id.*

19. See *Lujan v. National Wildlife Federation*, 497 U.S. 871 (1990) (holding that recreational and aesthetic use of land near an affected area was not a sufficient basis for standing); *Lujan v. Defenders of Wildlife*, 504 U.S. 555 (1992) (holding that a future intent to visit an affected area was too speculative to confer standing).

20. See *Friends of the Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc.*, 528 U.S. 167 (2000).

21. *Id.* See also Edgar B. Washburn, *Courts Go Too Far in Allowing Environmental Citizen Suits*, TOXIC CHEMICALS LITIG. REP. (August 24, 2001) (discussing the tightening of standing requirements by the United States Supreme Court and the impact of the *Laidlaw* decision on this trend).

22. See Channing J. Martin, *Supreme Court Spells Relief for Environmental Groups*, VA. ENVTL. COMPLIANCE UPDATE (March 2000).

23. *Laidlaw Envtl. Servs. (TOC), Inc.*, 528 U.S. at 183, quoting *Sierra Club v. Morton*, 405 U.S. 727, 735 (1972).

24. *Id.* at 181.

25. *State Water Control Board v. Crutchfield*, 265 Va. 416, 422, 578 S.E.2d 762, 765 (2003).

26. *Crutchfield v. State Water Control Board*, 55 Va. Cir. 92, 94-95 (2001).

27. *Crutchfield*, 265 Va. at 422, 578 S.E.2d at 765.

28. The circuit court did grant Mr. Broaddus and Mrs. Crutchfield leave to amend their petition to add a "necessary party," Hanover County. At this time Mr. Broaddus and Mrs. Crutchfield also attempted to add more detailed allegations of injury to their recreational interests but these changes were stricken. The court's decision to grant leave to amend to allow the addition of Hanover County was also heavily contested, but is outside the scope of this article.

29. *Crutchfield v. State Water Control Board*, 2002 Va. App. LEXIS 206, 9 (unpublished).

30. *Id.* at 13-15.

## The Liberalization of Standing in Virginia *(continued)*

finding and ruled that Mr. Broaddus and Mrs. Crutchfield had standing based on their rights as riparian owners and because "allegations and evidence of injury to their recreational interests and use of the river established that they met all three requirements of Article III standing" as required under Virginia law.<sup>31</sup>

Of course, since Mr. Broaddus and Mrs. Crutchfield are not the permittee, they are not "owners aggrieved."<sup>32</sup> Therefore, it was necessary that they meet the alternative requirements for standing under the State Water Control Law. There was no question that Mr. Broaddus and Mrs. Crutchfield had participated in the public comment process. They had both spoken at the public hearing on the permit and had submitted written comments to the DEQ. Thus, arguments before the court focused on whether Mr. Broaddus and Mrs. Crutchfield met the Article III requirements, and more specifically, whether they had suffered "an actual or imminent injury" to meet the injury-in-fact requirement of Article III.

Mr. Broaddus's and Mrs. Crutchfield's status as riparian owners made the case easy. Under Virginia common law riparian owners have the right to make reasonable use of the water that adjoins their land.<sup>33</sup> The *Crutchfield* court found that the ability to enjoy the recreational and aesthetic advantages of the property is included in this right.<sup>34</sup>

### III. The Court's Other Opinions

#### A. Options for Avoiding an Expansion of Standing

The Virginia Supreme Court could have easily let their decision in *Crutchfield* rest on the holding that riparian owners meet the injury-in-fact requirement of Article III. To leave the case here would have restricted its precedential value and limited the persons who are entitled to standing in environmental cases. Significantly, the court decided to go much further than this, treating the Broaddus's status as riparian owners almost as a side note.<sup>35</sup> The court goes on to relax standing to such a great extent that the door is open for anyone who has a "recreational interest" to obtain standing.

Surprisingly, prior to the *Crutchfield* case, it was not even well established that riparian owners had the right to challenge the issuance of VPDES permits.<sup>36</sup> In extending standing to riparian owners, the court did more than it had to do, and likely more than the General Assembly hoped it would do. It would have been difficult for the *Crutchfield* court to follow the amended State Water Control Law without granting standing to at least riparian owners, but it did not have to include language in its opinion suggesting that anyone with a recreational interest is

entitled to standing. However, even if the court had avoided a relaxation of standing in *Crutchfield*, it would have been difficult for the court to avoid the expansion of standing in future cases.

The *Crutchfield* court could also have easily avoided a decision that relaxed standing to the extent that this decision did. The *Crutchfield* case involved additional issues that could have allowed the court to avoid a decision based on an interpretation of the amended judicial review provision of the State Water Control Law.

For example, the issue of whether it is sufficient for standing purposes to simply allege injury-in-fact, or whether the injuries alleged must be supported by adequate evidence arose in *Crutchfield*.<sup>37</sup> Under federal law, it is not enough to merely allege an injury; instead the injury must be supported by ample evidence.<sup>38</sup> Moreover, federal cases have found that the injury must not be hypothetical.<sup>39</sup>

The *Crutchfield* court could have easily found any harm to Mr. Broaddus and Mrs. Crutchfield to be purely hypothetical since they had not been injured by the time of the lawsuit. The court could have also found that the harm was not adequately supported by the facts. It would have been easy for the court to follow the lead of the circuit court and to use the proof of injury requirement to avoid granting standing in this case.<sup>40</sup> The court took a big step in choosing not to ignore the standing issue.

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31. *Crutchfield*, 265 Va. at 427-28; 578 S.E.2d at 764. The court did not need to reach the issue of whether Mr. Broaddus and Mrs. Crutchfield should have been granted leave to amend their petition to add allegations of injury because they found that the original petition included sufficient allegations of injury to confer standing, but the court noted that the denial of a request to amend a petition must be supported by the record and there is nothing on the record to support the denial. *Id.* at 425.

32. Hanover County is the permittee and thus the "owner aggrieved" in *Crutchfield*.

33. See *Carr v. Kidd*, 261 Va. 81, 95, 540 S.E.2d 884, 892-93 (2001); *Thurston v. City of Portsmouth*, 205 Va. 909, 911-12, 140 S.E.2d 678, 680 (1965); *Taylor v. Commonwealth*, 102 Va. 759, 47 S.E. 875, 880-81 (1904).

34. *Crutchfield*, 265 Va. at 427, 578 S.E.2d at 768.

35. The court stated, "We also note that the location of the petitioners' farm is relevant to the present standing inquiry." *Crutchfield*, 265 Va. at 427, 578 S.E.2d at 768. In fact, the location of the farm alone could have decided the standing issue.

36. See *Envtl. Defense Fund v. Va. State Water Control Bd.*, 12 Va. App. 456, 463, 404 S.E.2d 728, 732 (1991), *relig en banc denied* (denying standing to an environmental group suing on behalf of members who were riparian owners and used the receiving waters for recreational purposes). This is the only case besides *Crutchfield* where a Virginia court has discussed riparian owner status when considering standing in an environmental permitting action.

37. The circuit court dismissed the case after finding that although Mr. Broaddus and Mrs. Crutchfield had averred sufficient harm to provide them with standing, they had not adequately proved standing. *Crutchfield v. State Water Control Board*, 55 Va. Cir. 92, 94 (2001).

38. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 561 (1992) (citing *Lujan v. National Wildlife Federation*, 497 U.S. 871, 883-89; *Gladstone Realtors v. Vill. of Bellwood*, 441 U.S. 91, 114-15 (1979); *Simon v. E. Ky. Welfare Rights Org.*, 426 U.S. 26, 45, n. 25 (1976); *Warth v. Seldin*, 422 U.S. 490, 527, and n.6 (1975)) (discussing Article III standing requirements and stating "[s]ince they are not mere pleading requirements but rather an indispensable part of the plaintiff's case, each element must be supported in the same way as any other matter on which the plaintiff bears the burden of proof, i.e., with the manner and degree of evidence required at the successive stages of the litigation").

