FEDERAL PREEMPTION OF STATE REGULATION IN THE FIELD OF ELECTRICITY AND NATURAL GAS: A SUPREME COURT CHRONICLE

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I. INTRODUCTION

The complexity inherent in a federal system of government is illustrated in the regulation of electricity and natural gas. Each of these industries has an interstate aspect, which includes interstate transmission and wholesale sales (so-called "sales-for-resale"), and an intrastate aspect, which includes production and local distribution to retail consumers. As Justice Brennan has observed:

> Maintaining the proper balance between federal and state authority in the regulation of electric and other energy utilities has long been a serious challenge to both judicial and congressional wisdom. On the one hand, the regulation of utilities is one of the most important of the functions traditionally associated with the police power of the States. On the other hand, the production and transmission of energy is an activity particularly likely to affect more than one State, and its effect on interstate commerce is often significant enough that uncontrolled regulation by the States can patently interfere with broader national interests.[1]

Essentially, the electric power and natural gas industries are regulated in their interstate aspect by the Federal Energy Regulatory Commission (FERC) (formerly the Federal Power Commission (FPC)), and in their intrastate aspect by the states and, to a lesser extent, localities. This division of responsibility has its roots in a series of cases decided by the Supreme Court under the Commerce Clause of the Constitution[2] in the period leading up to the enactment of the principal federal regulatory statutes, the Federal Power Act (Power Act)[3] and the Natural Gas Act (Gas Act),[4] in the mid-1930s. In those cases, the Court drew a bright line between the "intrastate" activities of electric and gas companies, which the states were free to regulate, and those activities, principally interstate transmission and sales-for-resale, considered to be "interstate" in nature and hence beyond the power of the states under the Commerce Clause. Congress, in turn, enacted the Power Act and the Gas Act to "fill the gap" in state regulation, thereby assuring that the ultimate consum-

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1. Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n, 461 U.S. 375, 377 (1983) (citations omitted).
2. U.S. CONST., art. I, § 8, cl. 3.
3. 16 U.S.C. §§ 824-825r (1982).
4. 15 U.S.C. §§ 717-717w (1982).

ers of electricity and natural gas would receive reliable service at reasonable rates.

The problem of distinguishing the sphere of federal authority from the sphere of state authority has been a persistent one, as evidenced by the fact such cases continue to arise in the Supreme Court with some regularity.[5] This article shows that the governing federal statutes and related case law, by relying upon longstanding "bright line" distinctions, make it possible to resolve such questions in a consistent and predictable manner.

II. THE EARLY COMMERCE CLAUSE CASES

Among the enumerated powers of Congress established by article II of the Constitution is the power "[t]o regulate Commerce . . . among the several States . . . ."[6] The Commerce Clause:

> serves a two-fold purpose: it is the direct source of the most important powers which the Federal Government exercises in peacetime, and, except for the due process and equal protection clauses of the Fourteenth Amendment, it is the most important limitation imposed by the Constitution on the exercise of state power.[7]

As the Supreme Court has acknowledged, the Commerce Clause cases in the field of electricity and natural gas are of two types. In the cases which predate the enactment of the Power Act and the Gas Act, the Court used a "mechanical test for determining when interstate commerce end[ed] and intrastate commerce beg[an] . . . ."[8] On this basis, the Court would distinguish between the activities the states could tax and regulate and those they could not. In contrast, under the modern approach, which dates to the period just after enactment of the Power Act and the Gas Act, the Court has attempted to balance state and federal interests. In these cases:

> [The Court] has been less concerned to find a point in time and space where the interstate commerce in gas ends and intrastate commerce begins, and has looked to the nature of the state regulation involved, the objective of the state, and the effect of the regulation upon the national interest in the commerce.[9]

It is, of course, somewhat artificial to attempt to separate into distinct "interstate" and "intrastate" components the processes by which electricity

5. In the past two Terms, for example, the Supreme Court has decided three cases involving claims of federal preemption of state regulation in this field (Northwest Cent. Pipeline Corp. v. State Corporation Comm'n, — U.S. —, 109 S. Ct. 1262 (1989); Mississippi Power & Light Co. v. Mississippi *ex rel.* Moore, — U.S. —, 108 S. Ct. 2428 (1988); Schneidewind v. ANR Pipeline Co., — U.S. —, 108 S. Ct. 1145 (1988)), and a fourth case involving the related question whether the federal courts should abstain from exercising jurisdiction in cases in which utility companies seek to challenge state and local regulatory orders on preemption grounds (New Orleans Pub. Serv., Inc. v. New Orleans, No. 88-348 (June 19, 1989)).

6. U.S. CONST., art. I, § 8, cl. 3.

7. The Constitution of the United States of America: Analysis and Interpretation, S. DOC. NO. 82, 92d Cong., 2d Sess. 142 (1973). *See, e.g.,* Hughes v. Oklahoma, 441 U.S. 322, 326 (1979) ("The Commerce Clause has . . . been interpreted by this Court not only as an authorization for congressional action, but also, even in the absence of a conflicting federal statute, as a restriction on permissible state regulation.") (citing H.P. Hood & Sons, Inc. v. DuMond, 336 U.S. 525, 534-35 (1949)).

8. Illinois Natural Gas Co. v. Central Ill. Pub. Serv. Co., 314 U.S. 498, 504 (1942).

9. *Id.* at 505, *citing, inter alia,* South Carolina State Highway Dep't v. Barnwell Bros., Inc., 303 U.S. 177 (1938).

and natural gas reach the ultimate consumer. One commentator noted the following in 1945:

> [In] the use of wires and pipes to get power and light and fuel into the service of ultimate consumers, there is a trinitarian fusing of what in the case of chattels embraces three distinct operations: (1) making; (2) going to market; and (3) selling in packages suitable to the needs of individual customers.[10]

Nevertheless, each of these steps, generation and production in the state of origin, retail distribution in the state of consumption, and transmission between the two, was regarded as legally distinct under the Commerce Clause cases decided prior to the enactment of the Power Act and the Gas Act.

A. *Generation and Production*

In 1932, in *Utah Power & Light Co. v. Pfost*,[11] the Supreme Court considered whether a state could levy a tax on the generation of electricity that, upon generation, was instantaneously transmitted to another state for consumption there. The electric company, in challenging the tax, asserted that because of the instantaneous flow of electricity, generation was "so linked with the transmission as to make it an inseparable part of a transaction in interstate commerce" and hence immune from state taxing authority.[12] Emphasizing the "practical" nature of its inquiry,[13] *Pfost* found that generation was indeed a separate step that, "despite its hidden character, is no less real than the conversion of wheat into flour at the mill."[14] Hence, the generation of electric power, although the power was instantaneously transmitted to interstate markets, was held to be "subject to state taxation and control" in the state of origin.[15]

A natural gas parallel to *Pfost* can be found in a 1927 decision, *Hope Natural Gas Co. v. Hall*,[16] which held that the Commerce Clause did not preclude the states from taxing the production of natural gas at the wellhead, even though the gas was shipped interstate immediately upon production. The Supreme Court accepted the view that the tax under the statute was based solely on the value of the gas at the wellhead, and upheld it on that basis.[17]

Relying in part on the *Pfost* and *Hall* decisions, the Supreme Court in 1932, in *Champlin Refining Co. v. Corporation Comm'n*,[18] rejected a Commerce Clause challenge to state rules requiring "proration" of production

10. Powell, *Physics and Law: Commerce in Gas and Electricity*, 58 HARV. L. REV. 1072, 1083 (1945).

11. Utah Power & Light Co. v. Pfost, 286 U.S. 165 (1932).

12. *Id.* at 178-79.

13. *Id.* at 179.

14. *Id.* at 180.

15. *Id.* at 182. *Accord* South Carolina Power Co. v. South Carolina Tax Comm'n, 286 U.S. 525 (1932) (per curiam) (summarily affirming a three-judge district court decision (South Carolina Power Co. v. South Carolina Tax Comm'n, 52 F.2d 515 (E.D.S.C. 1931)), which denied an interlocutory injunction against a state tax on electric power generation, finding that it did not violate, *inter alia*, the Commerce Clause).

16. Hope Natural Gas Co. v. Hall, 274 U.S. 284 (1927).

17. *Id.* at 288. One commentator suggested that it "probably was a highly strained interpretation of the statute" to conclude, as the Court did, that West Virginia's tax was based solely on the value of gas at the wellhead. Howard, *Gas and Electricity in Interstate Commerce*, 18 MINN. L. REV. 611, 696 (1934).

18. Champlin Refining Co. v. Corporation Comm'n, 286 U.S. 210 (1932).

from oil wells.[19] Because these proration rules "appl[ied] only to production and not to sales or transportation" and because "production is essentially mining operation and therefore is not a part of interstate commerce," the Court concluded, "[n]o violation of the commerce clause is shown."[20]

These three cases—*Pfost, Hope v. Hall*, and *Champlin*—established that the generation of electricity and the production of natural gas, like manufacturing or mining, were essentially local in nature, and therefore could be taxed or, as in *Champlin*, regulated, by state authorities without offending the Commerce Clause.[21]

B. Local Distribution

Retail distribution of natural gas in the state of consumption was deemed to be sufficiently local in nature to withstand challenges to state regulation under the Commerce Clause. This was true even where the gas was imported by pipeline from another state and flowed uninterrupted into the local mains of the retail distributor.

The Supreme Court first considered this issue in 1919, in *Public Utilities Commission v. Landon*.[22] In that case, two states, Missouri and Kansas, asserted regulatory authority over retail distribution of natural gas that had been transmitted by pipeline from Oklahoma. The Court upheld their authority to do so, finding that the "sale and delivery of gas to their customers at burner-tips by the local companies" did not "constitute[ ] any part of interstate commerce," but rather that "[i]nterstate movement ended when the gas passed into local mains."[23]

One year later, in *Pennsylvania Gas Co. v. Public Service Comm'n*,[24] the Court rejected a similar Commerce Clause challenge to state regulatory authority. Unlike the *Landon* decision, however, the Court in *Pennsylvania Gas* did not base its decision on the theory that interstate commerce "ended"

19. Proration schemes are commonly used in oil and gas producing states to prevent waste and to protect the correlative rights of land owners in oil and gas pools beneath the surface. *See Champlin*, 286 U.S. at 233; Railroad Comm'n v. Rowan & Nichols Oil Co., 310 U.S. 573 (1940); *see also*, Note, *Natural Gas Regulation and Vested Property Interests: Ratable Taking, Proration Standards, and Fieldwide Civil Liability*, 62 TEX. L. REV. 691 (1983). Thus, although *Champlin* involved petroleum rather than natural gas, it would apply equally to either. *See, e.g.*, Northwest Cent. Pipeline Corp. v. State Corporation Comm'n, — U.S. —, —, 109 S. Ct. 1262, 1274 (1989) (citing interchangeably, in a case involving a challenge to state regulation of natural gas production, both *Champlin* (a petroleum case) and Thompson v. Consolidated Gas Utils. Corp., 300 U.S. 55 (1937) (a natural gas case)).

20. *Champlin*, 286 U.S. at 235 (emphasis added).

21. A fourth case arguably within this series was Cloverdale v. Arkansas-Louisiana Pipe Line Co., 303 U.S. 604 (1938), which upheld a privilege tax imposed by the State of Louisiana on the operation of gas engines used to increase the pressure of natural gas in pipelines. The Court in that case concluded that, as in *Pfost*, the state tax was imposed on production, not transmission, and "production occurs prior to transmission. It is just as much local as the generation of electrical power." 303 U.S. at 611. The *Cloverdale* case, however, was decided in 1938, too late to have influenced the language of the Gas Act, which was then on the verge of enactment, and it has not been cited in any subsequent Supreme Court decision interpreting the preemptive effect of the Gas Act on the authority of the producing states.

22. Public Utils. Comm'n v. Landon, 249 U.S. 236 (1919).

23. *Id.* at 245.

24. Pennsylvania Gas Co. v. Public Serv. Comm'n, 252 U.S. 23 (1920).

when the gas was introduced into local mains. Instead, the Court adopted the view, more akin to the post-1938 cases under the Commerce Clause, that although interstate commerce could not be said to "end" at any point before the gas reached the burner-tip,[25] the state's interest in the regulation of retail utility service at the local level was sufficiently strong, and its impact on interstate commerce sufficiently slight, to justify the orders in question. As the Court explained:

> The pipes which reach the customers served are supplied with gas directly from the main of the company which brings it into the State, nevertheless the service rendered is essentially local, and the sale of gas is by the company to local consumers who are reached by the use of the streets of the city in which the pipes are laid, and through which the gas is conducted to factories and residences as it is required for use.[26]

More than a decade later, in *East Ohio Gas Co. v. Tax Commission*,[27] the Court resolved the doctrinal conflict between these two cases by expressly repudiating the view articulated in *Pennsylvania Gas* and reaffirming the earlier approach adopted in *Landon*. The transmission of natural gas by pipeline, the Court emphasized, was "essentially national—not local—in character and is interstate commerce within as well as without th[e] state."[28] However, after the interstate shipment, the gas "passe[d] from the distribution lines into the supply mains," where it was "relieved of nearly all . . . pressure," its volume "expanded many times what it was in the high pressure interstate transmission lines," and the flow "divided into the many thousand relatively tiny streams that enter the small service lines connecting such mains with the pipes on the consumers' premises."[29] The Court concluded that this process of pressure reduction was comparable to "the breaking of an original package, after shipment in interstate commerce, in order that its contents may be treated, prepared for sale and sold at retail."[30] It followed, therefore, "that the furnishing of gas to consumers" through the mains of the local distributor was "not interstate commerce but a business of purely local concern exclusively within the jurisdiction of the State."[31]

In a 1937 case, *Southern Gas Corp. v. Alabama*,[32] the Supreme Court held that direct sales by an interstate pipeline to industrial end-users also were in intrastate commerce and therefore subject to state taxing authority. The pipeline in that case had built "service lines" to several factories at "widely separated" points within the state, and delivered natural gas at reduced pressure directly to these plants.[33] The Court, in an opinion by Chief Justice Hughes, concluded that it could "perceive no essential distinction in law between the

25. The theory employed by the Court in *Pennsylvania Gas*, as one commentator put it, "kept the interstate commerce unbroken until the gas was lit." Powell, *supra* note 10, at 1081.

