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Antitrust Alert

Justices Spar Over Pre-Emption as High Court Allows State Law Antitrust Claims to Proceed Against Interstate Pipelines

04.27.2015

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On April 21, 2015, in a 7-2 decision authored by Justice Breyer, the U.S. Supreme Court ruled that state law antitrust claims brought against interstate pipeline companies by a group of manufacturers and other retail buyers of natural gas are not pre-empted by the Natural Gas Act ("NGA" or the "Act"). *Oneok, Inc. et al. v. Learjet, Inc. et al.*, No. 13-271, slip op. (U.S. Apr. 21, 2015). The question presented was whether the NGA pre-empts state law antitrust claims when the challenged conduct affects both federally regulated wholesale natural gas prices and non-federally regulated retail natural gas prices. Affirming the Ninth Circuit's opinion,[1] the Court rejected arguments advanced by petitioners and the U.S. Solicitor General that respondents' state law antitrust claims were barred because they fall within the field of matters relating to wholesale sales and transportation of natural gas in interstate commerce that the NGA pre-empts. According to the majority, the state law price-manipulation claims were not pre-empted because they were directed at practices affecting retail rates, which falls squarely on the states' side of the dividing line. Justice Scalia and Chief Justice Roberts strongly dissented. Writing for the dissent, Justice Scalia stated that the Court "smudges" the "firm line" drawn by the Court's prior cases between national and local authority over the natural gas trade. He predicted that the Court's decision "will invite state antitrust courts to engage in targeted regulation of the natural-gas industry" and will likely subject pipelines to the heavy burden of ensuring that their conduct conforms "to the discordant regulations of 50 States."

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Natural Gas Regulation and the NGA

The natural gas industry involves three segments: (1) the exploration and production of natural gas resources and the extraction and gathering of gas from the earth, (2) the transportation of gas via interstate pipeline systems to storage facilities, local distribution companies, and other consumers who purchase the gas at wholesale from the pipeline company, and (3) the retail sale and delivery of gas to businesses and residential consumers by the local distributor. Natural gas is also traded like commodities as a financial product derived from physical natural gas.

The NGA provides the Federal Energy Regulatory Commission ("FERC") with the exclusive jurisdiction to regulate the second segment, involving the interstate transportation and wholesale sale of gas, which includes regulating the terms of access and prices for interstate gas transportation and storage. Specifically, Section 5(a) of the NGA gives rate-setting authority to the FERC, providing it with jurisdiction over "any rate, charge, or classification … collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of [FERC]."[2] It also provides FERC with jurisdiction over "any rule, regulation, practice, or contract affecting" jurisdictional rates. Natural gas production, gathering, intrastate transportation, and retail sales of gas are exclusively within the jurisdiction of state regulation.

Factual and Procedural History

The issues in the case arise out of claims that interstate pipeline companies who engaged in the trading of natural gas, manipulated the price of natural gas from 2000-2002. During this time, retail buyers purchased natural gas directly from pipeline companies for their own consumption.

Retail buyers alleged that the pipeline companies manipulated the price of natural gas by, among other things,

reporting false information to price indices published by trade publications and engaging in other conduct designed to sell natural gas at artificially inflated prices. FERC conducted an investigation and concluded that the significant price increase in the electricity market was facilitated by the rise in spot gas prices to extraordinary levels, which FERC determined stemmed, in part, "from efforts of energy trading companies to manipulate price indices compiled by trade publications."[3]

Retail gas purchasers subsequently filed antitrust lawsuits in state and federal court beginning in 2005, which were eventually removed to federal court and consolidated into a multidistrict litigation proceeding. Defendants filed a motion for summary judgment arguing that FERC had jurisdiction to regulate "any practice" affecting a rate subject to the jurisdiction of the Commission (i.e., a jurisdictional rate).[4] The District Court agreed and granted the Defendants' motion for summary judgment. Plaintiffs appealed to the Ninth Circuit, which subsequently reversed. The Ninth Circuit recognized that the price-manipulation claims affected jurisdictional wholesale sales as well as nonjurisdictional retail sales, but narrowly construed the NGA's pre-emptive scope, holding that the Act "did not pre-empt state-law claims aimed at obtaining damages for excessively high *retail* natural-gas prices stemming from interstate pipelines' price manipulation, even if the manipulation raised *wholesale* rates as well."[5] The Supreme Court granted certiorari.