39. *Id.* at 560.

40. *Crutchfield*, 265 Va. at 427, 578 S.E.2d at 768 (2003) (citing *Lujan*, 504 U.S. at 561; *Pye v. United States*, 269 F.3d 459, 467 (4th Cir. 2001) (stating "[the] components of Article III standing are not merely requirements of pleading, but must be supported by adequate evidence"). See *Lujan*, *supra*, at note 55.

## The Liberalization of Standing in Virginia *(continued)*

Also of concern in this case was whether Mr. Broaddus and Mrs. Crutchfield had even sufficiently alleged standing in their initial petition. The circuit court did not even consider allegations of standing based on recreational or aesthetic interest because it found that these allegations were not sufficiently pleaded in the petition. The Virginia Supreme Court could have also utilized this escape route, but once again, they declined.

### B. Options Allowing for More of an Expansion of Standing

There is no question that the *Crutchfield* court had the support of federal court decisions in determining that a recreational interest alone is sufficient to confer standing. It is also clear that federal case law would have permitted the Virginia Supreme Court to go further than it did in its expansion of standing.<sup>41</sup>

The *Crutchfield* court discussed harm to recreational and aesthetic interests as a means of obtaining standing, yet this discussion was only dicta since the holding was based on Mr. Broaddus's and Mrs. Crutchfield's rights as riparian owners.<sup>42</sup> The court also made certain to cite Virginia common law that confers special rights "to enjoy the recreational and aesthetic advantages" that go along with being a riparian owner to support its decision.<sup>43</sup> Therefore, the decision is not binding in cases where the standing of persons who are not riparian owners is at issue.

The *Crutchfield* case invited a decision on whether harm to the recreational or aesthetic interests of members of the public who used the affected area, but who were not riparian owners, was sufficient to confer standing. Mr. Broaddus's and Mrs. Crutchfield's petition challenging the DEQ's decision on the permit was somewhat ambiguous. The petition did not specifically state that Mr. Broaddus and Mrs. Crutchfield used the river for recreational purposes. Rather, the petition alleged harm to all persons with a recreational interest in the use of the river. Attached to the petition was a comment letter stating that "[t]hose using this area are not limited to the property owners."<sup>44</sup>

The petition was certainly ambiguous enough to open the door for the court to at least comment on the ability of someone besides a riparian owner to obtain standing based on their recreational interest; however, the Virginia Supreme Court declined to relax standing anymore than they already had. Thus, the court failed to go as far as the U.S. Supreme Court went in *Laidlaw*.

Significantly, according to Virginia case law, when a case arises that requires that the issue be addressed, the state's courts should interpret Article III as broadly as have the federal courts.<sup>45</sup> In this case

the Virginia Supreme Court may not have gone as far as the federal courts have gone, but the issue is likely to arise again in the near future and at that time the court should relax standing to the extent that the *Laidlaw* Court did. The *Crutchfield* court moved in this direction by leaving open the possibility that recreational and aesthetic interests alone are sufficient to confer standing.<sup>46</sup> According to the EPA, if Virginia fails to grant standing to the extent that it is granted under the CWA, then Virginia may be stripped of the authority to administer its VPDES permitting system.<sup>47</sup>

### IV. Conclusion

The court had many options in writing the *Crutchfield* opinion. The route they chose certainly expanded standing more than was necessary in this particular case. This move is surprising considering the fight the Virginia General Assembly put up when the EPA forced it to change the standing provision in the State Water Control Law. However, the Virginia Supreme Court likely realized that they could not avoid the issue forever and that eventually they would have to relax standing in accordance with the amended statute. The court could have also extended standing further than they did, thus encompassing more potential citizen suit plaintiffs. The court did not choose the most liberal route, but they did leave the door open for this option in the future and have begun to pave the way for standing based on recreational and aesthetic interests alone. ■



41. See generally, *Friends of the Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc.*, 528 U.S. 167 (2000). See also *Ecological Rights Found v. Pac. Lumber Co.*, 230 F.3d 1141 (9th Cir. 2000) (applying *Laidlaw* and granting standing where the plaintiff had a recreational interest in the affected area but did not have regular or continuous contact with the area); *Friends of the Earth v. Gaston Copper Recycling* 204 F.3d 149 (4th Cir. 2000) (holding that plaintiffs' fear of harm to their recreational interests because of defendant's discharges into a waterway used by plaintiffs was sufficient to grant standing); Edgar B. Washburn, *Courts Go Too Far in Allowing Environmental Citizen Suits*, TOXIC CHEMICALS LITIG. REP. (August 24, 2001) (stating that after *Laidlaw* "concerns" about discharges and "beliefs" about the impact of those discharges are sufficient harm to meet the Article III injury-in-fact requirement).

42. For example, the court found that Mr. Broaddus and Mrs. Crutchfield would suffer an imminent injury with the granting of the permit because of the "injury to their recreational enjoyment," but the court goes on to note that their harm is to the enjoyment of "their property and the river's resources to which they have a recognized right as riparian owners." *Crutchfield*, 265 Va. at 428; 578 S.E.2d at 768. See also James R. Kibler, Jr., *Annual Survey of Virginia Law: Administrative Law*, 38 U. RICH. L. REV. 39, 52 (2003) (stating that the *Crutchfield* case is "not purely a statutory analysis decision" because it borrows the notion of riparian rights from the common law).

43. See, e.g., *Carr v. Kidd*, 261 Va. 81, 95, 540 S.E.2d 884, 892-93 (2001); *Thurston v. City of Portsmouth*, 205 Va. 909, 911-12, 140 S.E.2d 678, 680 (1965); *Taylor v. Commonwealth*, 102 Va. 759, 773, 47 S.E. 875, 880-81 (1904).

44. *Crutchfield*, 265 Va. at 421, 578 S.E.2d at 765.

45. See *Mattaponi Indian Tribe v. Commonwealth*, 261 Va. 366, 376, 541 S.E.2d 920, 925 (2001) (finding that the judicial review provision of the State Water Control Law "tracks the statements by the United States Supreme Court about standing requirements imposed by the 'case' or 'controversy' provisions of Article III of the U.S. Constitution").

46. Federal courts have granted standing based on recreational and aesthetic interests alone. See *Friends of the Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc.*, 528 U.S. 167 (2000). Moreover, representational standing, where an organization can bring suit on behalf of its members, is available under federal law and arguably is not available under Virginia law. The representational standing issue did not come up in the *Crutchfield* case because the petitioners were private individuals rather than an organization.

47. See *supra* note 14. See also "EPA's Response to EarthJustice's March 12, 2001 Comments on Virginia's Title V Operating Permit System," available at <http://www.epa.gov/air/oaqps/permits/response/va-earthjustice.pdf> (discussing standing in air permitting cases and stating that state programs are required to "provide at least the same opportunity for judicial review of permit actions as would be available in federal court under Article III of the Constitution" and that failure to do so render the state's program "deficient").

# Closing Down the Stables: The "Reason to Believe" Standard and The Virginia Racing Commission

In 1988 the Virginia General Assembly created a racing commission and vested it with "control of all horse racing with pari-mutuel wagering in the Commonwealth, [and] with plenary power to prescribe regulations and conditions...so as to maintain horse racing in the Commonwealth of the highest quality and free of any corrupt, incompetent, dishonest or unprincipled practices and to maintain in such racing complete honesty and integrity."<sup>1</sup>

One way the Virginia Racing Commission seeks to maintain the integrity of horse racing is by strictly regulating its participants. This regulation is achieved through the granting of licenses or permits to the various players, including owners, trainers, jockeys, and the like. When, however, the Commission wishes to suspend or revoke the license or permit of an individual, the Commission need only provide a "reason to believe" that an individual has violated a provision, condition, or regulation of the agency.<sup>2</sup> This standard of proof is questionable because it does not require a finding greater than probable cause, may be incapable of producing decisions that can withstand the "substantial evidence" test upon judicial review, and the standard places little emphasis on the importance of an individual's right to continue in his or her chosen livelihood and profession. Accordingly, the General Assembly may need to reexamine the language of the statute and possibly amend the Virginia Code to require a "preponderance of the evidence" standard when the Virginia Racing Commission engages in disciplinary proceedings involving suspension or revocation of licenses and permits.