26. Pennsylvania Gas, 252 U.S. at 31.

27. East Ohio Gas Co. v. Tax Comm'n, 283 U.S. 465 (1931).

28. *Id.* at 470.

29. *Id.* at 470-71.

30. *Id.* at 471.

31. *Id.*

32. Southern Gas Corp. v. Alabama, 301 U.S. 148 (1937).

33. *Id.* at 152.

establishment of such a local activity to meet the needs of consumers in industrial plants and the service to consumers in the municipalities which was found in the [*East Ohio*] case to constitute an intrastate business."[34]

In several early cases, the Supreme Court held that state officials could examine the reasonableness of wholesale rates in cases where the local company had a corporate affiliation with the interstate pipeline through a parent holding company and sought to pass through in its rates to local consumers the prices it paid its affiliate.[35] As the Court stated in one such case:

> The state authority whose powers are invoked to fix a reasonable rate is certainly entitled to be informed whether advantage has been taken of the situation to put an unreasonable burden upon the distributing company, and the mere fact that the charge is made for an interstate service does not constrain the Commission to desist from all inquiry as to its fairness. Any other rule would make possible the gravest injustice, and would tie the hands of the state authority in such fashion that it could not effectively regulate the intrastate service which unquestionably lies within its jurisdiction.[36]

In summary, *Landon, Pennsylvania Gas, East Ohio* and *Southern Gas* established that the Commerce Clause did not inhibit the authority of the consuming state to regulate and tax the delivery of natural gas to the ultimate end user. The decisions in *Landon* and in the later *East Ohio* case rested on the view that gas entirely lost its interstate character and became a subject of intrastate commerce when, after being transmitted through an interstate pipeline at high pressure, it was reduced in pressure and introduced into the local mains from which retail distribution was made. The holding company cases, in turn, found that state regulatory commissions were not constrained by the Commerce Clause to pass through to consumers without review the wholesale prices for gas supplies paid by local distribution companies to interstate pipelines with which they had a corporate affiliation.

C. Interstate Transmission and Sales-For-Resale: The Attleboro Doctrine

In 1927, the Supreme Court found that the Commerce Clause did limit state authority over interstate transmission and sales-for-resale of electricity and natural gas. The most noted of these cases was *Public Utilities Commission v. Attleboro Steam & Electric Company.*[37] In that case, the Attleboro Steam & Electric Company, a Massachusetts utility, purchased a small amount of electric power at wholesale from the Narragansett Electric Lighting Company, a Rhode Island utility engaged principally in retail sales of electric-

34. *Id.* at 155.

35. Lone Star Gas Co. v. Texas, 304 U.S. 224 (1938); Arkansas La. Gas Co. v. Department of Public Utils., 304 U.S. 61 (1938); Columbus Gas & Fuel Co. v. Public Utils. Comm'n, 292 U.S. 398 (1934); Dayton Power & Light Co. v. Public Utils. Comm'n, 292 U.S. 290 (1934); State Corp. Comm'n v. Wichita Gas Co., 290 U.S. 561 (1934); Western Distrib. Co. v. Public Serv. Comm'n, 285 U.S. 119 (1932).

36. Western Distrib. Co., 285 U.S. at 124-25. *See also* Dayton Power & Light Co., 292 U.S. at 295 (stating "[t]here is no doubt under the decisions of this court that the [State] Commission was not concluded by the price fixed in the agreement [between the affiliated companies]. This results from the relation of intimate alliance between the buyer and the seller. They were not dealing with each other at arm's length, and the prices that they fixed in their intercompany transactions were of no concern to the consumer unless kept within the bounds of reason.").

37. Public Utils. Comm'n v. Attleboro Steam & Elec. Co., 273 U.S. 83 (1927).

ity within Rhode Island.[38] The Rhode Island Public Utilities Commission issued an order requiring Narragansett to increase the rate charged for its sales to the Attleboro Company, on the ground that the existing rate was too low and therefore that Rhode Island ratepayers were in effect subsidizing Narragansett's wholesale service to Attleboro. The Attleboro company, in turn, challenged the order under the Commerce Clause.

The Supreme Court concluded that the Rhode Island commission's order was invalid under the Commerce Clause because the sale of electric power between the two companies was in interstate commerce and the state, by attempting to regulate such a sale, "place[d] a direct burden upon interstate commerce."[39] This burden was "none the less beyond the power of the State because [the wholesale service to Attleboro] may be the smaller part of [the Narragansett Company's] general business."[40] Neither the "forwarding state," Rhode Island, nor the "receiving state," Massachusetts, could regulate this transaction, the Court held, since "the paramount interest in the interstate business carried on between the two companies is not local to either State, but is essentially national in character."[41] The Court concluded that "if such regulation is required it can only be attained by the exercise of the power vested in Congress."[42]

The origins of the *Attleboro* doctrine can be traced to a series of natural gas cases, the most important of which was *Missouri ex rel. Barrett v. Kansas Natural Gas Co.*,[43] decided in 1924. In that case, the Supreme Court held that the states of Missouri and Kansas could not compel an interstate pipeline to reduce its rates for natural gas sales to local distribution companies in those states. The Court, distinguishing the *Landon* and *Pennsylvania Gas* cases, concluded that:

> [T]he sale of gas is in wholesale quantities, not to consumers, but to distributing companies for resale to consumers in numerous cities and communities in different States. The transportation, sale and delivery constitute an unbroken chain, fundamentally interstate from beginning to end . . . . The paramount interest is not local but national, admitting of and requiring uniformity of regulation.[44]

In a case decided in 1921, *United Fuel Gas Co. v. Hallanan*,[45] the Supreme Court held invalid under the Commerce Clause a state tax imposed

38. *Id.* at 91 (Brandeis, J., dissenting) (stating the Attleboro company "t[ook] less than 3 per cent of the electricity produced and manufactured by the Narragansett, which has over 70,000 customers in Rhode Island.").

39. *Id.* at 89.

40. *Id.* at 90.

41. *Id.*

42. *Id.* Justice Brandeis was the lone dissenter in *Attleboro*. He thought that the state commission's rate order did not impose a direct burden on interstate commerce but "resemble[d] more nearly that increase in the cost of an article produced and to be delivered which arises by reason of higher taxes laid upon plant, operations or profits, or which arises by reason of expenditures required under police regulations." *Id.* at 92 (Brandeis, J., dissenting) (citations omitted). He distinguished other Commerce Clause cases invalidating various state actions where "the businesses were essentially interstate" or where the state's action discriminated against interstate commerce. *Id.* at 92-93.

43. Missouri ex rel. Barrett v. Kansas Natural Gas. Co., 265 U.S. 298 (1924).

44. *Id.* at 309-10.

45. United Fuel Gas Co. v. Hallanan, 257 U.S. 277 (1921).

on the shipment of locally-produced gas in an interstate pipeline, where the gas in question was destined for points outside the state.[46] Similarly, in *Ozark Pipe Line Corp. v. Monier,*[47] the Court held invalid a state tax assessed against the property of an interstate oil pipeline that passed through the state without making any pickups or deliveries therein, despite the fact that the pipeline maintained its principal office within the state. Nor was such a tax valid, the Court held in *State Tax Commission v. Interstate Natural Gas Co.*,[48] where the pipeline made sales of gas at wholesale to local distributors within the state, notwithstanding the fact that the pipeline reduced the pressure of the gas prior to making deliveries to the distributors.[49] In contrast to these cases, however, the Court in a 1926 decision, *Peoples Natural Gas Co. v. Public Service Commission*,[50] held that although state authorities in Pennsylvania had no jurisdiction over the portion of an interstate pipeline's gas supply that was imported from a neighboring state, they could order the pipeline to continue service to a local distribution company within the state, since it happened that "more than enough Pennsylvania gas goes into the mixture to meet the requirements of the order," and thus in that circumstance "the order [did] not interfere with or affect the interstate commerce in which the [pipeline] company [was] engaged."[51]

In several other cases, the Supreme Court found invalid under the Commerce Clause actions by natural gas producing states that attempted to restrict the export of natural gas to other states. In *West v. Kansas Natural Gas Co.*,[52] the Court sustained a Commerce Clause challenge to an Oklahoma statute that effectively banned the construction and operation of pipelines for transporting natural gas outside the state. Similarly, in *Pennsylvania v. West Virginia*,[53] the Court struck down a West Virginia statute requiring that natural gas could be exported only if the gas was shown to be in excess of the quantities needed to satisfy in-state consumers. Finally, although turning on constitutional grounds other than the Commerce Clause, the Court in *Thompson v. Consolidated Gas Utilities Corp.*[54] held that the Texas Railroad Commission could not order natural gas pipelines engaged in production from their own

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46. In a companion case, Eureka Pipe Line Co. v. Hallanan, 257 U.S. 265 (1921), the Court held the same state statute invalid as applied to an oil pipeline. In both cases, however, the Court noted that the validity of the tax was not disputed as to quantities of locally-produced oil or gas introduced into the pipeline but ultimately sold within the state.

47. Ozark Pipe Line Corp. v. Manier, 266 U.S. 555 (1925).

48. State Tax Comm'n v. Interstate Natural Gas Co., 284 U.S. 41 (1931).

49. The Court in the *Interstate* case explained:

> The pressure of the gas is reduced by the [pipeline] before it passes into the purchaser's hands. The work done by the [pipeline] is done upon the flowing gas to help the delivery and seems to us plainly to be incident to the interstate commerce between Louisiana and Mississippi. The [pipeline] simply transports the gas and delivers it wholesale not otherwise worked over than to make it ready for delivery to the independent parties that dispose of it by retail.

Id. at 43-44.

50. Peoples Natural Gas Co. v. Public Serv. Comm'n, 270 U.S. 550 (1926).

51. *Id* at 553, 555.

52. West v. Kansas Natural Gas Co., 221 U.S. 229 (1911).

53. Pennsylvania v. West Virgina, 262 U.S. 553 (1923).

54. Thompson v. Consolidated Gas Utils. Corp., 300 U.S. 55 (1937).

wells to purchase gas ratably from nearby well owners who had no pipeline connections and were therefore without a market for their gas.[55]

In sum, under the *Attleboro* doctrine, the Supreme Court attempted to separate into entirely distinct spheres the interstate and intrastate aspects of electricity and natural gas by means of a mechanical, bright line test. Essentially, wholesale transactions were deemed to be exclusively interstate in nature and thus beyond the power of the states under the Commerce Clause. Therefore, no state could regulate or tax the interstate transmission or the sale-for-resale of electric power or natural gas, even where, as in *Attleboro*, the amount transmitted and sold for resale in interstate commerce was only a small fraction of the utility company's overall business.

III. FEDERAL REGULATORY LEGISLATION: FILLING THE "ATTLEBORO GAP"

On August 26, 1935, President Roosevelt signed into law Part II of the Federal Power Act;[56] less than three years later, on June 21, 1938, he signed the Natural Gas Act.[57] As the Supreme Court has stated, "the limitations established on [federal] jurisdiction [in both statutes] were designed to coordinate precisely with those constitutionally imposed on the states" in the Commerce Clause cases discussed above.[58] Thus, Congress:

> intended to 'fill the gap'—the phrase is repeated many times in the hearings, congressional debates and contemporary literature—left by *Attleboro* in utility regulation. Congress interpreted that case as prohibiting state control of wholesale rates in interstate commerce for resale, and so armed the Federal Power Commission [now the Federal Energy Regulatory Commission] with precisely that power.[59]

The enactment of these statutes changed the nature of the Court's inquiry in jurisdictional cases involving electricity and natural gas. The issue no longer was whether state regulatory orders aimed at a particular problem involving electricity or natural gas were permissible under the Commerce Clause, but rather whether Congress had brought the issue within the scope of federal regulation under these statutes, or left it to the states. In other words, the issue now was to what extent was state law preempted by the federal statutes under the Supremacy Clause of the Constitution.[60]

55. Texoma Natural Gas Co. v. Railroad Comm'n, 59 F.2d 750, 754 (W.D. Tex. 1932), *cited with approval in Thompson*, 300 U.S. at 61 n. 8.

56. 16 U.S.C. §§ 824-825r (1982).

57. 15 U.S.C. §§ 717-717z (1982). *See also* DeVane, *Highlights of Legislative History of the Federal Power Act of 1935 and the Natural Gas Act of 1938*, 14 GEO. WASH. L. REV. 30, 38-39 (1945).

58. United States v. Public Utils. Comm'n, 345 U.S. 295, 311 (1953).

59. *Id.* at 307-08. *See also* FPC v. Panhandle Eastern Pipe Line Co., 337 U.S. 498 (1949):

> [S]uffice it to say that the Natural Gas Act did not envisage federal regulation of the entire natural-gas field to the limit of constitutional power. Rather it contemplated the exercise of federal power as specified in the Act, particularly in that interstate segment which the states were powerless to regulate because of the Commerce Clause of the Federal Constitution. The jurisdiction of the Federal Power Commission was to complement that of the state regulatory bodies.

Panhandle, 337 U.S. at 502-03 (footnotes omitted).