Analysis

The battle over pre-emption and the division of power between federal and state regulators under the NGA is not new. Over 70 years ago in *United Fuel*, the Court held that the Commerce Clause prohibited states from regulating the interstate transportation and wholesale sale of gas, which the Court deemed to be within the exclusive jurisdiction of FERC.[6] The current case revives an issue that the dissent asserts was "settled beyond debate" by *United Fuel* and its progeny.[7] Namely, the proper test for pre-emption as it relates to the division of responsibility between national and local regulators under the NGA.

Guided by its prior precedent, the Court concluded that the proper test for pre-emption in the natural gas context involves drawing a "significant distinction" between "measures *aimed directly at* interstate purchasers and wholesales for resale, and those aimed at subjects left to the States to regulate." Applying this test, the Court found that the Act did not pre-empt state law antitrust claims even if the alleged price-manipulation also affected wholesale rates (governed by the NGA), because the price-manipulation claims were *aimed* at obtaining damages for excessively high retail natural gas prices, which are "firmly on the States' side of that dividing line."

The NGA, Justice Breyer wrote, "was drawn with meticulous regard for the continued exercise of state power, not to handicap or dilute it in any way." Thus, the Court "must proceed cautiously" when state law can be applied to nonjurisdictional as well as jurisdictional sales, and should find "pre-emption only where detailed examination convinces us that a matter falls within the pre-empted field as defined by our precedents." Breyer explained that the Court's prior precedent emphasized "the importance of considering the target at which the state law aims in determining whether that law is pre-empted." The Court concluded that petitioners and the Solicitor General failed to point to a specific FERC determination that the state antitrust claims at issue fall within the field pre-empted by the NGA. Evidence of FERC's promulgation of detailed rules governing the manipulation of price indices was also unpersuasive. Moreover, the Court distinguished nearly every case relied on by petitioners as conflict pre-emption cases that were inapplicable to the field pre-emption case at issue.[8]

This approach drew sharp criticism from Justice Scalia and Chief Justice Roberts, who strongly dissented from the majority's decision and its analysis of prior precedent. According to Scalia, because the Commission's exclusive authority extends to the conduct challenged here — pipelines' use of sham trades and false reports to manipulate gas price indices — state antitrust regulation of that conduct is preempted. From the dissent's perspective, "the Act does not give the Commission the power to aim at particular effects; it gives it the power to regulate particular activities. When the Commission regulates those activities, it may consider their effects on *all* parts of the gas trade, not just on wholesale sales." Thus, the proper test for preemption in this context "is whether the matter on which the State asserts the right to act is in any way regulated by the Federal Act." Characterizing the majority's opinion as "unprecedented," Scalia stated that the Court's approach "makes a snarl of our precedents," and further reiterated that the "Court's make-it-up-as-you-go-along approach to preemption has no basis in the Act, contradicts our cases, and will prove unworkable in practice."[9]

Conclusion

The precise impact of this decision on pipeline companies and the natural gas trade remains to be seen, but it will undoubtedly be closely watched to see if the dissent's predictions of its impact come true.

If you have any questions about this topic, please contact the author or your principal Mintz Levin attorney.

Endnotes

[1] See *In re Western States Wholesale Natural Gas Antitrust Litigation*, 715 F. 3d 716 (2013).

[2] 15 U.S.C. §717d(a).

[3] Id. at 724.

[4] Id. at 728.

[5] 575 U.S. ___ (2015) (slip op., at 9).

[6] *Public Util. Comm'n of Ohio v. United Fuel Gas Co.*, 317 U.S. 456 (1943).

[7] *Northern Natural Gas Co. v. State Corporation Comm'n of Kan.*, 372 U.S. 84 (1963); *Exxon Corp. v. Eagerton*, 462 U.S. 176 (1983); *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293 (1988).

[8] Because the parties had not argued conflict pre-emption, the Court did not address the issue, leaving it to be resolved by the lower courts.

[9] Justice Thomas concurred in part and concurred in the judgment, stating, "Because the Court today avoids extending its earlier questionable precedents, I concur in its judgment and join all but Part I-A of its opinion."

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4896-0415-NAT-AFR