## I. The Racing Commission's Power Over Licenses and Permits in Virginia.

In Virginia, all owners and operators of horse racetracks must secure a license before participating in horse racing.<sup>3</sup> Additionally, "no person shall participate in [Virginia] horse racing, including but not limited to a horse owner, trainer or jockey...unless such person possesses a permit from the Commission."<sup>4</sup> In other words, everyone from the owners of the racetracks to the jockeys who ride the horses must either have a license or a permit before taking part in the sport.

The Virginia Racing Commission is exempt from the Virginia

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Administrative Procedure Act ("VAPA")<sup>5</sup> when acting by and through its duly appointed stewards or in matters related to any specific race meeting.<sup>6</sup> Thus, when the Racing Commission decides to suspend or revoke a license or permit, it does so according to its own proscribed rules and regulations. A person who has had a permit or license suspended or revoked by the Commission may seek review of such action in the Circuit Court for the City of Richmond.<sup>7</sup> However, when reviewing an appeal of the Racing Commission's decision, the Circuit Court must comply with Article 5 of the VAPA,<sup>8</sup> and the court must find "substantial evidence" in the record that supports the agency's conclusions.<sup>9</sup>

Before appealing a suspension or revocation decision to the Circuit Court of Richmond, however, a hearing must be conducted by the Commission. It is at this time that the Commission may suspend or revoke any license or permit "in any case where it has reason to believe that" any provision, regulation, or condition of the Commission has been violated.<sup>10</sup>

## II. Procedural Due Process.

The Fourteenth Amendment of the United States Constitution provides, in part: "nor shall any State deprive any person of life, liberty, or property, without due process of law."<sup>11</sup> If a licensee were to challenge the license revocation provision in §59.1-385(A) because of an alleged improper burden of proof standard, questions of procedural due process would be implicated. The two-part test for evaluating an alleged procedural due process violation must then be analyzed. First, has the plaintiff been deprived of a life, liberty, or property interest, and, if so, what process is he or she due?<sup>12</sup>

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1. VA. CODE ANN. §59.1-364(A).

2. See VA. CODE ANN. §59.1-385 and §59.1-390.

3. See VA. CODE ANN. §59.1-387(A) ("no person shall construct, establish or own a horse racetrack or satellite facility where pari-mutuel wagering is permitted" without receiving an owner's license from the commission").

4. *Id.*

5. VA. CODE ANN. §2.2-4000, *et seq.*

6. VA. CODE ANN. §2.2-4002(A)(18). Since "race meeting" includes the whole consecutive period of time during which horse racing with pari-mutuel wagering is conducted by a licensee (see VA. CODE ANN. §59.1-365), the process of suspending or revoking a racing license or permit would seem to fall under this exemption status as well.

7. VA. CODE ANN. §59.1-373 ("Any person aggrieved by the suspension or revocation of a license or permit, the imposition of a fine, or any other action of the Commission, may seek review of such action in Richmond Circuit Court").

8. *Id.*

9. See VA. CODE ANN. §2.2-4027.

10. VA. CODE ANN. §59.1-385(A); see also VA. CODE ANN. §59.1-390.

11. U.S. CONST. amend. XIV, §1.

12. Logan v. Zimmerman Brush Co., 455 U.S. 422, 428 (1982).

## Closing Down the Stables *(continued)*

With respect to the first step of the Due Process analysis, a license issued by the state, which can be suspended or revoked only upon a showing of cause, creates a property interest protected by the Fourteenth Amendment.<sup>13</sup> Since the Racing Commission may not suspend or revoke a valid license or permit unless the Commission has a "reason to believe" that the licensee has violated one of its regulations,<sup>14</sup> a property interest is thus created. Even if the licensee is entitled to procedural due process, however, it must still be determined what procedural safeguards are due the licensee.

### III. The Standard of Proof.

The standard of proof the Racing Commission imposes for revoking a horse racing license or permit is crucial because, should the Commission conclude the evidence meets the established standard, a racing license or permit may be forever lost and the ability to pursue this chosen livelihood and reap the benefits it may supply may no longer exist. As the Supreme Court has articulated, consideration of this deprivation is crucial in regard to alleged denial of due process:

"Once licenses are issued, their continued possession may become essential in the pursuit of a livelihood. . . . In such cases the licenses are not to be taken away without that procedural due process required by the Fourteenth Amendment."<sup>15</sup>

The function of a standard of proof, as that concept is embodied in the Due Process Clause and in the realm of factfinding, is to instruct the factfinder concerning the degree of confidence our society thinks he should have in the correctness of factual conclusions for a particular type of adjudication.<sup>16</sup> With this in mind, it appears as though the "reason to believe" standard imposed by the Virginia Racing Commission for suspending or revoking a racing license or permit may not meet constitutional muster.

To properly evaluate the "reason to believe" standard used by the Commission for suspending or revoking a racing license or permit, it must first be determined where the "reason to believe" standard fits on the standard of proof continuum, and secondly, whether this location is appropriate in a racing license or permit disciplinary proceeding.

### IV. The "Reason to Believe" Standard and Probable Cause.

The "reason to believe" standard imposed by the Commission falls closer to the standard of "probable cause" than any other burden of proof standard. District courts located in the Fourth Circuit have taken the position that "reason to believe" does not meet the level of probable cause. In *Smith v. Tolley*,<sup>17</sup> the District Court for the Eastern District of Virginia held that "reason to believe" was not the equiva-

lent of probable cause. The court remarked that, "it cannot reasonably be thought that the Supreme Court intends to impose a probable cause standard by using the 'reason to believe' language."<sup>18</sup> For the court, the logic of this conclusion was demonstrated by the truism that, when the Court wishes to use the term "probable cause," it knows how to do so.<sup>19</sup> As a result, if the "reason to believe" standard cannot exceed the standard of "probable cause," then it is necessary to understand where this latter standard fits on the standard of proof continuum.

Probable cause, like "reason to believe," is a difficult term to precisely define. In the Fourth Circuit, probable cause is defined as "facts and circumstances within the officer's knowledge that are sufficient to warrant a prudent person, or one of reasonable caution, in *believing* that the suspect has committed, is committing, or is about to commit an offense."<sup>20</sup> If "reason to believe," *at best*, requires a similar standard of reasonableness inherent in probable cause, and if probable cause requires only that a reasonably cautious person have a "belief" that a crime has been committed, then it becomes apparent that the Racing Commission's "reason to believe" standard is an extremely low standard of proof indeed, for a person's livelihood can theoretically be deprived upon a mere "belief" that a person has violated a regulation or rule imposed by the Commission. Accordingly, the argument can be made that a higher standard—proof by a "preponderance of the evidence"—should replace the present "reason to believe" language.

### VI. At a Minimum, the "Preponderance" Standard Should be Used.

#### A. Application of the Preponderance Standard in Other Jurisdictions.

Amending the language in the aforementioned sections of the Virginia Code to require a "preponderance of the evidence" standard would provide increased fairness to licensees and permittees, and would help to legitimize the Commission's decisions.

Since there is no applicable Virginia case law articulating or validating an appropriate standard of proof for disciplinary proceedings conducted by the Virginia Racing Commission, case law from other jurisdictions must be evaluated. *Pelling v. Illinois Racing Board*<sup>21</sup> con-

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13. *Barry v. Barchi*, 443 U.S. 55, 64 (1979); *see also*, *Richardson v. Eastover*, 922 F.2d 1152, 1156 (4th Cir. 1991) (relying on *Barchi* in holding that appellee did not have a property interest in a nightclub license since it had been automatically renewed).