60. U.S. CONST. art. VI, cl. 2. As the Supreme Court has stated, the enactment of the Power Act and

Each of these statutes begins with a similarly-worded general provision setting the parameters of federal jurisdiction. Section 201(a) of the Power Act states that federal regulation is "to extend only to those matters which are not subject to regulation by the States."[61] Section 201(b), in turn, provides that the Act:

> shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce, but . . . shall not apply to any other sale of electric energy . . . . The [Federal Energy Regulatory] Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction . . . over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.[62]

Similarly, Section 1(b) of the Gas Act states:

> The provisions of this [Act] shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.[63]

The Supreme Court, in construing these and other provisions of the Power Act and Gas Act, has established a practice of citing interchangeably decisions interpreting the pertinent sections of the two statutes.[64]

A. *Electricity in the State of Origin*

1. Federal Jurisdiction Over Facilities Used to Transmit Electric Power to Interstate Markets

In a 1943 case, *Jersey Central Power & Light Co. v. FPC*,[65] which the Supreme Court later referred to as "the first of the major FPC jurisdictional cases,"[66] the Court considered whether the FPC had jurisdiction over a utility company that was engaged principally in intrastate retail sales, but also sold small quantities of power at wholesale to another electric utility in the same state, which subsequently resold at least some of that power to an out-of-state

Gas Act "shifted this Court's main focus—in determining the permissible scope of state regulation of utilities—from the constitutional issues that concerned us in *Attleboro* to analyses of legislative intent." Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n, 461 U.S. 375, 379 (1983).

61. 16 U.S.C. § 824(a) (1982).

62. 16 U.S.C. § 824(b) (1) (1982). Section 201(b) was amended in 1978 to include within the scope of federal jurisdiction certain so-called "alternative" energy producers. *See generally* American Paper Inst., Inc. v. American Elec. Power Serv. Corp., 461 U.S. 402 (1983). Those amendments, however, did not change the basic division of federal and state jurisdiction over traditional public utilities, and therefore are not within the scope of this article.

63. 15 U.S.C. § 717(b).

64. FPC v. Sierra Pac. Power Co., 350 U.S. 348, 353 (1956), *cited with approval in* Arkansas La. Gas Co. v. Hall, 453 U.S. 571, 577 n.7 (1981); Permian Basin Area Rate Cases, 390 U.S. 747, 820-21 (1968).

65. Jersey Cent. Power & Light Co. v. FPC, 319 U.S. 61 (1943).

66. FPC v. Florida Power & Light Co., 404 U.S. 453, 459 (1972).

utility for resale to consumers in the second state.[67] The company, Jersey Central, a New Jersey utility, and the ultimate purchaser, Staten Island Edison Corporation, a New York utility, were not directly connected and had no contractual relationship. Jersey Central sold power to an intermediary, Public Service Electric & Gas Company, another New Jersey utility, which was transmitted by Public Service to a "bus bar," a switching mechanism located in one of Public Service's New Jersey substations, that in turn was connected by a transmission line with the New York facilities of the Staten Island utility. The record showed that "there were moments of time . . . when all the energy flowing into the bus bar at Mechanic Street came from Jersey Central and at the same moments energy flowed from Mechanic Street in New Jersey to the Atlantic substation in New York."[68] Although the amounts transmitted were small, the Court found that there was "a substantial basis for the conclusion of the Commission that facilities of Jersey Central are utilized for the transmission of electric energy across state lines."[69] The jurisdictional provisions of the Power Act, the Court concluded, "show the intent to regulate such transactions as are beyond state power under the *Attleboro* case."[70] Thus, the Court found it impossible to conclude, as Jersey Central urged, that the FPC's jurisdiction under the Power Act was limited to utility companies that actually transmitted power across a state line, and not those that, like Jersey Central, transmitted only within the state of origin to an intermediary, which in turn transmitted to an out-of-state recipient.[71] The Court reasoned that "[i]f intervening companies might purchase from producers in the state of production, free of federal control, cost would be fixed prior to the incidence of federal regulation and federal rate control would be substantially impaired, if not rendered futile."[72]

In a 1952 case, *Pennsylvania Water & Power Co. v. FPC*,[73] there was a challenge to the FPC's jurisdiction to set rates for wholesale sales of electric power by a Pennsylvania utility, on the ground that most of the power (83 percent) was sold for resale and ultimate consumption within Pennsylvania.

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67. The narrow issue in *Jersey Central* was whether FPC approval was needed prior to a sale of the utility's stock, as required by Section 203(a) of the Power Act, 16 U.S.C. § 824b(a). However, the effect of the FPC's order asserting jurisdiction, as the Court noted (319 U.S. at 67 n.6), was to subject the utility to all of the substantive provisions of the Power Act, including those related to rates, ascertainment of the cost of property, and accounting methods.

68. *Jersey Central*, 319 U.S. at 66.

69. *Id.* at 67 (footnote omitted).

70. *Id.* at 70-71.

71. *Id.*

72. *Id.* at 71-72. Justice Roberts in dissent, joined by Chief Justice Stone and Justice Frankfurter, thought the limitation of Section 201(a) that federal regulation is "to extend only to those matters which are not subject to regulation by the States," together with the language of Section 201(b)(1) stating that the Act "shall apply to the *transmission* of electric energy in interstate commerce and to the sale of electric energy *in interstate commerce, but shall not apply to any other sale of electric energy*" (emphasis added), should be read to exclude a company like Jersey Central, which was "not engaged in the business of transmitting electric energy beyond the point of connection with Public Service's system, certainly not beyond the bus bar where Public Service alone determines its destination." *Id.* at 82-83 (Roberts, J., dissenting). The dissent emphasized various statements in the legislative history to the effect that the Act was intended to supplement, not displace, state regulation. *Id.* at 85-88.

73. Pennsylvania Water & Power Co. v. FPC, 343 U.S. 414 (1952).

The utility owned and operated a hydroelectric project on the Susquehanna River in southern Pennsylvania, and, in conjunction with the owner of a second such project, engaged in coordinated power exchanges with an electric utility company in nearby Maryland. Thus, at times of low river flow the Pennsylvania company transmitted little or no power to the Maryland utility, but instead received power from the Maryland utility's steam plants, while at times of high flow the Maryland company received power from the two hydroelectric projects.[74] The utility and the Pennsylvania Commission asserted that the FPC's ratemaking jurisdiction extended only to sales of power that actually crossed the state line, while the remainder was subject to regulation by the state.[75] The Supreme Court disagreed, finding merit to the FPC's conclusion that "[a] complete integration and pooling of the power producing and transmitting facilities of the three companies" rendered all of the sales interstate in nature and therefore subject exclusively to federal rate regulation.[76] As Justice Black wrote for the Court, "We hold that the Federal Power Commission has complete authority to regulate all of this commingled power flow. The Commission's power does not vary with the rise and fall of the Susquehanna River."[77]

In a 1953 decision, *United States v. Public Service Commission*,[78] the Supreme Court rejected an argument that federal ratemaking jurisdiction did not extend to electric power generated by a federally-licensed hydroelectric project under a statutory provision purporting to withhold federal jurisdiction over sales of hydroelectric power if such sales are regulated by the affected states.[79] The statutory provision in question pre-dated the *Attleboro* decision and thus, as the Court said in *United States v. Public Service Commission*, "quite obviously [was] not based on any recognition of the constitutional barrier, but rather assume[d] what *Attleboro* held did not exist—state authority to reach interstate sales of energy for resale. . . ."[80] Accordingly, Congress, the Court held, did not intend to create a special exemption from federal ratemaking jurisdiction for sales of hydroelectric power generated by federally-licensed projects.

In the last of the cases in this series, *FPC v. Florida Power & Light Co.*,[81] the Supreme Court returned to the problem presented by *Jersey Central*—specifically, whether a utility company, by selling power to another utility that in turn is connected with utilities in other states, renders its sales-for-resale

74. *See id.* at 419-20.
75. *Id.* at 419.
76. *Id.* at 419-20.
77. *Id.* at 420 (footnote omitted).
78. United States v. Public Serv. Comm'n, 345 U.S. 295 (1953).
79. *Id.* at 300-11. The statutory provision referred to, 16 U.S.C. § 813, which predated by some 15 years the Power Act provisions enacted in 1935, indicates that the Federal Commission should take jurisdiction of the rates for sales of hydroelectric power only "whenever any of the States directly concerned has not provided a commission or other authority to enforce the requirements of this section within such State . . . or such States are unable to agree through their properly constituted authorities on the services . . . or the rates . . . ." 16 U.S.C. § 813.
80. United States v. Public Serv. Comm'n, 345 U.S. at 304.
81. FPC v. Florida Power & Light Co., 404 U.S. 453 (1972).

subject to federal jurisdiction under the Power Act. In this case, however, unlike *Jersey Central,* there was no evidence of actual flows of energy from the utility across the interstate connector. The generating utility, Florida Power & Light Company (FP&L), sold power to a Northern Florida utility, which in turn transmitted power to an out-of-state utility in Georgia. FP&L's power flowed to a "bus" connecting its system with that of the other Florida utility. The FPC based its claim of jurisdiction over FP&L on the following theory:

> Power supplied to the bus from a variety of sources is said to merge at a point and to be commingled just as molecules of water from different sources (rains, streams, etc.) would be commingled in a reservoir. On this basis the FPC need only show (1) FP&L power entering the bus and (2) power leaving the bus for out-of-state destinations at the same moment, in order to establish the fact that *some* FP&L power goes out of State.[82]

The Supreme Court agreed, holding that the record, consisting exclusively of expert testimony on the nature of electricity and its transmission, supported the FPC's theory. Thus, the Court rejected the view that actual tracing studies were needed to "show[ ] an energy flow-through like that demonstrated in *Jersey Central.*"[83] As the Court said, "[t]he fact that the FPC was exceptionally convincing in that leading case does not raise the standard that it must meet in all future cases."[84] The Court emphasized that tracing studies are time-consuming and, in particular, that such a requirement "might encourage the artificial and wasteful complication of interconnections for the purpose of avoiding federal jurisdiction."[85]

2. The Preemptive Effect of Federal Licensing Authority Over Hydroelectric Projects and Nuclear Generating Plants

Although the principal focus of this article is on preemption of state law under section 201 of the Federal Power Act and section 1(b) of the Natural Gas Act, the issue also arises in the case of hydroelectric projects and nuclear generating plants, both of which require a federal license prior to construction.

In the case of hydroelectric projects, the Supreme Court in a 1946 decision, *First Iowa Hydro-Electric Cooperative v. FPC,*[86] held that the states were preempted by federal statutory provisions governing hydroelectric projects[87] from requiring an applicant for a federal license to apply for and obtain paral-

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82. *Id.* at 461 (emphasis in original) (footnote omitted).

83. *Id.* at 467.

84. *Id.*

85. *Id.* at 468. Justice Douglas, in dissent, warned that "[t]he Commission's abandonment of the conventional test in favor of the commingled method will now mean that every privately owned interconnected facility in the United States (except for those isolated in Texas) is within the FPC's jurisdiction." *Id.* at 471 (Douglas, J., dissenting). Douglas was of the view that "[r]ather than the engineering battle over tracing methods, the central question ought to be whether the 'commingling' is so *de minimis* as to warrant the fastening of the federal bureaucracy on this local company." *Id.* at 473. "The federal camel has a tendency to occupy permanently any state tent." *Id.* at 476.

86. First Iowa Hydro-Electric Coop. v. FPC, 328 U.S. 152 (1946).

87. Part I of the Federal Power Act, 16 U.S.C. §§ 791-823a (1982), originally enacted in 1920, requires a federal license for hydroelectric projects constructed on navigable rivers of the United States. *See generally* Udall v. FPC, 387 U.S. 428 (1967). These licenses are issued and administered by the Federal Energy Regulatory Commission.

lel approval from the state. The Court concluded that the state's claim of authority amounted to "a veto power over the federal project" and that "[s]uch a veto power easily could destroy the effectiveness of the Federal Act."[88] Thus, the Court held that the federal license applicant did not have to show, as a condition of receiving a license, that it had complied with duplicate state requirements for a state permit.[89] As the Court concluded, "[t]he detailed provisions of the Act providing for the federal plan of regulation leave no room or need for conflicting state controls."[90]

An additional limitation on the authority of the states over hydroelectric power produced within their borders was found to arise, not from statutory preemption but from the Commerce Clause itself in *New England Power Co. v. New Hampshire*.[91] In that case, the Supreme Court held that a state could not prohibit or restrict the export of low-cost hydroelectric power to other states pursuant to a longstanding but previously unenforced state statute designed to reserve such power for in-state consumers. The Court held that the state statute in issue was not "saved" from invalidation by language in Section 205(b) of the Power Act providing that the Act does not "deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a State line."[92]

With respect to nuclear power plants, which are licensed by the United States Nuclear Regulatory Commission under the Atomic Energy Act of 1954,[93] the Supreme Court in *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission*,[94] upheld a California statute that effectively gave state officials a veto over the construction of federally-licensed nuclear power plants in the state. The statute among other things imposed a moratorium on the issuance of state permits for such plants until state officials found "that there has been developed and that the United States through its authorized agency has approved and there exists a demonstrated technology or means for the disposal of high-level nuclear waste."[95] The Supreme Court found that the state statute was not preempted by the Atomic Energy Act. The Court emphasized the following:

> [F]rom the passage of the Atomic Energy Act in 1954, through several revisions,

88. *First Iowa*, 328 U.S. at 164.

89. *Id.* at 166-67.

90. *Id.* at 181. The preemptive effect of the federal licensing power over hydroelectric facilities addressed in *First Iowa* has recently been a source of renewed controversy. In California *ex rel.* Water Resources Control Board v. FERC, 877 F.2d 743 (9th Cir. 1989), the Ninth Circuit affirmed a FERC order finding that the State of California had no authority under *First Iowa* to impose minimum water flow requirements for a FERC-licensed hydroelectric project lower than those set by the FERC. In Pennsylvania Dep't of Envtl. Resources v. FERC, 868 F.2d 592 (3d Cir. 1989), the court affirmed the FERC's denial of a request by state authorities to waive, and hence to delegate to the state, its exclusive responsibility under *First Iowa* to administer a 40-year license issued for a small hydroelectric generator installed on a state-owned dam originally constructed for other purposes.

91. New England Power Co. v. New Hampshire, 455 U.S. 331 (1982).

92. *Id.* at 340-43.

93. 42 U.S.C. §§ 2011-2296 (1982).