14. *Supra*, note 10.

15. *Bell v. Burson*, 402 U.S. 535, 539 (1971) (emphasis added). In *Bell*, the petitioner was challenging the suspension of a license to operate a motor vehicle.

16. *Addington v. Texas*, 441 U.S. 418, 423 (1979).

17. 960 F.Supp. 977 (E.D. Va. 1997).

18. *Id.* at 987.

19. *Id.*

20. *Pritchett v. Alford*, 973 F.2d 307, 314 (4th Cir. 1992) (emphasis added).

21. 574 N.E.2d 116 (Ill. App. Ct. 1991).

## Closing Down the Stables *(continued)*

cerned the Illinois Racing Board's decision to suspend a jockey's license for six years as a result of the Board's conclusion from the evidence that Pelling fixed a race by intentionally finishing further back in the pack than it appeared he should have. In upholding the six-year suspension, the court held that the Board's finding of proof beyond a *preponderance of the evidence* was sufficient.<sup>22</sup>

Other courts have upheld the sufficiency of the preponderance standard in Racing Commission disciplinary proceedings as well. In *Arkansas State Racing Comm'n v. Sayler*,<sup>23</sup> the Arkansas Racing Commission suspended a jockey who was found, before a race started, to be in possession of a shocking device which was a violation of the Commission's rules and regulations. The Arkansas Supreme Court upheld the Commission's imposition of the suspension, and the concurring opinion noted that the Commission was only required to make findings where the preponderance of the evidence lay.<sup>24</sup> Thus, the "reason to believe" standard used by the Virginia Racing Commission is contrary to the standards delineated by other jurisdictions.

### B. The Preponderance Standard Applied to Other Professions.

Further support for the use of a preponderance standard instead of the "reason to believe" standard is the fact that higher standards of proof are used in suspension and revocation proceedings for other professions. Not one of them uses a standard below the preponderance standard.<sup>25</sup> In *Goad v. Virginia Board of Medicine*,<sup>26</sup> the Court of Appeals of Virginia confronted the Board of Medicine's decision to take disciplinary action against a physician for "unprofessional conduct."<sup>27</sup> The court, assuming that a preponderance of the evidence standard was necessary to establish the doctor's guilt,<sup>28</sup> found no substantial evidence to support the Board of Medicine's decision.<sup>29</sup> In noting the lack of evidence, the Virginia Court of Appeals concluded that there was "no evidence on the record that demonstrated, absent reliance on speculation and pure conjecture, that Goad performed any act likely to deceive, defraud, or harm the public."<sup>30</sup> Thus, in holding the Board of Medicine to proof by a preponderance of the evidence, the court suggested that reliance on "speculation and conjecture" alone would be insufficient to satisfy this burden of proof.

Thus, if a mere belief or speculation, according to the *Goad* court, would not be an adequate basis for suspending a physician's license to practice medicine, it does not follow that a similarly low standard should be used for suspending an individual's racing license or permit. After all, why should a "reason to believe" force a jockey to lose his racing permit, when the same standard would allow a surgeon to continue to operate on patients even though he or she is believed to be acting improperly?

### C. Damage to Reputation and the Message Sent to Others.

Without a racing license, a person wanting to engage in any form of horse racing in Virginia is expressly forbidden from doing so, and is likely forbidden from doing so in any other state which permits regulated thoroughbred racing.<sup>31</sup> Accordingly, suspension or revocation of a racing license or permit may not only deprive an individual of a pecuniary interest, but also may tarnish the person's reputation in Virginia and other states where horse racing is permitted. This is an important consideration.

The New Hampshire Supreme Court, in the case of *In re Preisendorfer*,<sup>32</sup> had the occasion to evaluate the probable cause standard as applied to a situation in which reputation could be damaged and the right to future employment would be severely hindered. The case involved a decision by a hearing panel of the New Hampshire Division for Children, Youth and Families ("DCYF") to add the petitioner's name to the state's sex offender registry. The DCYF had concluded that probable cause existed based on allegations of child sexual abuse and inappropriate touchings, and the petitioner's name was to remain in the registry for seven years.<sup>33</sup> The petitioner was alleged to have sexually abused three of his students. The New Hampshire Supreme Court found that the decision to enter petitioner's name into the registry essentially barred him from working with children, and caused him to become unemployed and unemployable in his profession.<sup>34</sup>

The court concluded that the probable cause standard was insufficient for placing the petitioner on the registry and thereby denying him of his desire to work with children. The court said:

The standard for an action resulting in loss of employment should not place the risk of error entirely on the individual. *[Probable cause] is not justified when it results in a permanent denial of the right to employment* in the childcare field without any consideration of the accuracy of the fact-finding process.<sup>35</sup>

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22. *Id.* at 120 (emphasis added).

23. 462 S.W.2d 472 (Ark. 1971).

24. *Id.* at 478.

25. See, e.g., *Blue v. Seventh Dist. Committee of Virginia State Bar*, 265 S.E.2d 753, 757 (Va. 1980) ("The burden is on the Bar to establish the violation by clear proof"). "Clear proof" has been used interchangeably with "clear and convincing evidence." See *Modley v. Virginia State Bar*, 536 S.E.2d 101, 107 (Va. 2000).

26. 580 S.E.2d 494 (Va. Ct. App. 2003).

27. *Id.*

28. *Id.* at 501 n.10.

29. *Id.* at 502-03.

30. *Id.* at 502.

31. See *National Racing Compact: Frequently Asked Questions: What If I'm Suspended in One State?*, available at <http://www.racinglicense.com/faq.html>.

32. 719 A.2d 590 (N.H. 1998).

33. N.H. REV. STAT. ANN. §169-C: 35(III) (1994).

34. *Id.* at 592.

35. *Id.* (emphasis added).

## Closing Down the Stables (continued)

It is obvious then that the "reason to believe" standard is too minimal for revoking a horse racing license or permit. A person who suffers disciplinary action at the hands of the Racing Commission is likely to encounter a stigma which will prevent that person from engaging in his or her chosen profession for months, years, or in the case of revocation, forever. Additionally, the stigma is not localized because it can, and likely will, prevent a person from engaging in horse racing in any other state. With such risks at stake, the "reason to believe" standard is inappropriate for use in Racing Commission disciplinary proceedings. As the New Hampshire Supreme Court noted in *Preisendorfer*, the probable cause standard places the brunt of the risk of error, if not the entire risk of error, on a person subject to being placed in the central register.<sup>36</sup> The "reason to believe" standard unreasonably places the same burden on persons granted licenses and permits by the Virginia Racing Commission, and likewise subjects them to placement in a similar form of "registry" which makes future engagements in the racing profession virtually impossible.

In essence, the "reason to believe" standard suggests to licensees and the general public as a whole that the private interest involved in a horse racing license is relatively meaningless, and can be permanently revoked based on probable cause. Such a suggestion ignores the premise that a license may often be "essential in the pursuit of a livelihood,"<sup>37</sup> and thus should not be deprived at the "whim of the grantor."<sup>38</sup>

### D. The Commonwealth's Interests.

However, it must be understood that horse racing is a strictly regulated industry.<sup>39</sup> Understandably, Virginia has a legitimate interest in assuring that the racing industry remains untarnished. Imposition of sanctions upon a licensee or permittee serves not only as punishment to the disciplined individual, but also serves as a deterrent to other owners, operators, jockeys, trainers, and the like. By policing the horse racing industry, Virginia ensures that other licensees and permittees will be less likely to violate one of the Commission's rules or regulations in the future.