94. Pacific Gas & Electric Co. v. State Energy Resources Conservation & Dev. Comm'n, 461 U.S. 190 (1983).

95. *Id.* at 198 (quoting the California statute).

> and to the present day, Congress has preserved the dual regulation of nuclear-powered electricity generation: the Federal Government maintains complete control of the safety and 'nuclear' aspects of energy generation; the States exercise their traditional authority over the need for additional generating capacity, the type of generating facilities to be licensed, land use, ratemaking, and the like.[96]

The Court accepted the state's argument that its statute was intended to accomplish "economic," as distinct from safety objectives, and concluded, accordingly, that "the statute lies outside the occupied field of nuclear safety regulation."[97]

B. Electricity in the Consuming State

1. The "Bright Line" Between Federal and State Jurisdiction

In the state of consumption, the Federal Power Act expressly excludes from federal jurisdiction "facilities used in local distribution" of electric energy.[98] The only case that has considered this "local distribution" exception was *Connecticut Light & Power Co. v. FPC.*[99] In that case, the FPC asserted jurisdiction over a Connecticut utility that owned and operated facilities used to receive power from out-of-state sources at high voltage and "step down" the power to the voltage at which it could be distributed at retail to local consumers. The Supreme Court held that the FPC had erred in failing to determine whether these were "facilities used in local distribution" and therefore exempt from federal jurisdiction by section 201(b) of the Act. This provision, when "read in harmony with the policy provision" in section 201(a), stating that "Federal regulation [is] to extend only to those matters which are not subject to regulation by the States," reflected the intent of Congress to preserve state jurisdiction over companies engaged in local distribution.[100] Thus, the Commission's order asserting jurisdiction could survive, the Court held, only if "this company owned facilities that were used in transmission of interstate power *and* which were *not* facilities used in local distribution."[101] Since the FPC had failed to undertake this analysis, the case was remanded for further consideration.[102]

Of more general significance was the Court's 1964 decision in the *City of*

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96. *Id.* at 211-12.

97. *Id.* at 216. The Court also held that the California statute was not preempted by federal legislation governing nuclear waste. *Id.* at 217-220. Although acknowledging that the state statute here could frustrate Congress' intent to promote development of nuclear power under the Atomic Energy Act, the Court, distinguishing *First Iowa*, reasoned that "the legal reality remains that Congress has left sufficient authority in the States to allow the development of nuclear power to be slowed or even stopped for economic reasons." *Id.* at 222-23.

98. 16 U.S.C. § 824(b) (1982).

99. Connecticut Light & Power Co. v. FPC, 324 U.S. 515 (1945).

100. *Id.* at 525-31.

101. *Id.* at 531 (emphasis added).

102. *See* Powell, *supra* note 10, at 1072-93 (commenting favorably on the *Connecticut Light & Power Co.* decision). On remand, the FPC dismissed its proceedings against Connecticut Light & Power, concluding that "[o]n the basis of our review of the record in the light of the opinion of the Supreme Court, it is extremely doubtful that the necessary finding can now properly be made." *Connecticut Light & Power Co.*, 6 F.P.C. 104, 106 (1947).

Colton case.[103] In that case, a utility receiving interstate power, Southern California Edison Company, resold a small portion of that power to the City for resale to consumers within the same state. The Supreme Court reversed a lower court decision finding this sale outside the FPC's jurisdiction on the theory that because the sale could be regulated by the state utility commission under the Commerce Clause, it was exempt from federal jurisdiction.[104] The Supreme Court discussed at some length both the early Commerce Clause decisions in the field, especially *Attleboro*,[105] and the Court's subsequent decisions under the Power Act and the Gas Act.[106] This history showed, the Court emphasized, that Congress in both statutes intended to adopt the bright line test articulated in *Attleboro* in order to distinguish between state and federal spheres of authority.[107] In an often-quoted passage, the Court concluded:

> In short, our decisions have squarely rejected the view of the Court of Appeals that the scope of FPC jurisdiction over interstate sales of gas or electricity at wholesale is to be determined by a case-by-case analysis of the impact of state regulation upon the national interest. Rather, Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction, making unnecessary such case-by-case analysis.[108]

2. Wholesale Sales by Rural Electric Power Cooperatives to Their Members: A Departure from the "Bright Line" Rule

The Power Act by its terms brings within the scope of federal regulation any "sale of electric energy at wholesale in interstate commerce."[109] In 1967, however, the FPC, relying not on the statutory language but on extracts of legislative history, held that its regulatory authority did not extend to wholesale sales of electric power in interstate commerce by rural electric cooperatives financed by loans administered by the Rural Electric Administration (REA) under the Rural Electrification Act.[110] As the FPC stated, "Congress never intended this Commission to regulate cooperatives under the Federal Power Act."[111] Nor did the REA thereafter attempt to regulate wholesale sales of power by rural cooperatives. In 1983, the Supreme Court, in *Arkansas*

103. FPC v. Southern Cal. Edison Co., 376 U.S. 205 (1964).

104. *Id.* at 209, 210.

105. *Id.* at 212-14.

106. Panhandle Eastern Pipe Line Co. v. Public Serv. Comm'n, 332 U.S. 507 (1947); United States v. Public Utils. Comm'n, 345 U.S. 295 (1953); Connecticut Light & Power Co. v. FPC, 324 U.S. 515 (1945); and Illinois Natural Gas Co. v. Central Ill. Pub. Serv. Co., 314 U.S. 498 (1942).

107. *City of Colton*, 376 U.S. at 214-16.

108. *Id.* at 215-16. As it had in United States v. Public Utilities Comm'n of California, 345 U.S. 295 (1953), and Pennsylvania Water & Power Co. v. FPC, 343 U.S. 414 (1952), the Court in *City of Colton* concluded that a federal statute regulating hydroelectric projects, in this case Section 6 of the Boulder Canyon Project Act, 43 U.S.C. § 617e, which governed sales of power from the Hoover Dam and which predated Part II of the Federal Power Act, did not show that Congress intended to permit state regulation of power generated by such projects. *City of Colton*, 376 U.S. at 216-20. The legislative history of the Power Act, the Court found, "demonstrates that Congress believed that *Attleboro* and the related cases compelled it to forego its assumption as to state regulation and displace it with comprehensive federal regulation." *Id.* at 220.

109. 16 U.S.C. § 824(b) (1982).

110. 7 U.S.C. §§ 901-916 (1982).

111. Dairyland Power Coop., 37 F.P.C. 12, 15 (1967).

Electric Cooperative, Inc. v. Arkansas Public Service Commission,[112] held that, in the absence of federal regulation of such sales, the states could do so.

At the outset, the Court cautioned that none of the parties before it questioned the correctness of the FPC's decision that it did *not* have regulatory jurisdiction over electric cooperatives, and acknowledged that if that decision were overturned "we would obviously be faced with a very different pre-emption question."[113] Taking the FPC's decision as its starting point, the Court found that neither the Power Act, as interpreted by the FPC, nor the Rural Electrification Act, as interpreted by the REA, required a finding that state regulation of wholesale cooperatives was preempted by federal law.[114] Accordingly, the Court next turned to the issue of whether the state's assertion of authority violated the Commerce Clause, concluding that it did not.

In its Commerce Clause analysis, the Court in *Arkansas Cooperative* first found that the "anachronistic" bright-line analysis adopted in *Attleboro* could "no longer be thought to provide the sole standard by which to decide this case," and went on "to undertake an analysis grounded more solidly in our modern cases."[115] Under that approach, which attempts to balance the importance of the state's interest against the burden imposed on interstate commerce, the Court found that state regulation of the wholesale rates of a rural electric cooperative was proper.[116]

C. Federal Jurisdiction over Natural Gas in the Producing States: The "Production and Gathering" Exception

Section 1(b) of the Natural Gas Act expressly provides that the Act does not apply, among other things, to "the production or gathering of natural gas."[117] This language plainly reserves to the states the power to regulate production and gathering of natural gas. However, the task of defining the proper line between the sphere of federal authority and the sphere of state

112. Arkansas Elec. Coop., Inc. v. Arkansas Pub. Serv. Comm'n, 461 U.S. 375 (1983).

113. *Id.* at 383 n.7. As Justice White wrote in a dissenting opinion in *Arkansas Cooperative,* it is unquestionable that, "[h]ad there been at the time of *Attleboro* a cooperative that generated electricity and sold it for resale across state lines, state regulation of such sales would have been foreclosed as an interference with commerce." *Id.* at 396. Thus, in the event that the underlying assumption of *Arkansas Cooperative—i.e.,* that the Power Act, despite its broad reach over all wholesale sales of electric energy in interstate commerce, does not give the FERC jurisdiction over the wholesale rates of rural electric cooperatives—should prove to be incorrect, the Court's opinion does not give the states a very secure claim to jurisdiction over such sales.

114. *Id.* at 383-89.

115. *Id.* at 393, *citing, inter alia,* Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

116. *Id.* at 393-95. Justice White dissented in an opinion joined by Chief Justice Burger. He thought it inescapable that, under the Power Act, "state regulation of rural cooperative wholesale power rates is pre-empted because Congress has occupied the field of wholesale power rate regulation." *Id.* at 396 (White, J., dissenting). The Court's prior decisions left no doubt, Justice White believed, that Congress intended federal jurisdiction to completely fill the gap left by *Attleboro.* "Given the 48-year period in which Congress has asserted jurisdiction over wholesale rates and never manifested any belief that its policies would be furthered by state regulation of such rates," he wrote, "this Court should not purport to negate the congressional decision to abide by *Attleboro.*" *Id.* at 401.

117. 15 U.S.C. § 717(b) (1982 & Supp. V 1987).

authority in the natural gas producing states has been the single most intractable jurisdictional problem in the entire field of electric and gas regulation.

1. Early Cases Construing the "Production and Gathering" Exception

The meaning of the "production or gathering" limitation on federal jurisdiction first arose in the context of rate proceedings before the FPC. In establishing the rates for interstate sales-for-resale by jurisdictional pipeline companies, the FPC included in its rate base calculations the value of production and gathering facilities owned and operated by the pipelines. In a 1944 case,[118] the Court dismissed in a footnote a suggestion that this practice posed any problem, finding it "essential to the rate-making function as customarily performed in this country."[119] One year later, the Court expressly held in a group of three companion cases[120] that the Commission, by incorporating production and gathering facilities in the rate base, did not overstep its jurisdiction under the "production and gathering" exception. The Court explained:

> [This result] does not mean that the part of § 1(b) which provides that the Act shall not apply 'to the production or gathering of natural gas' is given no meaning. Certainly that provision precludes the Commission from any control over the activity of producing or gathering natural gas. For example, it makes plain that the Commission has no control over the drilling and spacing of wells and the like. It may put other limitations on the Commission. We only decide that it does not preclude the Commission from reflecting the production and gathering facilities of a natural gas company in the rate base and determining the expenses incident thereto for the purposes of determining the reasonableness of rates subject to its jurisdiction.[121]

In a 1947 decision, *Interstate Natural Gas Co., Inc. v. FPC*,[122] the Court rejected an argument by a pipeline engaged in sales of gas within the state of production to several interstate pipelines that its sales were part of the "gathering" process and therefore could not be regulated by the FPC.[123] The pipe-

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118. FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944).

119. *Id.* at 614 n.25. Moreover, in earlier cases arising under the fourteenth amendment, the Court had assumed that state authorities, although they had no jurisdiction over out-of-state production facilities owned by local distribution companies or their affiliates, could incorporate the value of such facilities in establishing the rate base of the local companies. *See e.g.*, Dayton Power & Light Co. v. Public Utils. Comm'n, 292 U.S. 290, 295-303 (1934); United Fuel Gas Co. v. Railroad Comm'n, 278 U.S. 300, 312-18 (1929).

120. Colorado Interstate Gas Co. v. FPC, 324 U.S. 581 (1945); Colorado-Wyoming Gas Co. v. FPC, 324 U.S. 626 (1945); Panhandle Eastern Pipe Line Co. v. FPC, 324 U.S. 635 (1945).

121. Colorado Interstate Gas Co. v. FPC, 324 U.S. at 602-03. The dissenting opinion concluded:

> Where a regulated utility procures from an unregulated source the product which it distributes, the proper cost which the regulated company should be allowed to pay for it, when the Commission is not authorized to regulate the production, presents a problem not free from difficulties. But here the Commission has made no effort to meet these difficulties, if such there be, except by the one course which the statute forbids, by subjecting the production property to regulation.

Id. at 622 (Stone, C.J., dissenting).

122. Interstate Natural Gas Co., Inc. v. FPC, 331 U.S. 682 (1947).

123. The Court in *Interstate Natural Gas* also rejected the argument that transmission of natural gas wholly within the state of production was not "in interstate commerce" within the meaning of section 1(b) of the Gas Act. *See infra* pp. 303-04.

line produced some gas itself and purchased other gas from unaffiliated producers in the same producing field. The gas, as the Court explained, flowed at the pressure from which it emerged from the wells, through a series of branch lines, then into trunk lines, and finally "into the main trunk lines from which delivery is made to the three purchasing companies."[124] At the point of sale, the pressure of the gas was increased for transmission in the interstate pipelines to out-of-state markets. All of these steps, including the sales to the pipelines, occurred within the state of production. The Court held that the sales in question did not fall within the "gathering" exception of section 1(b), emphasizing that "[e]xceptions to the primary grant of jurisdiction in the section are to be strictly construed,"[125] and also the fact that "[u]nreasonable charges exacted at this stage of the interstate movement" inevitably would be passed along in large part to downstream purchasers, "including the ultimate consumer."[126] The Court found it "unnecessary" to resolve whether the sales in question occurred during or subsequent to the "gathering" process: "By the time the sales are consummated," the Court found, "nothing further in the gathering process remains to be done."[127]

In contrast, the Court in *FPC v. Panhandle Eastern Pipeline Co.*,[128] held that the FPC did not have jurisdiction, because of the "production and gathering" exception, over the transfer by an interstate pipeline of substantial undeveloped gas reserves in a particular producing field. After a review of the legislative history of the "production and gathering" exception, the Court concluded that Congress, in recognition of the "broad and elaborate power" exercised by producing states over natural gas production and gathering, had made a conscious decision "to keep the power over the production and gathering of gas within the states."[129] The Court found that "the transfer of undeveloped gas leases is an activity related to the production and gathering of natural gas and beyond the coverage of the Act," and, therefore, that "the authority of the Commission cannot reach the sales [of such leases]."[130]

These early cases interpreting the "production and gathering" exception in section 1(b) of the Gas Act showed that the Supreme Court was wary of permitting sellers of natural gas in interstate commerce to use that exception as a shield against federal regulation of the price and other aspects of such sales. However, the Court also clearly recognized that section 1(b) did preserve to the producing states their traditional broad powers to regulate the production and gathering of natural gas.[131]

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124. *Interstate Natural*, 331 U.S. at 685.