Furthermore, constitutional challenges to provisions of Racing Commission statutes have generally been unsuccessful when the provision in question is perceived to be directly related to the integrity of racing and gambling, and thus within the state's police power.<sup>40</sup> The Court of Appeals of Florida in *Simmons v. Division of Pari-mutuel Wagering*<sup>41</sup> perhaps best expresses this rationale: "Authorized gambling is a matter over which the state may exercise greater control and exercise its police power in a more arbitrary manner because of the noxious qualities of the enterprise..."<sup>42</sup>

Notwithstanding the valid concerns embraced by the Commonwealth, if the Racing Commission continues to utilize the

"reason to believe" standard, when these decisions are appealed, they may not be able to withstand judicial review.

### E. Judicial Review.

The evidentiary standard of proof an agency utilizes in adjudication is crucial because agency findings are accorded "great deference"<sup>43</sup> by a reviewing court due to the agency's presumed expertise in the field it seeks to regulate. When a Richmond Circuit Court is asked to review a decision of the Racing Commission, the court must find there is "substantial evidence" supporting the Commission's findings. The "substantial evidence" standard is designed to give great stability and finality to the fact-findings of an administrative agency.<sup>44</sup> Accordingly, the reviewing court may reject the agency's findings of fact only if a reasonable mind would necessarily come to a different conclusion.<sup>45</sup> As a result, where the issue concerns an agency decision based on the proper application of its expert discretion, the reviewing court will not substitute its own independent judgment for that of the agency but rather will reverse the agency decision only if that decision was arbitrary and capricious.<sup>46</sup> Actions are "arbitrary and capricious" when they are wanton and unjust and are made in disregard of the facts or law or make no attempt to determine principle.<sup>47</sup>

First, it is difficult to conceive a "reasonable mind" agreeing with the conclusion that evidence acknowledging a "reason to believe" a Racing Commission regulation has been violated is sufficient to support a finding of substantial evidence by the reviewing court that an individual's racing license or permit should be suspended or revoked.

Furthermore, under the "reason to believe" standard, it would seem virtually impossible for a reviewing court to conclude that the Racing Commission acted in an "arbitrary or capricious" manner in suspending or revoking a license or permit. The "reason to believe" standard is such a low threshold that it would appear difficult for a court to determine when the Racing Commission "disregarded the facts" on the record in a particular case, particularly because the Commission may very well not have many facts on the record in the

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36. *Id.* at 594.

37. Bell, 402 U.S. at 539.

38. See Bishop, 426 U.S. at 345-47.

39. See, e.g., O'Daniel v. Ohio State Racing Comm'n, 307 N.E.2d 529, 533 (Ohio 1974) ("[H]orse racing is one of those fields subject to extraordinarily broad regulatory powers.")

40. Sandstrom v. California Horse Racing Bd., 189 P.2d 17, 21 (Cal. 1948) (upholding a California Racing Board rule which made a trainer the absolute insurer of a horse's condition).

41. 407 So.2d 269 (Fla. Dist. Ct. App. 1981).

42. *Id.* at 271.

43. See Atkinson v. Virginia Alcoholic Beverage Control Comm'n, 336 S.E.2d 527, 531 (Va. Ct. App. 1985).

44. Virginia Real Estate Comm'n v. Bias, 308 S.E.2d 123, 125 (Va. 1983).

45. Johnston-Willis, Ltd. v. Kenley, 369 S.E.2d 1, 7 (Va. 1988).

46. See 7-Eleven, Inc. v. Dept of Environmental Quality, 573 S.E.2d 289, 294 (Va. Ct. App. 2002).

47. See School Board of City of Norfolk v. Wescott, 492 S.E.2d 146, 150 (Va. 1997).

# The Twenty-Second Annual National Regulatory Conference

On May 10th and 11th of 2004 the Administrative Law Section, in conjunction with the Virginia State Corporation Commission and the Marshall-Wythe School of Law, presented the Twenty-Second Annual National Regulatory Conference in Williamsburg. The conference was very well attended with more than 152 attorneys, regulators and industry executives registered. The theme of this year's conference was *Regulating Reality* and it centered on the reality of the regulatory world.

The first panel of the conference was entitled "The Security and Protection of Utility Facilities: Fear is Not a Factor." Massoud Tahamtani, the current Director of the Division of Utility and Railroad Safety, began the conference with an eye-opening speech regarding the differences in security and protection of utility facilities before and after September 11, 2001. Then, Jack Fox, the Branch Chief, Pipeline Infrastructure with the Department of Homeland Security gave an informative presentation outlining infrastructure security from this newly created department's prospective. Finally, Ralph Fisher, Division Head-Operations for Washington Gas Light Company gave an enlightening speech, especially with regards to his analysis of the company's field response to the Pentagon attack on September 11, 2001. After the presentations, a panel discussion ensued, moderated by Mr. Tahamtani.

The conference's second panel, moderated by Lydia Pulley of Verizon, discussed who might be the ultimate "survivor" in the broadband world. The panel consisted of four individuals representing various sectors of the broadband market. Rick Cimerman, a Senior Director with the National Cable & Telecommunications Association, represented the cable providers. Link Hoewing, Assistant Vice President, Internet and Technology Policy of Verizon, spoke from the perspective of the incumbent local exchange providers. Russell Frisby, Jr., CEO and President of CompTel/ASCENT, offered the point of view of the competitive exchange providers. Michael J. Balhoff, Managing Director of Legg Mason, shared the insights of an industry analyst.

The Keynote Address was given by Dr. Massoud Amin,

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Director of the Center for the Development of Technological Leadership at the University of Minnesota. He discussed North America's infrastructure including the historical trends, the lessons learned from wide-spread blackouts, and the aftermath of Y2K and September 11th. In addition, Dr. Amin provided insight into the understanding of the full impacts of decision pathways.

After lunch, Brian R. Greene of Christian & Barton, LLP, moderated a panel entitled "Extreme Makeover – Overhauling the Electric Generation and Gas Pipeline Landscape." The speakers examined the financial and regulatory hurdles needed to create new electric generation and pipelines in Virginia. John A. Stevens, Senior Utilities Engineer at the Virginia State Corporation Commission, provided the perspective of a state regulator. Chris Broemmelsiek, Vice President of Competitive Power Ventures, Inc., represented the electric market. James C. Moore, Director of Marketing Services of Williams Gas Pipeline - Transco, presented the gas pipeline perspective. Matthew I. Kahal, Senior Associate Consultant with Exeter Associates, Inc. provided an analysts perspective of the new directions that electric transmission planning should take.

The final panel on Monday entitled "Trading Spaces – Utility Siting Issues" was moderated by Cliona Mary Robb of Christian & Barton, LLP. The members of this panel also came from a variety of arenas. John D. Smatlak, Managing Director – Electric Transmission with Dominion Virginia Power, represented the large utility company. Wayne Smith, Senior Counsel at the State Corporation Commission, provided a state regulator's perspective. Charles Simmons, retired Vice President of Appalachian Power Company, gave the consultants view. Mr. Smatlak admitted that the siting process was a painful one. Mr. Smith provided insight into the Commission's process for responding to complaints. Mr. Simmons discussed possible solutions to improving the siting process and used slides to illustrate the various ways to construct electric lines.

In the evening, a reception was held at the Williamsburg Hospitality House. The reception offered an opportunity for all attending the conference to meet other attendees including moderators, panelists and the Commissioners of the Virginia State Corporation Commission.

The second day's sessions began with a panel, introduced by Paige E. Holloway of Anderson & Holloway, LLC, regarding the

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potential for new technologies in long-standing industries. R. Peter Lalor, President of Commonwealth Company, LLC, moderated the panel. A lively debate occurred amongst the diversified panelists: Carl D. Giesy, Director of MCI's Policy and Planning Group, Peter T. Disser, Vice President of NiSource Energy Technologies, and James Bradford Ramsey, General Counsel for National Association of Regulatory Utility Commission. Each panelist and the moderator had their own view of the impact that new telecommunications and energy technologies will have on regulated industries.