125. *Id.* at 690-91.

126. *Id.* at 693.

127. *Id.*

128. FPC v. Panhandle Eastern Pipeline Co., 337 U.S. 498 (1949).

129. *Id.* at 512.

130. *Id.* at 515. However, in 1965, the Court, distinguishing this *Panhandle* case, held that a transfer of a *substantially developed* natural gas field was subject to federal jurisdiction, and thus could not be undertaken without FPC approval. United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392 (1965) (discussed *infra*, pp. 301-02).

131. In FERC v. Shell Oil Co., 440 U.S. 192 (1979), the Supreme Court affirmed by an equally divided vote a decision of the Fifth Circuit, Shell Oil Co. v. FERC, 566 F.2d 536 (5th Cir. 1978), which reversed on

2. Federal Jurisdiction Over the Price of Natural Gas at the Wellhead

An issue of concern to producing and consuming states alike under the Gas Act, although not resolved until the mid-1950s, was whether federal jurisdiction over sales of natural gas for resale in interstate commerce extended to sales at the wellhead by producers, or whether these sales were immune from federal regulation by virtue of the "production and gathering" exception of section 1(b).

In two companion cases decided in 1950, the Court held that the orders of a state regulatory agency fixing a minimum wellhead price for natural gas produced within the state did not violate the Commerce Clause.[132] But the Court expressly cautioned that the issue "[w]hether the Gas Act authorizes the Power Commission to set field prices on sales by independent producers, or leaves that function to the states, is not before this Court."[133]

The latter question finally did arise and was resolved in favor of federal jurisdiction by a divided Court in the seminal 1954 case, *Phillips Petroleum Co. v. Wisconsin*.[134] In that case, the Supreme Court held that Phillips Petroleum, an independent producer that sold natural gas to five interstate pipelines, was a "natural-gas company" as defined in the Gas Act, and therefore "that its sales in interstate commerce of natural gas for resale are subject to the jurisdiction of and regulation by the Federal Power Commission."[135] The Court expressly rejected the view that wholesale sales of gas by independent producers were removed from federal jurisdiction by the "production or gathering" exception of section 1(b). "[W]e believe," the Court concluded, "[that] the legislative history indicates a congressional intent to give the Commission jurisdiction over the rates of *all* wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company."[136]

Justice Clark, in a dissenting opinion in *Phillips*, predicted that "federal regulation of these sales means an inevitable clash with a complex of state

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the basis of the "production and gathering" exception an order of the FERC requiring, as a means of combating shortages of natural gas, that natural gas producers "act as 'prudent operator[s]' in developing and maintaining deliverability from natural gas reserves." 566 F.2d at 537. "To hold that the power to issue [this regulation] is within the jurisdiction of the FERC," the court of appeals concluded, "would all but eliminate the 'production or gathering' exclusion and would allow the FERC to encroach on areas reserved to the states." *Id.* at 540.

132. Cities Service Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179 (1950) (minimum price orders directed at an interstate pipeline); Phillips Petroleum Co. v. Oklahoma, 340 U.S. 190 (1950) (minimum price orders directed at an independent producer) (*see infra* p. 297). The orders upheld by the Supreme Court in the first of these cases also directed the interstate pipeline, which produced gas from its own wells, to purchase gas ratably from another producer.

133. *Cities Service*, 340 U.S. at 188-89.

134. Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954). The *Phillips* decision has been called one of "the three great regulatory milestones of the [natural gas] industry," along with enactment of the Natural Gas Act of 1938 and the Natural Gas Policy Act of 1978. Associated Gas Distributors v. FERC, 824 F.2d 981, 993 (D.C. Cir. 1987), *cert. denied*, 108 S. Ct. 1468 (1988).

135. *Phillips*, 347 U.S. at 677.

136. *Id.* at 682 (emphasis added). Shibley & Mickum, *The Impact of Phillips Upon the Interstate Pipelines*, 44 GEO. L.J. 628, 639-56 (1956).

regulatory action, including minimum pricing."[137] This prediction came to pass within a year after *Phillips*, when the same state minimum wellhead pricing scheme that had been sustained against a Commerce Clause challenge in 1950 again came before the Court for a decision on the question of whether such action was preempted by the Gas Act.[138]

The subsequent history of federal wellhead price regulation was a turbulent one, resulting not only in administrative difficulties for the FPC in attempting to regulate hundreds of independent producers, but, more importantly, in severe shortages of natural gas in the interstate markets during the 1970s because prices were too low to provide the necessary economic incentives for new production.[139] Congress in 1978 responded by enacting the Natural Gas Policy Act (NGPA),[140] which removed from the jurisdiction of the FERC much of its former authority over wellhead prices, imposing instead a scheme of statutory ceiling prices and a program of phased price decontrol.[141] "To encourage production," as the Supreme Court recently explained, "the

137. *Phillips*, 347 U.S. at 698. Justice Douglas wrote a separate dissent. In considering the Gas Act, Douglas pointed out, Congress had been preoccupied with regulation of pipelines, and "little or no consideration was given to the need of regulating the sales by *independent producers* to the pipelines." *Id.* at 688 (Douglas, J., dissenting) (emphasis in original). In these circumstances, he thought the Court should defer to the contemporaneous construction of the Act given by the FPC, whose members, with one dissent, had concluded shortly after enactment of the Act that it did not authorize federal regulation of such sales. *Id.* at 689 (citing FPC cases). Douglas expressed concern that federal regulation of wellhead sale prices would "have profound effects on the rate of production, the methods of production, the old wells that are continued in production, the new ones explored, etc." *Id.* at 690.

138. Natural Gas Pipeline Co. v. Panoma Corp., 349 U.S. 44 (1955); *see also* Cities Serv. Gas Co. v. State Corp. Comm'n, 355 U.S. 391 (1958) (per curiam).

139. *See generally* Public Service Commission v. Mid-Louisiana Gas Co., 463 U.S. 319, 327-31 (1983); W. MOGEL, TRANSPORTATION AND MARKETING OF NATURAL GAS 40-44 (1985); Bryer & MacAvoy, *The Natural Gas Shortage and the Regulation of Natural Gas Producers*, 86 HARV. L. REV. 941, 965-79 (1973). At least one state attempted to counteract the economic disincentives caused by low federal wellhead prices, by adopting minimum wellhead prices in excess of federal limits, but the FPC successfully sought an injunction against the state's rule, which the Supreme Court summarily affirmed. FPC v. Corporation Comm'n, 362 F. Supp. 522, 525 (W.D. Okla. 1973), *aff'd*, 415 U.S. 961 (1974). Two justices dissented, on the basis that the FPC had no authority under the Gas Act to bring the suit in the first place. The state conservation agencies, Justice Rehnquist wrote in dissent, "must surely feel a special kinship with the young lady from Niger":

> There was a young lady from Niger
> Who smiled as she rode on a tiger.
> They returned from the ride
> With the lady inside
> And the smile on the face of the tiger.

415 U.S. at 962, 961 (Rehnquist, J., dissenting).

140. 15 U.S.C. §§ 3301-3342 (1982).

141. The NGPA, the Supreme Court has stated,

> has been justly described as "a comprehensive statute to govern future natural gas regulation." Note, *Legislative History of the Natural Gas Policy Act*, 59 TEX. L. REV. 101, 116 (1980). . . . [I]t establishes an exhaustive categorization of natural gas production, and sets forth a methodology for calculating an appropriate ceiling price within each category. . . .
>
> In each category of gas, the statute explicitly establishes an incentive pricing scheme that is wholly divorced from the traditional historical-cost methods applied by the Commission in implementing the NGA.

Mid-Louisiana Gas Co., 463 U.S. at 332-33.

NGPA took wellhead sales of 'new' and 'high-cost' gas outside the coverage of the [Gas Act], and provided instead for market-driven wellhead pricing, at first up to a high ceiling, and later with no ceiling."[142] The NGPA, in short, was "intended to provide investors with adequate incentives to develop new sources of supply."[143]

3. Preemption of State Rules Designed to Insure "Ratable Production" by Natural Gas Producers

In the 1932 *Champlin* case, it will be recalled, the Supreme Court rejected a Commerce Clause challenge to state-imposed rules eliminating the common law "rule of capture" for oil and gas and imposing instead a "ratable" production requirement on wells drilled into common subterranean pools. Oil production, the Court found, "is essentially a mining operation and therefore is not a part of interstate commerce even though the product obtained is intended to be and in fact is immediately shipped in such commerce."[144] Similarly, in a 1950 case, *Cities Service Gas Co. v. Peerless Oil & Gas Co.*,[145] the Court sustained under the Commerce Clause the orders of a state conservation agency directing an interstate pipeline to purchase gas ratably from other producers in the same field in which the pipeline had its wells.[146]

In several other cases, the Supreme Court has considered whether state orders seeking to encourage ratable production of natural gas by influencing, directly or indirectly, the purchasing decisions of interstate pipelines, are preempted by the Gas Act because of potential interference with the comprehensive scheme of federal regulation of interstate markets under that Act. In a nutshell, such state orders are preempted where they purport to dictate directly to an interstate pipeline the amount of gas it may purchase from particular producers, but not where they do so only indirectly by regulating the pace of production in a manner reasonably calculated to advance the state's interest in assuring ratable production and avoiding waste.

In 1963, in *Northern Natural Gas Co. v. State Corporation Commission*,[147] the Supreme Court held that the orders of a state conservation agency directing an interstate pipeline to purchase gas ratably from wells within a certain field in the state were preempted by the federal scheme of regulation under the Gas Act. The Court concluded that the state's orders did not fall within the area of "production or gathering" reserved to the states by section 1(b), since its earlier decisions in *Interstate* and *Phillips* had held that these terms should be "narrowly confined to the physical acts of drawing the gas from the earth and preparing it for the first stages of distribution."[148] Moreover, even though the Kansas orders here did not attempt to fix the price of

142. Northwest Cent. Pipeline Corp. v. State Corp. Comm'n, — U.S. —, 109 S. Ct. 1262, 1269 (1989) (citation omitted).

143. Mid-Louisiana Gas Co., 463 U.S. at 334.

144. *Champlin*, 286 U.S. at 235. *See supra* pp. 279-80.

145. Cities Serv. Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 170 (1950). *See supra* p. 296.

146. *Id.* at 183 (discussing on the merits only the minimum price aspect of those orders).

147. Northern Natural Gas Co. v. State Corp. Comm'n, 372 U.S. 84 (1963).

148. *Id.* at 91-92.

gas, the Court reasoned, they were an invalid regulation of matters within the exclusive federal sphere of authority under the Gas Act, because they "necessarily deal[t] with matters which directly affect the ability of the Federal Power Commission to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act."[149]

The Court in *Northern Natural* also rejected the state's argument that its ratable take orders, although addressed directly to interstate pipelines, were comparable to the ratable production orders that had been sustained against a Commerce Clause challenge in the *Champlin* case. The Court stressed the "significant distinction . . . between conservation measures aimed directly at interstate purchasers and wholesales for resale, and those aimed at producers and production."[150] Moreover, the Court noted that the state here was not "without alternative means of checking waste and disproportionate or discriminatory taking" in its natural gas fields,[151] and referred specifically to "orders directed at producers" as an example of such alternatives.[152]

In 1986, in *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board*,[153] the Court considered whether Congress' decision in the NGPA to deregulate certain wellhead prices reflected an intent to permit the sort of ratable take order the Court had found to be preempted in the *Northern Natural* case. As the Court said, the issue was "whether Congress, in enacting the NGPA, altered those characteristics of the federal regulatory scheme which provided the basis in *Northern Natural* for a finding of pre-emption."[154] The Court concluded that, although the NGPA had removed from federal wellhead price regulation the gas reserves at issue in this case, the NGPA "[did] not constitute a federal retreat from a comprehensive gas policy."[155] On the contrary, the Court found, the state's attempt to require an interstate pipeline to purchase ratably from all producers in a given area "directly undermine[d] Congress' determination that the supply, the demand, and the price of high-cost gas be determined by market forces."[156] Accordingly, the Court held that, "[i]n light of Congress' intent to move toward a less regulated natural gas market, its decision to remove jurisdiction from FERC cannot be interpreted as an invitation to the States to impose additional regulations."[157]

In a 1989 decision, *Northwest Central Pipeline Corp. v. State Corporation*

149. *Id.* at 91-92.

150. *Id.* at 94.

151. *Id.*

152. *Id.* n.12.

153. Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Bd., 474 U.S. 409 (1986).

154. *Id.* at 417.

155. *Id.* at 421.

156. *Id.* at 422.

157. *Id.* at 423. Justice Rehnquist dissented in an opinion joined by Justices Powell, Stevens and O'Connor. The dissent, emphasizing the strong conservation interest of the producing states, reasoned that Mississippi's ratable take order would promote, not frustrate, the development of a competitive interstate natural gas market as contemplated by Congress in the NGPA, and concluded, therefore, that it was not preempted. *Id.* at 434 (Rehnquist, J., dissenting).

Commission,[158] the Court, distinguishing both *Northern Natural* and *Transco*, found that a state proration order directed not at interstate pipelines but only at producers was neither preempted by the Gas Act, nor invalid under the Commerce Clause. The state commission in that case sought to address a problem of uneven production as between producers selling to intrastate purchasers and those obligated by contract to sell to interstate pipelines, the result of which was that the producers with intrastate markets were over-producing their relative share of the common gas pool, while those with interstate markets were under-producing and accumulating substantial "underages" under the state's rules governing correlative rights. To resolve this imbalance, the state issued an order providing that accumulated "underages" would be permanently cancelled unless produced within a certain period. Although admittedly designed to encourage interstate pipelines to increase their takes from producers within the state, the order was a valid exercise of the state's authority over "production and gathering," the Supreme Court found.

Initially, the Court in *Northwest Central* concluded that the state's orders constituted "a regulation of 'production and gathering' " within the meaning of section 1(b) of the Gas Act.[159] Unlike *Northern Natural* and *Transco*, the Court found, where the states had "trespass[ed] on federal territory by imposing purchasing requirements on interstate pipelines," here the state "has regulated production rates in order to protect producers' correlative rights—a matter firmly on the States' side of that dividing line."[160]

The Court next considered whether the state's orders, even though within the "production and gathering" exception, nevertheless should be found to be preempted because of a "conflict", real or potential, with the federal scheme of regulation. All conservation measures undertaken by the producing states have at least an indirect impact on the price and availability of natural gas in the interstate markets regulated by the FERC. Therefore, the Court cautioned, "conflict-pre-emption analysis must be applied sensitively in this area, so as to prevent the diminution of the role Congress reserved to the States while at the same time preserving the federal role."[161] Thus, to survive a claim of "conflict" preemption, the Court wrote, "the State's purpose must be to regulate production or other subjects of state jurisdiction, and the means chosen must at least plausibly be related to matters of legitimate state concern."[162] The Court found that the state's order in this case did not lack a proper state purpose nor advance that purpose in so weak a manner as to be preempted because of its indirect effect on federally regulated purchasing practices by interstate pipelines.[163]

The Court reviewed whether the orders interfered with the provisions of

158. Northwest Cent. Pipeline Corp. v. State Corp. Comm'n, — U.S. —, 109 S. Ct. 1262 (1989).

159. *Id.* at 1275.

160. *Id.* at 1276.

161. *Id.* at 1276. "Nevertheless," the Court added in a footnote, "conflict-pre-emption analysis *is* to be applied, even though Congress assigned regulation of the production sphere to the States and Kansas has acted within its assigned sphere." *Id.* n.12 (emphasis in original).

162. *Id.* at 1278.

163. Northwest Cent. Pipeline Corp. v. State Corp. Comm'n, — U.S. —, 109 S. Ct. 1262, 1278-79 (1989).

the Gas Act governing dedication and abandonment of natural gas supplies in the interstate market, finding that they did not.[164] Finally, the Court considered separately whether the state's orders violated the Commerce Clause, notwithstanding the fact that they were not preempted under the Supremacy Clause, and again sustained the validity of the orders.[165]

4. Cases In Which Rights and Obligations Based on State Law Were Found to Yield to Federal Regulation of Wellhead Sales

The Supreme Court has reviewed a number of cases, arising in the producing states, which did not involve "preemption" as such, since they did not concern the validity of state statutes, rules, or orders. The cases instead, illustrate in the context of natural gas production and sales, the principle that legal rights and obligations deriving from state law must yield where their enforcement would interfere with the overarching scheme of federal regulation.

In a 1965 case, *California v. Lo-Vaca Gathering Co.*,[166] the parties to several sales contracts between natural gas producers and an interstate pipeline agreed that the gas sold would not be used for "resale" but instead would be consumed entirely by the pipeline to power its compressors, in an attempt to avoid federal regulation of the price and other terms of the sales.[167] The Supreme Court rejected the attempt and affirmed the FPC's assertion of jurisdiction, on the basis that, notwithstanding the agreements, the gas "will flow in a commingled stream with gas from other sources and that at least a portion of the gas will in fact be resold out of Texas."[168] If parties were "free to allocate by contract gas from a particular source to a particular use," the Court found, "havoc would be raised with the federal regulatory scheme . . . ."[169]

One month after its decision in *Lo-Vaca*, the Supreme Court again held, in *FPC v. Amerada Petroleum Corp.*,[170] that federal jurisdiction attached to a sale of natural gas by a supplier to an interstate pipeline, where the gas, although nominally dedicated for intrastate use, in fact was commingled in the pipeline's facilities with gas destined for interstate resale markets. The supplier in that case had separate intrastate and interstate contracts with the pipeline, but the record showed that both on "peak" days in the winter, and on non-peak days in the summer, at least some of the gas under the intrastate contract in fact left the state of production for resale in the interstate market.

164. *Id.* at 1279-80.

165. *Id.* at 1280-82. It should be noted that the Court's independent consideration of Commerce Clause issues in *Northwest Central* is of questionable necessity, since it is difficult to imagine how a state action found not to be preempted by legislation enacted by Congress under the Commerce Clause could at the same time be in violation of the limitations on state power imposed by the Commerce Clause.

166. California v. Lo-Vaca Gathering Co., 379 U.S. 366 (1965).

167. *Id.* at 367-68.

168. *Id.* at 368.

169. *Id.* at 369-70. Justice Harlan dissented. He criticized the "molecular theory" upon which the Commission had based its assertion of jurisdiction, because it would "result[ ] in expanding the regulatory scheme by sweeping within the Commission's authority gas that has not been supplied or used for interstate resale ('nonjurisdictional' gas)." *Id.* at 371 (Harlan, J., dissenting).

170. FPC v. Amerada Petroleum Corp., 379 U.S. 687 (1965).

The Court, in a brief *per curiam* opinion, concluded that this case was "[f]actually . . . on all fours" with *Lo-Vaca*, and affirmed the FPC's assertion of jurisdiction over the sales.[171]

Shortly thereafter, in *United Gas Improvement Co. v. Continental Oil Co.*,[172] the Supreme Court considered whether the FPC could assert jurisdiction over the sale of a substantially developed leasehold in a natural gas field—as contrasted to undeveloped leaseholds, the transfer of which was held to be outside the scope of federal regulation in the 1949 *Panhandle* case discussed above.[173] The Court in *Continental Oil* held that sales of improved leaseholds properly could be treated as jurisdictional " 'sales' of natural gas in interstate commerce for purposes of the Act."[174] Thus, the Court concluded that "even though a sale of natural gas in interstate commerce occurs before production or gathering is ended, it is nonetheless subject to regulation."[175] The "production or gathering" exception, the Court found, "relates to the physical activities, processes and facilities of production or gathering, but not to sales of the kind affirmatively subjected to Commission jurisdiction."[176]

In 1978, in *California v. Southland Royalty Co.*,[177] the Supreme Court held that natural gas dedicated to interstate commerce under a federal certificate of public convenience and necessity did not lose its jurisdictional status when the underlying producer-pipeline contract expired in accordance with its terms. The Court in *Southland* concluded that "the service obligation imposed by the Commission [under the certificate] survived the expiration of the private agreement which gave rise to the Commission's jurisdiction."[178] This obligation, the Court held, bound not only the original lessor but also a new owner who had purchased the original lessor's interest.[179]

One year later, in *United Gas Pipe Line Co. v. McCombs*,[180] the Court held that a federal certificate obligation to sell natural gas from a certain tract of land to a particular interstate purchaser did not expire when the supply of gas from the original well was exhausted, but on the contrary continued in existence unless formally abandoned by the certificate holder pursuant to section 7(b) of the Gas Act.[181] The producer in that case ceased making sales to

171. *Id.* at 690.

172. United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392 (1965).

173. *See supra* p. 295.

174. *Continental Oil*, 381 U.S. at 400.

175. *Id.* at 402.

176. *Id.*

177. California v. Southland Royalty Co., 436 U.S. 519 (1978).

178. *Id.* at 526.

179. *Id.* at 527-28. The Court noted that "[a]n analogy in state law may be found in the power of a tenant to seek a change in the zoning status of leased property." *Id.* at 527 n.5.

180. United Gas Pipe Line Co. v. McCombs, 442 U.S. 529 (1979).

181. Section 7(b), 15 U.S.C. § 717f(b) (1982), provides:

> No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

its pipeline purchaser when it appeared that the supply from the original well had been depleted, but did not seek abandonment authority from the Commission. Later an untapped reservoir was discovered under the same tract but at greater depth, and the producer attempted to sell this new supply to an intrastate industrial user. The Court concluded that the new supply was subject to federal jurisdiction because of the extant certificate covering the entire tract in question.[182]

5. Federal Preemption of Laws in the Producing States Regulating the Flow-Through of State Production Taxes by Interstate Pipelines

In two cases in the early 1980s, the Supreme Court struck down on preemption grounds, tax statutes enacted by producing states that purported to determine how certain taxes related to natural gas production were to be treated by downstream pipeline purchasers. In *Maryland v. Louisiana*,[183] the Court invalidated a Louisiana "First Use Tax" imposed on the processing within the state of natural gas produced in offshore wells. The statute required the purchaser of the natural gas to pass-through the tax to downstream consumers.[184] The effect of the state law, the Court found, was "to shift the incidence of certain expenses . . . to the ultimate consumer of the processed gas without the prior approval of the FERC."[185] Hence, the Court concluded that the Louisiana statute was preempted by the NGA.[186]

Similarly, in *Exxon Corp. v. Eagerton*,[187] the Court held that the Gas Act preempted a state statute purporting to prohibit natural gas producers from passing a state severance tax to downstream consumers in other states. The Court, relying on *Maryland v. Louisiana*, concluded that it was within the FERC's exclusive authority to determine whether these producers could be reimbursed for a state tax by their customers.[188]

D. Natural Gas in Transit Between the States: The Plenary Nature of Federal Authority over Transportation and Sales-for-Resale "in Interstate Commerce"

Section 1(b) of the Gas Act gives the FERC jurisdiction over transportation and sales-for-resale of natural gas "in interstate commerce."[189] In several cases in which the issue of preemption as such did not arise, this grant of jurisdiction has served as the basis for an expansive interpretation of the reach of federal regulatory authority. In addition, in one recent case,[190] the Supreme Court found that the FERC's broad regulatory authority over inter-

182. *McCombs*, 442 U.S. at 541-42.
183. Maryland v. Louisiana, 451 U.S. 725 (1981).
184. *Id.* at 748-49.
185. *Id.* at 750.
186. *Id.*
187. Exxon Corp. v. Eagerton, 462 U.S. 176 (1983).
188. *Id.* at 185.
189. 15 U.S.C. § 717(b) (1982).
190. Schneidewind v. ANR Pipeline Co., 485 U.S. 293 (1988).

state natural gas pipelines under the Gas Act did preempt a state regulatory statute as applied to an interstate pipeline.

In a 1945 case, in *Colorado-Wyoming Gas Co. v. FPC*,[191] a pipeline that purchased gas from an interstate pipeline at one point in a state, and then resold the gas at wholesale to local distributors within the same state, argued that the latter sales should not be regarded as sales "in interstate commerce" within the meaning of section 1(b) of the Gas Act, but rather as sales in intrastate commerce, outside the scope of federal jurisdiction. The Supreme Court rejected this view, finding that interstate commerce "does not end until the gas enters the service pipes of the distributing companies."[192]

Similarly, in *FPC v. East Ohio Gas Co.*,[193] the Supreme Court affirmed the FPC's assertion of jurisdiction over a natural gas company that received gas within Ohio and transported it through its own high-pressure pipeline for over 100 miles to its local distribution facilities, also in Ohio. The Court held this to be "transportation in interstate commerce" as defined in the Gas Act.[194] Furthermore, the Court found, the high-pressure line used by the local company to bring the gas from the point of connection with its interstate pipeline supplier to its own local distribution facilities did not come within the statutory exception for "local distribution" facilities.[195] The Court concluded:

> [W]hat Congress must have meant by 'facilities' for 'local distribution' was equipment for distributing gas among consumers within a particular local community, not the high-pressure pipe lines transporting the gas to the local mains. For in decisions prior to enactment of the statute this Court had sharply distinguished between the two: it had made it clear that the national commerce power alone covered the high-pressure trunk lines to the point where pressure was reduced and the gas entered local mains, while the state alone could regulate the gas after it entered those mains.[196]

If *Colorado-Wyoming Gas* and *East Ohio* concerned the point at which interstate commerce within the meaning of section 1(b) came to an end, the Court's 1947 decision in *Interstate Natural Gas Co.*[197] concerned the related problem of where it began. In that case, the Court held that the FPC properly could assert jurisdiction over a pipeline that made deliveries to its interstate pipeline customers within the state of production. As the Court stated, "it is clear that the sales in question were quite as much in interstate commerce as they would have been had the pipes of the petitioner crossed the state line before reaching the points of sale."[198] Nor did the fact that the gas was subject to compression for interstate transmission only at the point of sale defeat

191. Colorado-Wyoming Gas Co. v. FPC, 324 U.S. 626 (1945).

192. *Id.* at 631.

193. FPC v. East Ohio Gas Co., 338 U.S. 464 (1950).

194. *Id.* at 468-69.

195. *Id.* at 469-71.

196. *Id.* at 469-70 (emphasis added). In 1954, after the Court's decision in *East Ohio*, Congress enacted Section 1(c) of the Act, the so-called "Hinshaw Amendment," which provides an exception from federal regulation for companies that engage in interstate transportation or sales-for-resale as defined in the Act but do so wholly within the state where the gas is consumed, and are regulated by that state. 15 U.S.C. § 717(c) (1982).