The conference's final panel focused on ethical responsibilities and was introduced by C. Meade Browder of the Office of the Attorney General. The panel was moderated by Leslie A. T. Haley, Assistant Ethics Counsel of the Virginia State Bar. Panelists included Kodwo Ghartey-Tagoe, Chief Regulatory Counsel for Duke Energy Corporation, Robert Eicher of Williams Mullen, and James E. Moliterno, Professor at William and Mary School of Law. The panel discussed various hypothetical situations regarding the unauthorized practice of law both within and outside of the Commonwealth of Virginia. The panel also focused on the role of in-house counsel. Active discussion regarding the hypothetical situations and other situations raised by participants ensued.

By all accounts, the Twenty-Second Annual National Regulatory Conference was a tremendous success. The Administrative Law Section would like to thank the panelists, moderators, Program Committee and the Board of Governors for their efforts. Special thanks are also owed to Mary Council and Laura Martin for making all the necessary arrangements and their hard work in ensuring a successful conference. Plans for the Twenty-Third National Regulatory Conference are already underway. Those interested in participating on the Committee should contact Cliona Robb at Christian & Barton, (804) 697-4140 or at [crobb@cblaw.com](mailto:crobb@cblaw.com). ■

## Closing Down the Stables

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first place. The Commission, only needing to fulfill a standard of proof similar to probable cause, may have facts on the record that suffice in arousing a *suspicion* that someone has violated a Racing Commission provision, or a *probability* that a person has done the same, and even though the evidence may not be "substantial," it would likely not be seen as action that was "arbitrary and capricious" because the agency is simply fulfilling the low standard of proof the agency is required to meet when suspending or revoking a license or permit. In other words, a scenario could develop where

the Racing Commission would fail to possess enough evidence to satisfy the "substantial evidence" standard, but yet the Commission's actions to suspend or revoke a license or permit would not be held "arbitrary and capricious" because the agency could still be fulfilling its designated role legitimately, with good-faith, and with regard for the facts in the disciplinary proceeding.

Increasing the present standard to a "preponderance of the evidence" would help ensure a more reliable Racing Commission record during various proceedings, especially for those of the disciplinary sort, because the standard, by itself, would require a higher burden of proof, thereby necessitating more specific and comprehensive evidence on the record, and making the agency's ability to reach the "substantial evidence" standard a more likely possibility upon review in the Circuit Court.

### VII. Conclusion: The Burden Should Be Shared Equally.

The preponderance standard only requires that the litigants share a roughly equal risk of error,<sup>48</sup> and there is no reason to believe that this standard would harm the horse racing industry in Virginia on any significant level if it were adopted as the standard of proof for suspending or revoking a racing permit or license in the state. The interests that a licensee or permittee has in the continued ability to pursue his or her livelihood are substantial because, in many cases, the license represents the only form of livelihood for the licensee.<sup>49</sup> In addition, because suspension or revocation in one state often prevents a licensee or permittee from participating in horse racing in another state, an individual's reputation in his profession is dishonored as well, and potentially can be tarnished forever. Furthermore, since the "reason to believe" standard is primarily based on a "belief" that someone has committed a violation of a regulation, the "risk of erroneous deprivation" would appear to be high because the standard does not require actual proof that a violation of a racing rule occurred "more likely than not." Finally, increasing the standard of proof to the "preponderance" standard would seek to legitimize the disciplinary actions taken by the Virginia Racing Commission, increase the overall credibility of the agency's decision-making, and would help to further the Commission's role of "maintain[ing] horse racing in the Commonwealth of the highest quality."<sup>50</sup>

The interests at stake in Virginia Racing Commission disciplinary proceedings are sufficiently important to a racing licensee or permit holder such that the Fourteenth Amendment of the U.S. Constitution demands that the Commission utilize a degree of certainty greater than "reason to believe" before a deprivation of these all-too-important property interests are deprived. ■



48. *Addington*, 441 U.S. at 423.

49. See *Feliciano v. Illinois Racing Board*, 443 N.E.2d 261, 265 (Ill. App. Ct. 1982).

50. *Supra*, note 2.

## Local Review of Utility Elections to Join RTOs *(continued from page 2)*

State commissions, not surprisingly, would like to defend their authority to say for themselves *whether* these manifold changes amount to a good thing. FERC -- which enthusiastically promotes RTO formation and exercises regulatory oversight of their tariffs, underlying agreements, wholesale markets, and administrative practices -- appears to be looking with increasing disfavor on the independent jurisdiction of a state to condition, or block outright, a local utility's participation in an RTO. Were Virginia to continue to strain against FERC's use of PURPA to essentially force the issue, it would set the stage for an epic jurisdictional battle in the courts.<sup>7</sup>

### B. Lead-up to FERC's Challenge of Virginia's Independent Review.

Virginia's "hard look" at AEP's RTO formation efforts dates back to late 2000,<sup>8</sup> when AEP-Virginia applied to the SCC for permission to join the Alliance RTO. Before the SCC completed its review, AEP's application was overtaken by events, as FERC decided that the Alliance RTO proposal fell short of the geographical "scope" required of an RTO. Forced to return to square one, AEP then concluded that it should join PJM, advising FERC of this election in mid-2002.<sup>9</sup> In late 2002, AEP filed formal applications at both FERC and the relevant state commissions for approval to transfer operational control of its transmission system to PJM. Transfer of operational control -- the heart and soul of any RTO formation effort -- clearly is a matter of consequence, and it is not unusual for state commissions to initiate local proceedings, pursuant to state laws, to review such proposals. FERC had not previously contested such local proceedings as incompatible with its own jurisdiction over RTO formation. But FERC's concern over the SCC's independent and close scrutiny of AEP's RTO election (and the broader ramifications of RTO participation) was heightened by an RTO moratorium law passed in 2003<sup>10</sup> -- whereby Virginia mandated (among other things) that no transmission utilities operating in the state could join an RTO before July 1, 2004. The new statute also mandated, however, that Virginia TPs *had to join* an RTO by January 1, 2005. But that duty was subject to the SCC's approval and review of a Virginia-specific cost/benefit analysis.<sup>11</sup> Further setting the stage was AEP's filing at FERC in late 2002 of its plans for integrating operations with PJM. A large constituency of state commissions, utilities, and customers, both within PJM's historic footprint and its expanding western frontier, was eager to see AEP's participation in PJM transpire sooner rather

than later.<sup>12</sup> Yet, around the same time, the SCC was publicly expressing increasing misgivings over the likelihood of benefits from an RTO that, like PJM, makes widespread use of Locational Marginal Pricing ("LMP"), a complex mechanism which relies on generator bids to set prices for energy spot markets and transmission congestion costs. The SCC's overriding concern was that periodic exercises of market power by generators, and the attendant need to erect regulatory ramparts of uncertain effectiveness or build large amounts of new infrastructure to offset market power, clouded the prospect of tangible net benefits *within Virginia* from AEP's participation in PJM. In a public hearing FERC convened in September 2003 to address the growing controversy between the avidly pro-PJM states and the still skeptical ones (*i.e.*, Virginia and Kentucky), FERC was besieged by PJM adherents urging it to take forceful action to pre-empt Virginia's and Kentucky's seemingly too-fastidious review of AEP's RTO election. Their contention was that the doubtful states were interfering with FERC's exercise of its exclusive jurisdiction over transmission and wholesale power trading under the Federal Power Act, hampering interstate commerce and costing their ratepayers tens of millions of dollars in expected annual savings from RTO coordination activities.

The crisis tightened in November 2003, when FERC issued an order *tentatively* concluding that all the criteria in PURPA Section 205(a) necessary to trigger FERC's exempting authority were present in the Virginia (and, at that time, Kentucky).<sup>13</sup> But it directed an ALJ to hold an expedited hearing to confirm this preliminary view. In March, the ALJ issued his findings, which indeed confirmed that all the statutory criteria were met, allowing FERC to exempt AEP from the Virginia and Kentucky obstacles to its "voluntary coordination" with PJM.<sup>14</sup> The SCC -- joined by state commissions from several parts of the country holding simi-

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7. As this article was being completed, however, in the SCC proceedings considering the application of AEP-Virginia to join PJM, the parties submitted a negotiated stipulation of settlement. On August 30, the SCC issued an order that accepted the party-developed settlement as the framework for state conditions on allowing AEP's RTO proposal to go forward. Assuming FERC accepts these conditions (which are discussed at the end of the article), all sides may stand down.