197. Interstate Natural Gas Co. v. FPC, 331 U.S. 682 (1947) (discussed *supra*, p. 294).

198. *Id.* at 687-88.

federal jurisdiction over the gas prior to that point, the Court held. "Long before the gas reaches the compressor pumps," the Court concluded, "it has been committed to its interstate journey which follows without interruption or deviation."[199]

In a 1961 case, *FPC v. Transcontinental Gas Pipe Line Corp.*,[200] the Supreme Court considered whether the FPC could deny a certificate of public convenience and necessity for transportation by an interstate pipeline of natural gas purchased in Texas by a New York utility for use as boiler fuel in the utility's electric generating plants, on the basis of two concerns touching on areas outside the FPC's jurisdiction: (1) that burning gas as boiler fuel was an inferior use and would result in "economic waste" of a valuable natural resource, and (2) the price paid for the gas in question, which was exempt from federal regulation because the sale was not a "sale-for-resale," and which was higher than the federally-regulated rate for sales-for-resale in the same area, would trigger increases in the field price of gas generally, to the detriment of consumers.[201] The Court considered whether, given the limitations on federal jurisdiction embodied in section 1(b), "the Commission has trod on forbidden ground in making its decision."[202] After analyzing the statute and its legislative history, the Court held that the FPC had not exceeded its authority in basing its decision on these factors.

Perhaps the most expansive reading of federal jurisdiction to date occurred in a 1972 decision of the Supreme Court, *FPC v. Louisiana Power & Light Co.*,[203] which arose out of the FPC's efforts to ameliorate the effects of a critical nationwide shortage of natural gas. The issue in that case was whether the FPC, although its sales jurisdiction did not extend to so-called "consumptive" sales of natural gas, *i.e.*, direct sales by interstate pipelines to end-users, nevertheless could order pipelines to curtail deliveries to their direct sales customers so as to assure a greater supply of gas for residential and commercial customers served by the pipelines' resale customers. The Court held that federal jurisdiction over interstate *transportation* of natural gas was sufficiently broad to support the FPC's orders.

The Court in *Louisiana Power & Light Co.*, based on a review of the statutory language and legislative history, concluded that the exclusion of consumptive sales from federal jurisdiction was intended by Congress to apply only to the *rates* for such sales, "and in no wise limited the broad base of 'transportation' jurisdiction granted the FPC. That head of jurisdiction plainly embraces regulation of the quantities of gas that pipelines may transport."[204] The FPC's authority to prevent "undue discrimination" under section 4 of the Gas Act,[205] the Court found, was sufficiently broad to include the power to enforce a system-wide, non-discriminatory curtailment plan that

199. *Id.* at 689.
200. FPC v. Transcontinental Gas Pipe Line Corp., 365 U.S. 1 (1961).
201. *Id.* at 5.
202. *Id.* at 8.
203. FPC v. Louisiana Power & Light Co., 406 U.S. 621 (1972).
204. *Id.* at 640.
205. 15 U.S.C. § 717c (1982).

applied both to "jurisdictional" sales-for-resale and to "non-jurisdictional" direct, consumptive sales.[206]

In 1988, in *Schneidewind v. ANR Pipeline Co.*,[207] the Supreme Court held that the FERC's broad regulatory authority over interstate natural gas pipelines under the Gas Act preempted an order of a state regulatory commission seeking to enforce against such a pipeline a state statute requiring the approval of state authorities prior to the issuance of securities by natural gas utilities operating in the state. Initially, the Court found that, although the Gas Act contains no express provisions governing securities issuances, it does "give FERC a number of tools for examining and controlling the issuance of securities of natural gas companies in the exercise of its comprehensive authority."[208] Nor was it dispositive, the Court concluded, that Congress had failed to enact specific legislative proposals providing for direct federal regulation of securities issuances by interstate natural gas pipelines.[209] Rather, the "crux of the issue" was whether the state here had attempted "regulation of the rates and facilities of natural gas companies used in transportation and sale for resale of natural gas in interstate commerce."[210]

Schneidewind concluded that the state statute, "when applied to natural gas [pipeline] companies, . . . amounts to a regulation of rates and facilities, a field occupied by federal regulation."[211] In every important respect, the Court found, "[t]he objectives sought by [the state statute] are the same as those sought by the [Gas Act]."[212] These included protection against rate increases and improper maintenance of facilities. "In short," the Court concluded, "the things [the state statute's] regulation is directed at, the control of rates and facilities of natural gas companies, are precisely the things over which FERC has comprehensive authority."[213] Moreover, the Court noted, the state statute also posed an "imminent possibility of collision" with the scheme of federal regulation under the Gas Act, because of the prospect that state authorities might deny approval of a securities issuance necessary to finance a FERC-approved project.[214]

E. Natural Gas in the Consuming State

Section 1(b) of the Natural Gas Act provides that the Act "shall not

206. Louisiana Power & Light Co., 406 U.S. at 645-46. In another case arising during the same period of natural gas shortages, Public Serv. Comm'n v. FERC, 610 F.2d 439 (6th Cir. 1979), the Sixth Circuit affirmed a FERC order prohibiting a jurisdictional pipeline company from providing service to local consumers located within a short distance of its wells in Kentucky, as required by a Kentucky statute. The Sixth Circuit concluded that the FERC's jurisdiction over interstate transportation of natural gas included the power to insist that any deliveries of gas along the gathering system of an interstate supplier could be made, if at all, only pursuant to a certificate of public convenience and necessity issued under the Natural Gas Act. *Id.* at 444.

207. Schneidewind v. ANR Pipeline Co., 485 U.S. 293, 108 S. Ct. 1145 (1988).

208. *Id.* at 1151.

209. *Id.* at 1153-54.

210. *Id.* at 1154.

211. *Id.*

212. Schneidwind v. ANR Pipeline Co., 485 U.S. 293 (1988).

213. *Id.* at 1155.

214. *Id.* at 1156.

apply . . . to the local distribution of natural gas or to the facilities used for such distribution . . . ."[215] The Act thus distinguishes between interstate transportation and sales-for-resale, which are subject to federal regulation, and "local distribution," which remains subject to state regulation.

1. Early Cases Under the Gas Act Finding Preemption of State Authority in the Consuming State

In a 1942 case, *Illinois Natural Gas Co. v. Central Illinois Public Service Co.*,[216] the Supreme Court considered whether the Gas Act permitted state officials to order an interstate pipeline to connect with and sell gas to a local distribution company.[217] Congress in the Gas Act, the Court found, had "brought under national control the very matters which the state has undertaken to regulate by the order [in this case]."[218] A central purpose of this legislation "was to afford, through the exercise of the national power over interstate commerce, an agency for regulating the wholesale distribution to public service companies of natural gas moving interstate, which this Court had declared to be interstate commerce not subject to certain types of state regulation."[219] Congress sought to "regulate a defined class of natural gas distribution, without the necessity, where Congress has not acted, of drawing the precise line between state and federal power by the litigation of particular cases."[220] The key here was that the pipeline "engages in interstate commerce in gas and in its interstate transportation, as those terms had been defined by this Court, before the adoption of the Act."[221] Accordingly, the Court held that, because Congress in the Gas Act had given the FPC exclusive jurisdiction to order extensions of pipe line facilities to serve the needs of local distribution companies, "the state commission was without power to order them."[222]

In a 1943 case, *Public Utilities Commission v. United Fuel Gas Co.*,[223] the Court again held that an assertion of jurisdiction by a state agency over a sale of natural gas to a local distribution company for resale to consumers was preempted by the Gas Act.[224] A state public utilities commission in that case, before the enactment of the Gas Act, had instituted proceedings to set the rates charged by an interstate pipeline for wholesale sales to a local distribution company. The Court affirmed a district court order enjoining the state proceedings, on the ground that the FPC had exclusive jurisdiction over these rates under the Gas Act.[225] The Court concluded:

It is clear, as the legislative history of the Act amply demonstrates, that Congress

215. 15 U.S.C. § 717(b) (1982).
216. Illinois Natural Gas Co. v. Central Ill. Pub. Serv. Co., 314 U.S. 498 (1942).
217. *Id.* at 503.
218. *Id.* at 506.
219. *Id.* (citing H.R. Rep. No. 709, 75th Cong., 1st Sess. (1937)).
220. *Id.* at 506-07.
221. *Id.* at 508.
222. *Id.* at 510.
223. Public Utils. Comm'n v. United Fuel Gas Co., 317 U.S. 456 (1943).
224. *Id.* at 466.
225. *Id.* at 469.

> meant to create a comprehensive scheme of regulation which would be complementary in its operation to that of the states, without any confusion of functions. The Federal Power Commission would exercise jurisdiction over matters in interstate and foreign commerce, to the extent defined in the Act, and local matters would be left to the state regulatory bodies. Congress contemplated a harmonious, dual system of regulation of the natural gas industry—federal and state regulatory bodies operating side by side, each active in its own sphere.[226]

2. Federal Versus State Jurisdiction Over the "By-Pass" of Local Distribution Facilities by Pipelines Providing Direct Service to Industrial End-Users

Direct service by interstate natural gas pipelines to industrial end-users has long been a source of controversy in those instances where the end-user is located within the franchised service area of a state-regulated local distribution company. The controversy is particularly acute when the end-user has previously been served by the local distribution company and arranges for direct service by the pipeline, thus effecting a "by-pass" of the local distribution company, with potentially adverse consequences for both the local distribution company and its remaining customers.

In a 1947 case, *Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana*,[227] the Supreme Court held that a state public utilities commission could regulate the *rates* for sales of natural gas by an interstate pipeline to industrial end-users within the state. At the time the Gas Act was enacted in 1938, the Court noted, the states under the Commerce Clause "could regulate sales direct to consumers, even though made by an interstate pipe-line carrier."[228] Congress, accordingly, had excluded direct sales for consumptive use from the grant of jurisdiction to the FPC. The Court explained:

> [Section 1(b) of the Act] determines the Act's coverage and does so in the light of the situation existing at the time. Three things and three only Congress drew within its own regulatory power, delegated by the Act to its agent, the Federal Power Commission. These were: (1) the transportation of natural gas in interstate commerce; (2) its sale in interstate commerce for resale; and (3) natural gas companies engaged in such transportation or sale.[229]

Accordingly, Congress, the Court concluded, had declined to extend federal jurisdiction over direct sales of any sort.[230] "The line of the statute was thus clear and complete," the Court explained. "It cut sharply and cleanly between sales for resale and direct sales for consumptive uses."[231] With "unusual legislative precision," the Court explained, Congress had attempted to complement, not supplant, state regulatory power: "The Act was drawn with meticulous regard for the continued exercise of state power, not to handicap or dilute it in any way."[232] It followed, then, that since direct industrial sales

226. *Id.* at 467.
227. Panhandle Eastern Pipe Line Co. v. Pub. Serv. Comm'n, 332 U.S. 507 (1947).
228. *Id.* at 514.
229. *Id.* at 516.
230. *Id.* at 516-17.
231. *Id.* at 517.
232. *Id.* at 517-18.

by an interstate pipeline had been held to be in "intrastate" commerce under the older Commerce Clause cases, the Gas Act did not preempt the state's effort in this case to regulate the rates for such sales.

Similarly, in *Panhandle Eastern Pipe Line Co. v. Michigan Public Service Commission*,[233] the Supreme Court rejected a Commerce Clause challenge to a state statute requiring a state-issued certificate of public convenience and necessity for direct sales service by pipelines to industrial end-users in the state. The Court again emphasized the important state interest in regulating such sales,[234] and, relying upon and quoting extensively from the opinion in the *Panhandle-Indiana* case, concluded that regulation of these sales by the state would not unduly burden interstate commerce.[235] No federal certificate had been issued to the pipeline to construct the facilities needed to effectuate such a sale, however, and the Court, accordingly, found that "[t]here are no opposing directives and hence no necessity for us to resolve any conflicting claims as between state and federal regulation."[236]

F. Federal Preemption Under the "Filed Rate Doctrine"

As the Supreme Court has explained, the ratemaking provisions of the Power Act and the Gas Act are substantially similar and are often cited interchangeably.[237] Unlike, for example, railroad rates fixed by the Interstate

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233. Panhandle Eastern Pipe Line Co. v. Michigan Pub. Serv. Comm'n, 341 U.S. 329 (1951).

234. The Court explained:

> To accommodate its operations, appellant [pipeline company] proposes to use the streets and alleys of Detroit and environs. A local utility already operating in the same area, Consolidated, receives its entire supply of natural gas from appellant. A substantial portion of Consolidated's revenues is derived from sales to large industrial customers. Appellant ignored requests of Consolidated for additional gas to meet the increased wants of its industrial customers. Instead of attempting to meet the increased needs through Consolidated, appellant launched a program to secure for itself large industrial accounts from customers, some of whom were already being served by Consolidated. In connection with the Ford Motor Company, it is noteworthy that the tap line by which appellant proposed to serve Ford directly would be substantially parallel to and only a short distance from the existing tap line by which Consolidated now serves Ford.

Id. at 333-34.

235. *Id.* at 334-36. The Court noted that no actual conflict between the federal and state schemes of regulation was presented in this case. *Id.* at 336. Recently, such a conflict has occurred in a case arising out of a very similar factual situation involving the same Michigan statute and the same pipeline. In that case, the FERC approved the issuance of a certificate for transportation and delivery of natural gas to an industrial end-user in Michigan. The customer, however, bought the gas at its source in Oklahoma and the pipeline merely transported it, so that no sale occurred within Michigan. In National Steel Corp. v. Long, 689 F. Supp. 729 (W.D. Mich. 1988), a federal district court, distinguishing the *Panhandle-Indiana* and *Panhandle-Michigan* cases, enjoined the Michigan Public Service Commission from requiring the pipeline to obtain a state certificate of convenience and necessity before providing service under the federal certificate. The district court reasoned that the state's authority was preempted by the federal certificate, and, further, that the language of section 1(b) of the NGA preserving state jurisdiction over "local distribution" facilities did not apply to these deliveries by the pipeline. The district court decision is now on appeal in the United States Court of Appeals for the Sixth Circuit. Michigan Consol. Gas Co. v. Panhandle Eastern Pipeline Co., No. 88-1650 (6th Cir. January 30, 1989). Meanwhile, the FERC certificate orders are on review in the D.C. Circuit. Michigan Consol. Gas Co. v. FERC 883 F.2d 117 (D.C. Cir., 1989).

236. *Panhandle-Michigan*, 341 U.S. at 336.

237. *See* Arkansas La. Gas Co. v. Hall, 453 U.S. 571, 577 n.7 (1981); FPC v. Sierra Pac. Power Co., 350 U.S. 348, 353 (1956); Permian Basin Area Rate Cases, 390 U.S. 747, 820-21 (1968).

Commerce Commission, the ratemaking provisions of the Power Act and Gas Act do not "requir[e] compliance with a single schedule of rates applicable to all shippers" but instead "permit[ ] the relations between the parties to be established initially by contract, the protection of the public interest being afforded by supervision of the individual contracts, which to that end must be filed with the Commission and made public."[238]

In a 1951 case, *Montana Dakota Utilities Co. v. Northwestern Public Service Co.*,[239] the Court held that the federal "filed rate," established by power sales contracts filed with, and accepted by the FPC, was binding on the Federal courts. A party to those contracts, the Court held, "can claim no rate as a legal right that is other than the filed rate, whether fixed or merely accepted by the Commission, and not even a court can authorize commerce in the commodity on other terms."[240]

The "filed rate doctrine" articulated in *Montana-Dakota Utilities* operates not only to preclude federal courts from making their own rate determinations, but also preempts state courts and regulatory agencies from requiring the payment of rates other than the federal filed rate. This preemptive effect of the filed rate doctrine in the field of electricity and natural gas was first recognized in a 1981 case, *Arkansas Louisiana Gas Co. v. Hall*,[241] which held that a natural gas producer, whose contract for sales of natural gas to an interstate pipeline was filed as part of its federal tariff, could not collect damages in state court for a past breach of that contract by the pipeline. The filed rate doctrine, the Court noted, "bars a regulated seller of natural gas from collecting a rate other than the one filed with the Commission and prevents the Commission itself from imposing a rate increase for gas already sold."[242] Thus, the state courts, in enforcing the gas producer's contract rights, likewise could not impose a retroactive price increase on the assumption that the FPC, had it been asked at the appropriate time to approve such an increase, might well have done so.[243] "It would surely be inconsistent with this congressional purpose," the Court wrote, to permit a state court to do through a breach-of-contract action what the Commission itself may not do."[244] Accordingly, the Court, citing a case that found a state tort action preempted by orders of the Interstate Commerce Commission,[245] held that the filed rate doctrine preempted the state courts from awarding the producer a remedy for the pipe-

238. United Gas Pipe Line Co. v. Mobile Gas Serv. Corp., 350 U.S. 332, 338-39 (1956) (construing the NGA); *see also* FPC v. Sierra Pac. Power Co., 350 U.S. 348, 350-51 (1956) (noting that the ratemaking provisions of the Power Act "are substantially identical" to those of the Gas Act).

239. Montana Dakota Utils. Co. v. Northwestern Pub. Serv. Co., 341 U.S. 246 (1951).

240. *Id.* at 251. The Court held:

> [T]he right to a reasonable rate is the right to the rate the Commission files or fixes, and . . . except for review of the Commission's orders, the courts can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one.

Id. at 251-52.

241. Arkansas La. Gas Co. v. Hall, 453 U.S. 571 (1981).

242. *Id.* at 578.

243. *Id.* at 579-80.

244. *Id.* at 580.

245. Chicago & North Western Transp. Co. v. Kalo Brick & Tile Co., 450 U.S. 311 (1981).

line's breach of contract. Moreover, the Court emphasized, "[n]o appeal to equitable principles can justify this usurpation of federal authority."[246]

In a 1986 case, *Nantahala Power & Light Co. v. Thornburg*,[247] the Supreme Court held that an allocation by the FERC of low-cost hydroelectric power between two subsidiaries of the Aluminum Company of America, one of which, Nantahala Power & Light Company, was a North Carolina public utility, preempted the North Carolina Public Service Commission from allocating a higher (and thus more favorable) portion of that power to the Nantahala Company for ratemaking purposes. Initially, the Court emphasized that, under the "filed-rate doctrine," the FERC-approved rates are entitled to respect by federal and state courts.[248] The Court explained:

> [The] FERC clearly has exclusive jurisdiction over the rates to be charged Nantahala's interstate wholesale customers. Once the FERC sets such a rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable. A State must rather give effect to Congress' desire to give the FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority.[249]

Next, the Court expressly rejected the view that the North Carolina authorities might decide whether to pass through in retail rates the wholesale rates they were obliged to accept under the filed rate doctrine. "The fact that [the State Commission] is setting retail rates does not give it license to ignore the limitations that FERC has placed upon Nantahala's available sources of low-cost power."[250] On the contrary, the Court reasoned that

> [w]hen the FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate. . . . Such a 'trapping' of costs is prohibited.[251]

Finally, the Court in *Nantahala* held that the state court had "erred in relying on cases treating the reasonableness of purchasing from a particular source of, rather than paying of particular rate for, the FERC-approved power."[252] The Court was willing to "assume that a particular *quantity* of power procured by a utility from a particular source could be deemed unreasonably excessive if lower-cost power is available elsewhere, even though the higher-cost power actually purchased is obtained at a FERC-approved, and therefore reasonable, *price*."[253] But Nantahala in this case had no alternative sources of power, and "[t]he North Carolina court's ruling that Nantahala had purchased an unreasonably large quantity of high-cost power . . . there-

246. *Hall*, 341 U.S. at 584.

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

248. *Id.* at 962 (citing Montana Dakota Utils. Co. v. Northwestern Pub. Serv. Co., 341 U.S. 248, 251-52 (1951)).

249. *Nantahala*, 476 U.S. at 966 (citations omitted).

250. *Id.* at 970.

251. *Id.* (citation omitted).

252. *Id.* at 972.

253. *Id.* (emphasis in original). The Court cited a leading state court decision that did so hold, Pike County Light & Power Co. v. Pennsylvania Pub. Util. Comm'n, 77 Pa. Commw. 268, 273-74, 465 A.2d 735, 737-38 (Pa. Commw. Ct. 1983).

fore conflicts with the FERC's orders in the same manner as would a refusal to recognize a FERC-approved price as a reasonable cost for purposes of retail ratemaking."[254]

More recently, in *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*,[255] decided in June 1988, the Court held that the reasoning of *Nantahala* also applied to preempt the Mississippi Public Service Commission (MPSC) from examining the prudence of the Mississippi Power & Light Company's (MP&L) FERC-established share of the costs of an extremely expensive source of power, the Grand Gulf nuclear power plant, which began operations in July 1985.[256] The FERC had allocated the costs of Grand Gulf between MP&L and the three other operating companies of Middle South Utilities (MSU), a multi-state utility holding company.[257] The Supreme Court concluded that here, as in *Nantahala*, "the Supremacy Clause compels the MPSC to permit MP&L to recover as a reasonable operating expense costs incurred as the result of paying a FERC-determined wholesale rate for a FERC-mandated allocation of power."[258]

It was immaterial, the Court held, that the FERC did not expressly decide whether MP&L's participation in the Grand Gulf project was "prudent" for ratemaking purposes, since the parties were given the opportunity to raise that issue in the FERC proceedings, and the FERC itself "did consider and reject some aspects of the prudence review the Mississippi Supreme Court directed the MPSC to conduct."[259] In these circumstances, the Court con-

254. *Nantahala*, 476 U.S. at 973.

255. Mississippi Power & Light Co. v. Mississippi *ex rel.* Moore, 108 S. Ct. 2428 (1988).

256. Id. at 2431. There have also been two lower court decisions of note concerning the FERC's allocation of costs attributable to the Grand Gulf plant, both by the United States Court of Appeals for the Eighth Circuit, and both involving another of the Middle South companies, Arkansas Power & Light Company (AP&L). In the first, the court affirmed a district court order enjoining the Arkansas Public Service Commission from conducting proceedings to determine whether to declare void the contracts establishing AP&L's share of the costs of Grand Gulf. Middle South Energy, Inc. v. Arkansas Pub. Serv. Comm'n, 772 F.2d 404 (8th Cir. 1985). In the second, the Court of Appeals for the Eighth Circuit held that although the Missouri Pub. Serv. Commission was obligated to pass through FERC-approved wholesale costs to retail ratepayers, it did not have to do so immediately but could employ its usual rules for implementing rate increases, which allow a period of suspension before rate increases are made effective. Arkansas Power & Light Co. v. Missouri Pub. Serv. Comm'n, 829 F.2d 1444 (8th Cir. 1987).

257. *See Mississippi*, 108 S. Ct. at 2433-34. The FERC's authority to allocate cost responsibility for the Grand Gulf plant among the various Middle South companies had earlier been affirmed on review by the U.S. Court of Appeals for the District of Columbia Circuit, although that court did not approve the specific allocation adopted by the FERC. Mississippi Indus. v. FERC, 814 F.2d 773 (D.C. Cir. 1987), *vacated in part and remanded*, 822 F.2d 1104 (D.C. Cir. 1987).

258. *Mississippi*, 108 S. Ct. at 2440. Here, as in *Nantahala*, the Court was willing to:

> 'assume that a particular *quantity* or power procured by a utility from a particular source could be deemed unreasonably excessive if lower-cost power is available elsewhere, even though the higher-cost power actually purchased is obtained at a FERC-approved, and therefore reasonable, price.' [*Nantahala*, 476 U.S.] at 972 (emphasis in original). As we assumed, it might well be unreasonable for a utility to purchase unnecessary quantities of high cost power, even at FERC-approved rates, if it had the legal right to refuse to buy that power. But if the integrity of FERC regulation is to be preserved, it obviously cannot be unreasonable for MP&L to procure the particular quantity of high-priced Grand Gulf power that FERC had *ordered* it to pay for.

Id. (emphasis added).

259. *Id.* at 2441.

cluded, "[t]he MPSC cannot evaluate either the prudence of MSU's decision to invest in Grand Gulf and bring it on line or the prudence of MP&L's decision to be a party to agreements to construct and operate Grand Gulf without traversing matters squarely within FERC's jurisdiction."[260]

In a concurring opinion, Justice Scalia wrote that,

> [a]fter today, the battle will no longer be over who has jurisdiction, FERC or the States, to evaluate the prudence of a particular utility's entering pooling arrangements with affiliated companies for the sharing of electrical generating capacity or the creation and wholesaling of electrical energy. FERC has asserted that jurisdiction and has been vindicated. What goes along with the jurisdiction is the responsibility, where the issue is appropriately raised, to protect against allocations that have the effect of making the ratepayers of one State subsidize those of another.[261]

Nantahala and *Mississippi* establish not only that the federal "filed rate" encompasses more than rates *per se*, and includes FERC-mandated allocations of power among affiliated companies, but also that the "filed rate doctrine" is binding on state regulatory agencies. On the other hand, the Court in both cases expressly assumed, albeit in *dicta*, that where the local utility has the ability to purchase supplies from more than one FERC-regulated wholesale source, state authorities are free to examine the "prudence" of the utility's purchasing decisions.[262]

Finally, it should be noted that a practical issue of some importance in this regard is whether the federal courts should exercise their jurisdiction to consider challenges to state regulatory orders that allegedly violate the federal filed rate doctrine, when those orders are also on review in state courts. The federal courts of appeals have split on this issue, and the Supreme Court recently heard argument in a case raising the question.[263]

IV. CONCLUSION

In both the Power Act and the Gas Act, Congress sought to "fill the gaps" in state authority that the Supreme Court had held to exist under the Commerce Clause by application of mechanical, bright line rules. Those rules, as the Court has acknowledged in recent years, "may have made considerable sense" in the context of the times, when no federal legislation existed to

260. *Id.* Justice Brennan dissented in an opinion joined by Justices Marshall and Blackmun. Citing the *Pike County* case, Justice Brennan reasoned that "although a state utility [commission] cannot decide that a retail utility should have bought wholesale power from a given source at other than the FERC-approved wholesale rate, it can decide that the utility should not have bought power from that source at all." *Id.* at 2446 (Brennan, J., dissenting). In other words, "the reasonableness of charging a rate as a wholesaler is distinct from the reasonableness of incurring that charge as a purchaser." *Id.* Brennan therefore concluded that FERC's approval of an interstate power pooling arrangement should not preclude individual states from "determin[ing] whether incurring those costs involved prudent purchase decisions that can be passed on to retail customers." *Id.* at 2449.

261. *Id.* at 2445 (Scalia, J., concurring).

262. *Compare* Kentucky West Virginia Gas Co. v. Pennsylvania Pub. Util. Comm'n, 837 F.2d 600 (3d Cir. 1988), *cert. denied*, 109 S. Ct. 365 (1988) (holding that a state utility commission was not preempted by the filed rate doctrine from determining whether a local distribution company had made prudent purchasing decisions as between several alternative FERC-approved wholesale sources available to it).

263. New Orleans Pub. Serv., Inc. v. New Orleans, 109 S. Ct. 2506 (1989).

resolve the often vexing jurisdictional problems arising in the electric power and natural gas industries.[264] Moreover, although the mechanical approach to Commerce Clause questions in the older cases could produce seemingly arbitrary restrictions on the otherwise lawful regulatory powers of the states, it did provide a high degree of predictability to the law in this field. By "freezing" the jurisdictional boundaries as they were found to exist in the old Commerce Clause cases, Congress took advantage of this predictability, while eliminating "regulatory gaps." For these reasons, the jurisdictional division between the federal government and the states in the field of electricity and natural gas established more than fifty years ago by the Power Act and the Gas Act has proven not only to be adequate for purposes of protecting the ultimate consumer, but also to be relatively simple for the courts and regulatory agencies to understand and apply.

264. Arkansas Electric Coop. Corp. v. Arkansas Pub. Serv. Comm'n, 461 U.S. 375, 393 (1983).