8. Sufficient "scope" was a stated requirement under FERC's Order No. 2000, which contains the blueprint for qualifying as an RTO. Just what constitutes sufficient "scope" is an issue with a large discretionary element, and FERC itself has shifted philosophies as its ideal paradigm (very large RTOs) has not been warmly accepted by some sections of the country.

9. FERC approved this election, subject to a host of conditions, in a July 31, 2002 order, *Alliance Companies, et al.*, 100 FERC ¶ 61,137.

10. House Bill 2453.

11. The 2003 legislation superseded earlier legislation that had put state utilities under a duty to join an RTO by 2001. The SCC's review, in any event, would have been required under Virginia law.

12. AEP's substantial multi-state transmission network and large fleet of relatively low-cost generators make it an attractive coordination partner for any power pool or RTO.

13. *New PJM Companies, et al.*, 105 FERC ¶ 61,251 (2003).

14. *New PJM Companies*, 106 FERC ¶ 63,029 (2004).

## Local Review of Utility Elections to Join RTOs *(continued)*

lar reservations about the extent of FERC's PURPA authority -- filed briefs contesting virtually all of the ALJ's factual and legal conclusions. As related below, FERC's recent order<sup>15</sup> stood behind the ALJ and held that FERC may, under these circumstances, derail state deliberations over whether a local utility wishing to join an RTO *should*, in fact, join one.<sup>16</sup>

### C. FERC's Holdings in the Virginia Case.

Although it is relatively brief, the language and structure of PURPA Section 205(a) leave plenty of room for argument over its applicability to specific instances. FERC's exemptive powers arise only upon a showing of (1) a utility's voluntary election to coordinate with other systems for efficiency gains; and (2) evidence that the state has prevented accomplishment of that coordination. Applying the statute also requires interpretation of a *savings clause* that reserves a state's right to act for certain broadly described public purposes. FERC made the following key findings:

1. AEP's participation in PJM is "voluntary coordination." The SCC<sup>17</sup> contested two threshold issues: (1) whether AEP's entry into PJM would, in fact, be the sort of "coordination" required to apply Section 205(a) and (2) whether it was truly voluntary. The SCC argued that setting up *competition among sellers* -- a principle at the center of PJM's RTO market design -- is not the same thing as *coordination* as conceived by Congress. Under the SCC's view, historical context matters, and Congress -- enacting Section 205(a) before the era of competitive power markets -- could not have had a PJM-style RTO in mind. But FERC dismissed this argument with a theme it would return to repeatedly -- namely, that employing a competitive market to select which generators would be dispatched and at what price is a form of "coordination" and, indeed, the *most efficient* form. FERC lauded bid-based markets as providing superior price signals both for guiding an efficient dispatch and stimulating the desirable investment in new infrastructure. FERC resolved the second issue -- whether AEP's commitment to join PJM was truly "voluntary" (since it stemmed from a merger condition FERC itself imposed in 2000) -- without much introspection concerning the meaning of "voluntary." It simply noted that AEP had not stated its commitment was "anything other than voluntary" and that even the SCC and the KPSC had, on prior occasions, recognized that the AEP commitment was voluntary.<sup>18</sup> Similarly, the fact that FERC has gradually "upped the ante" in terms of the *extent* of coordination and market mechanisms it expects from an RTO has not, in FERC's mind,

vitiating the essential voluntariness of the AEP merger election.

2. AEP's coordination with PJM is "designed" to obtain economic utilization of facilities. For Section 205(a) to apply, the "coordination" in question must also be "*designed to obtain economic utilization*" of the utilities' facilities in the area. Questioning whether AEP's participation in the PJM RTO satisfied this prong, the SCC argued that, because the exercise of market power and "strategic bidding" by generators cannot be ruled out, such hard-to-police conduct may frustrate the expectation that PJM's market design will produce more "economic utilization" of facilities (and lowering of costs) for consumers. But FERC countered that, as long as coordination is "designed" (in the sense of "intended") to obtain economic utilization, the statute does not require any *demonstration* that benefits will exceed costs or that customers will come out ahead. But just to hedge its bets on this point, FERC also affirmed the ALJ's finding that, based on PJM estimates in the record, the transaction was a win-win proposition, in that PJM customers *and* AEP stockholders should benefit handsomely from the coordination involved.<sup>19</sup> FERC also portrayed the SCC's questioning of the soundness of PJM's market design as an "attack" on FERC's prior approval of that design, noting that "imperfections" in LMP markets do not undermine the overall conclusion that they are an efficient means of coordinating utility operations and creating incentives for generation investment.

3. Virginia's legislative and regulatory actions constituted "prohibiting or preventing" the AEP-PJM coordination. The SCC maintained that Section 205(a) did not apply because it was not "prohibiting or preventing" coordination between utilities. Rather, it was commencing a hearing in late July to address the impacts of AEP's participation in PJM, and, given that the planned integration wasn't to take place until October, it could not be said that Virginia was *obstructing* that goal.<sup>20</sup> But FERC adopted the ALJ's

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15. *New PJM Companies*, Opinion No. 472, 107 FERC ¶ 61,271 (June 17, 2004).

16. This conclusion was limited to the Virginia scenario because Kentucky had, by this time, filed a settlement proposal.

17. For brevity, these positions will simply be described as the SCC's, but intervening state commissions supporting the SCC independently made similar arguments.

18. Nor did FERC muse over whether it mattered that the merger from which the RTO participation condition had sprung has not taken place, having not received final regulatory approval from the SEC (due to a judicial reversal of the SEC's initial approval).

19. The ALJ did not attribute the savings to Virginia customers of AEP in particular, but rather to the entire universe of customers in PJM -- consistent with FERC's view that it is looking after the welfare of multiple state customers rather than protecting the "parochial" interests of one state.

20. The ALJ chastised the SCC for making this argument, asserting the Virginia legislative and regulatory actions over the prior year bore responsibility for delaying AEP's integration until October.

## Local Review of Utility Elections to Join RTOs *(continued)*

finding that Virginia was obstructing coordination within the meaning of the statute. First, it viewed the Virginia legislation enacted in 2003 *barring* RTO participation (albeit only until July 1, 2004) as such a prohibition. FERC also agreed with the ALJ that, while the legislative bar would be lifted in mid-2004, it was still doubtful that the SCC would clear the path for participation as soon as October 2004. FERC concluded that the uncertainty reigning over the eventual structure of PJM and the impacts on other systems participating or seeking to participate in PJM were intolerable side effects of Virginia's deliberate pace.<sup>21</sup>

4. Statute's "savings clause," which provides state prohibition of "voluntary coordination" under limited circumstances, is *not* applicable to these facts. Virginia's final effort to shield itself from FERC's application of Section 205(a) was to argue that the savings clause at the end of Section 205(a) would apply here. The savings clause nullifies FERC's power to exempt a utility from state laws if the state is acting to protect "public health, safety, or welfare, or the environment or to conserve energy...." Virginia urged a broad (or "plain meaning") interpretation of the savings clause, contending it would expressly apply to regulation protecting ratepayers from perceived adverse *economic or reliability* impacts of coordination among utilities. The SCC's reading concludes that public "safety" and "welfare" are implicated -- and thus the savings clause applies -- if the proposed utility interactions are likely to impair reliability or threaten higher costs. But FERC retorted that such a reading was *too broad*, enabling the "exception to swallow the rule." Rather, the only sensible interpretation, FERC concluded, was a narrower one that limited the application of the savings clause to regulations of an *environmental or site-specific nature*.<sup>22</sup>

5. One last chance to avert PURPA. Despite finding that all the elements of Section 205(a) were present to warrant its application here, FERC gave Virginia one last chance -- stating it would *not* invoke Section 205(a) to exempt AEP from Virginia's laws and proceedings, *provided* the SCC gives AEP "timely" approval to participate in PJM and allow integration to proceed in October 2004. Under this approach, Virginia would be allowed to impose conditions, but only so long as they were "reasonable."<sup>23</sup>

### D. Kentucky Strikes a Deal.

On the same day in which it affirmed the ALJ's opinion that PURPA § 205(a) could be applied to Virginia for obstructing AEP's entry into PJM, FERC accepted an intricate settlement the KPSC, PJM, and AEP-Kentucky had negotiated after the ALJ had

likewise ruled that Section 205(a) justified shutting down the Kentucky proceedings scrutinizing AEP's RTO election. The AEP-Kentucky settlement staked out boundaries intended to preserve traditional state jurisdiction over the retail rate base and control over end-user costs even as FERC assumed jurisdiction over AEP's transmission-related activities (and associated wholesale markets) once it joined PJM. The agreement's key elements included:

- Clarification that purchases and sales of energy or capacity between AEP-Kentucky and PJM regional markets would be voluntary.<sup>24</sup>
- AEP-Kentucky's retail cost of service would be subject to "appropriate review" by the KPSC.
- The parties would "resist" any proposal to *mandate* participation by AEP-Kentucky in PJM's regional markets.
- PJM would give "due consideration" to the KPSC's findings on an appropriate reserve margin (without superseding, however, PJM's "obligation to ensure an adequate reserve margin").
- PJM would not direct AEP-Kentucky to curtail retail loads to compensate for generation insufficiencies elsewhere on the PJM system, so long as AEP was itself in compliance with its PJM capacity obligations.
- PJM would not direct retail load-shedding due to a transmission emergency unless all other alternatives had first been exhausted.
- PJM would make demand response programs available to AEP but would not offer them directly to retail customers.
- The settlement had no effect on the jurisdiction of either FERC or the KPSC, does not condone removal of assets from the rate base of AEP-Kentucky, and reaffirms that the KPSC has authority

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21. Part of FERC's criticism of the SCC was that it had not expeditiously proceeded with the AEP application (which dated from late 2002) up to this point. The SCC disputes this conclusion.

22. In this regard, FERC claimed support from the legislative history, which pointed to environmental or facility siting regulations as some examples of what would trigger the savings clause.

23. Under this "dispensation," FERC would be the final arbiter of whether the SCC's conditions were reasonable or not. And, clearly, FERC was saying that it was *not* an option for the SCC to conclude that AEP's entry into PJM failed to meet the public interest and could not proceed. Thus, the effect of FERC's holding is that it, and not the state commission, will finally decide whether a utility's voluntary participation in a particular RTO is in the public interest.

24. The notable exception would be if PJM or FERC concluded that AEP was withholding generation from PJM markets to exert market power and influence prices thereby.

## Local Review of Utility Elections to Join RTOs *(continued)*

to set revenue requirements for retail rates based on that rate base.

- The settlement does not alter the obligation of the KPSC to seek certificates of public convenience and necessity from the KPSC to construct transmission or generation.
- The settlement does not alter the laws or regulations of Kentucky requiring service to retail customers on a bundled basis.

Presumably, the KPSC concluded that, by anchoring these understandings to the settlement, it could preserve close to the *status quo* in terms of state rate regulation on a cost-of-service basis, while minimizing the likelihood of adverse reliability or cost impacts stemming from AEP's participation with PJM. While PJM was fully on board with the settlement agreement, that did not prevent some intervenors from submitting comments suggesting that some of the concessions Kentucky negotiated could prove to be escape hatches from the standard obligations of the PJM tariff and participant agreements. For example, one intervenor argued that the settlement's protocols protecting Kentucky from curtailments due to lack of capacity elsewhere on PJM's system should be understood as only "transitional" in nature -- that is, until AEP builds more transmission ties and is eventually assimilated into PJM's control area. Another suggested that it was contrary to PJM's tariff to protect *retail* customers from load-shedding ahead of *wholesale* customers of AEP-Kentucky, as opposed to curtailing them pro rata. FERC stepped around these critical comments carefully, offering cautious, at times narrow or obscure interpretations of the settlement agreement's substantive provisions. Doubtless FERC was anxious not to overtly override anything in the settlement, lest it violate the "no tampering" clause the parties had seen fit to include. Whether FERC's fine-line walking leaves all partisans reasonably content remains to be seen.

### E. What's Next? Virginia Tries a Settlement.

Since FERC, in its June 17 order, offered Virginia an "out" along the lines of Kentucky's settlement -- *i.e.*, the SCC must "timely" approve AEP's participation in PJM and any conditions must be "reasonable" -- the Kentucky case bears special importance to those involved in the Virginia-FERC donnybrook. As previously noted, the Virginia parties submitted a settlement

proposal with a set of SCC conditions on AEP-Virginia joining AEP in hopes of averting a long and hard-to-predict battle in the federal courts. It was not a carbon copy of the Kentucky conditions. Some of the provisions -- *e.g.*, those regarding non-curtailement of local loads and reinforcing the obligation to seek state certification before constructing transmission or generation -- closely track those in the Kentucky settlement. Others are designed to preclude efforts by AEP-Virginia to recover costs incurred due to its PJM participation unless the company puts all its costs and revenues on the table in a base rate case. (There are reciprocal provisions precluding the other settling parties from seeking rate *decreases* reflecting PJM-related revenues, unless in the context of a base rate case.) There is also a small monthly credit to flow to Virginia ratepayers and several reporting requirements to aid the SCC and affected parties in assessing the ongoing cost and reliability impacts of PJM participation. The fact that parts of the KPSC settlement are *not* replicated reflects the fundamentally different retail rate-setting models the states have adopted. (Virginia has embarked on phased-in competition in generation, while Kentucky has thus far chosen to retain the traditional regulated monopoly model, with cost-based rates determined from a retail "rate base.")

The SCC largely incorporated the settlement's proposed conditions into its August 30, 2004 order approving AEP-Virginia's application to join PJM. In the order, the SCC recounted previously expressed concerns about the effects of AEP's integration into PJM on Virginia consumers; but it also observed that the governing Virginia legislation provided a strong policy push in favor of all Virginia utilities participating in RTOs no later than January 2005. The SCC thus perceived boundaries in the scope of its own reviewing authority; while its approval of any application to join a specific RTO was specifically required -- along with a cost/benefit analysis -- it was not clear that the law also required a finding of *net benefits* to Virginia users, nor was there any explicit delegation of authority to the SCC to determine, in its own judgment, whether the participation was in the general public interest. Moreover, the cost/benefit analyses submitted in the record suggested only *de minimis* net impacts -- either a slightly adverse impact (the Staff's study) or an even slighter positive impact (the utility's study). The SCC concluded that, given the will of the legislature to see Virginia utilities join RTOs, the lack of overwhelm-

— *continued on next page*

## Local Review of Utility Elections to Join RTOs *(continued)*

ing evidence that AEP-Virginia’s participation in PJM would *harm* ratepayers,<sup>25</sup> and the SCC’s belief that PJM was one of the better RTO models in existence, it had no choice but to clear the way.

Notably, the SCC did not so much as mention the pressure FERC had applied to the state review process. The ball is now in FERC’s court to accept the Virginia conditions as “reasonable.” Given FERC’s favorable review of Kentucky’s set of conditions, this may be seen as a likelihood. ■



25. The SCC observed that all active parties to the case supported the settlement, though two unaffiliated public witnesses testified that the competitive model and RTO participation would be detrimental to Virginia consumer interests.

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